

CHINA UNICOM LTD  
Form 20-F  
June 28, 2005

## SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

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### FORM 20-F

**REGISTRATION STATEMENT PURSUANT TO  
SECTION 12(b) OR 12(g) OF THE SECURITIES EXCHANGE  
ACT OF 1934**

OR

**ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF  
THE SECURITIES EXCHANGE ACT OF 1934**

For the fiscal year ended December 31, 2004

OR

**TRANSITION REPORT PURSUANT TO SECTION 13 OR  
15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission file number 1-15028

## CHINA UNICOM LIMITED

(Exact Name of Registrant as Specified in Its Charter)

N/A

(Translation of Registrant's Name Into English)

Hong Kong

(Jurisdiction of Incorporation or Organization)

75<sup>th</sup> Floor, The Center  
99 Queen's Road Central  
Hong Kong

(Address of Principal Executive Offices)

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Securities registered or to be registered pursuant to Section 12(b) of the Act:

Title of Each Class	Name of Each Exchange On Which Registered
Ordinary shares, par value HK\$0.10 per share	New York Stock Exchange, Inc.*

\* Not for trading, but only in connection with the listing on the New York Stock Exchange, Inc. of American depositary shares, or ADSs, each representing 10 ordinary shares.

Securities registered or to be registered pursuant to Section 12(g) of the Act:

None  
(Title of class)

Securities for which there is a reporting obligation pursuant to Section 15(d) of the Act:

None  
(Title of Class)

Indicate the number of outstanding shares of each of the issuer's classes of capital or common stock as of the close of the period covered by the annual report.

12,607,241,000 Ordinary Shares as of December 31, 2004.

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No

Indicate by check mark which financial statement item the registrant has elected to follow.

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**NOTE REGARDING FORWARD-LOOKING STATEMENTS**



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This annual report for the year ended December 31, 2004 contains forward-looking statements that are, by their nature, subject to significant risks and uncertainties. Such forward-looking statements include, without limitation, our strategy and future plan, our capital expenditure plan, our future business condition and financial results, our abilities to expand network capacity and increase network efficiency, our ability to develop new technology applications and offer new services, our ability to realize the advantages of code division multiple access, or CDMA, technology and successfully execute our CDMA-related strategy, our ability to leverage our position as an integrated telecommunications operator and expand into new businesses and new markets, future growth of market demand for our services, the future prospects of and our ability to integrate the acquired business, and future regulatory and other developments in the Chinese telecommunications industry.

Such forward-looking statements reflect our current views with respect to future events. Actual results may differ materially from information contained in the forward-looking statements as a result of a number of factors, including, without limitation, any changes in the regulatory policies of the Ministry of Information Industry, or MII, the State-owned Assets Supervision and Administration Commission, or SASAC, and other relevant government authorities in China, the effects of competition on the demand and price of our telecommunications services, any changes in telecommunications and related technology and applications based on such technology, and changes in political, economic, legal and social conditions in China including the Chinese government's policies with respect to economic growth, consolidations of and other structural changes in the telecommunications industry, foreign exchange, foreign investment and entry by foreign companies into China's telecommunications market. In addition, our future network expansion and other capital expenditure and development plans are dependent on numerous factors, including the availability of adequate financing on acceptable terms, the adequacy of currently available spectrum or availability of additional spectrum and the adequate and timely supply of equipment when required. Please also see the D. Risk Factors section under Item 3.

### **CERTAIN DEFINITIONS**



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As used in this annual report, references to us , we , our, the Company and Unicom are to China Unicom Limited. Unless the context otherwise requires, these references include all of our subsidiaries. In respect of any time prior to our incorporation, references to us , we , our and Unicom are to the telecommunications businesses in which our predecessors were engaged and which were subsequently assumed by us. All references to Unicom Group are to China United Telecommunications Corporation, our indirect controlling shareholder. Unless the context otherwise requires, these references include all of Unicom Group s subsidiaries, including us and our subsidiaries. Please also see A. History and Development of the Company under Item 4 for our current shareholding structure.

**PART I**





**Item 1. Identity of Directors, Senior Management and Advisers**



Not Applicable.

**Item 2. Offer Statistics and Expected Timetable**



Not Applicable.

Item 3. **Key Information**



A.

## **Selected Financial Data**

A.

Selected Financial Data





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The following table presents our selected consolidated income statement data for the years ended December 31, 2000, 2001, 2002, 2003 and 2004 and our selected consolidated balance sheet data as of December 31, 2000, 2001, 2002, 2003 and 2004. The selected consolidated balance sheet data as of December 31, 2003 and 2004 and income statement and cash flow data for the years ended December 31, 2002, 2003 and 2004 have been derived from our audited consolidated financial statements included in this annual report. The selected consolidated balance sheet data as of December 31, 2000, 2001 and 2002 and income statement and cash flow data for the years ended December 31, 2000 and 2001 have been derived from our audited consolidated financial statements that are not included in this annual report. The financial statements for periods prior to our restructuring and initial public offering in 2000 reflect historical results of operations and financial positions of the businesses that were transferred to us from Unicom Group in 2000 in preparation of our initial public offering.

Our financial statements are prepared in accordance with generally accepted accounting principles in Hong Kong, or HK GAAP. Under HK GAAP, prior to 2003, deferred taxation was accounted for at the current taxation rate in respect of timing differences between net income as computed for taxation purposes and net income as stated in the income statement. A deferred tax asset was not recognized unless the related benefits are expected to crystallize in the foreseeable future. Upon the adoption of SSAP 12 in 2003, deferred taxation is provided in full, using the liability method, on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the financial statements. Taxation rates enacted or substantively enacted at the balance sheet date are used to determine deferred taxation. Deferred tax assets are recognized to the extent that it is probable that future taxable income will be available against which the temporary differences can be utilized. Under HK GAAP, the adoption of SSAP 12 in 2003 represents a change in accounting policy which has been applied retrospectively so that the comparative data presented have been restated to conform to the changed policy. A detailed description is set forth in Note 3 to the financial statements.

In addition, financial statements prepared in accordance with HK GAAP vary in certain material respects from generally accepted accounting principles in the United States, or US GAAP. In accordance with HK GAAP, we adopted the purchase method to account for our acquisitions from Unicom Group of certain cellular businesses and assets held by Unicom New Century Telecommunications Corporation Limited, or Unicom New Century, Unicom New World Telecommunications Corporation Limited, or Unicom New World, and China Unicom International Limited, or Unicom International. The acquisitions of Unicom New Century, Unicom New World and Unicom International became effective on December 31, 2002, December 31, 2003 and in September 2004, respectively, as described in A. History and Development of the Company under Item 4. Accordingly, our consolidated income statement and, except as otherwise noted, all other HK GAAP financial information for the year 2004 presented in this annual report include the operating results of Unicom New Century and Unicom New World for the year ended December 31, 2004 and the operating results of Unicom International from the effective date of the acquisition to December 31, 2004, but our consolidated income statement and all other HK GAAP financial information for the year 2003 presented in this annual report do not include the operating results of Unicom New World for the year ended December 31, 2003. Under the purchase method, our consolidated balance sheet as of December 31, 2003 includes the financial position of Unicom New Century and Unicom New World and our consolidated balance sheet as of December 31, 2004 also includes the financial position of Unicom International. In contrast, under US GAAP, these acquisitions would be accounted for as transfers of entities under common control. The financial statements prepared under US GAAP would retroactively be restated for all periods presented on a combined basis as if the acquisitions had been in effect since inception, whereby related assets and liabilities of the acquired businesses would be accounted for at historical cost and the results of operations of the acquired businesses would be included in the consolidated financial statements for the earliest period presented.

Under HK GAAP, the sale of Guoxin Paging Corporation Ltd., or Guoxin Paging, on December 31, 2003 by us to Unicom Group has been accounted for as a sale of discontinued operation. The difference between the sale proceeds and the carrying amount of net assets of Guoxin Paging as of December 31, 2003 was recorded as the loss on sale of discontinued operation in our consolidated income statement for the year ended December 31, 2003. The operating results of Guoxin Paging from January 1, 2003 to the effective date of the sale of Guoxin Paging were included in our consolidated income statement for the year ended December 31, 2003. Under US GAAP, the sale of Guoxin Paging to Unicom Group is considered a transfer of business between entities under common control and accounted for at historical cost of the net assets transferred, after reduction, if appropriate, for an indicated impairment of value. In addition, under US GAAP, the results of operations of a component or segment of an entity that has been disposed of should be reported in discontinued operations as a separate component of income, separated from continuing operations, in the period in which the disposal occurred and in prior periods. Accordingly, all the operating results of Guoxin Paging have been grouped into and reported in the income statement as Discontinued operation - Loss from discontinued operation under US GAAP.

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See Note 40 to the consolidated financial statements included in this annual report for a summary of the principal differences between HK GAAP and US GAAP that have a significant effect on our financial statements.

	As of or for the year ended December 31					
	2000	2001	2002	2003	2004	2004
	RMB	RMB	RMB	RMB	RMB	US\$(1)
(in millions, except number of shares and per share data)						
<b>Income Statement Data:</b>						
<u>Hong Kong GAAP (As restated)<sup>(2)</sup></u>						
Operating revenue (Turnover):						
Cellular Business	12,188	20,505	30,613	56,927	70,799	8,554
-GSM Business	12,188	20,505	27,388	40,304	46,579	5,628
-CDMA Business			3,225	16,623	24,220	2,926
Paging Business	8,483	4,342	2,161	1,403		
Long Distance Business	556	1,489	2,766	2,273	1,848	223
Data and Internet Business	540	1,820	2,793	3,437	3,663	443
Total service revenue	21,767	28,156	38,333	64,040	76,310	9,220
Sales of telecommunications products	1,925	1,237	2,244	3,596	3,022	365
Total operating revenue	23,692	29,393	40,577	67,636	79,332	9,585
Operating expenses	(18,470)	(24,129)	(33,253)	(59,122)	(71,376)	(8,624)
Operating income	5,222	5,264	7,324	8,514	7,956	961
Loss on sale of discontinued operation (Guoxin Paging)				663		
Income before taxation	4,482	5,463	6,303	6,096	6,467	781
Net income	3,324	4,602	4,598	4,217	4,387	530
-Basic net income per share <sup>(3)</sup>	0.297	0.367	0.366	0.336	0.349	0.042
-Number of shares outstanding for basic net income per share (in thousands) <sup>(3)</sup>	11,208,224	12,552,996	12,552,996	12,553,010	12,561,242	12,561,242
-Diluted net income per share <sup>(3)</sup>	0.297	0.367	0.366	0.336	0.348	0.042
-Number of shares outstanding for diluted net income per share (in thousands) <sup>(3)</sup>	11,208,224	12,552,996	12,552,996	12,568,683	12,607,241	12,607,241
-Basic net income per ADS <sup>(4)</sup>	2.966	3.666	3.663	3.359	3.492	0.422
-Number of ADS outstanding for basic net income per share (in thousands) <sup>(3)</sup>	1,120,822	1,255,300	1,255,300	1,255,301	1,256,124	1,256,124
-Diluted net income per ADS <sup>(4)</sup>	2.966	3.666	3.663	3.355	3.480	0.420
-Number of ADS outstanding for diluted net income per share (in thousands) <sup>(3)</sup>	1,121,968	1,255,300	1,255,300	1,256,869	1,260,724	1,260,724

	As of or for the year ended December 31									
	2000		2001		2002		2003		2004	2004
	RMB		RMB		RMB		RMB		RMB	US\$(1)
	(in millions, except number of shares and per share data)									
<b>US GAAP (As restated)<sup>(2)&amp;(5)</sup></b>										
Operating revenue			32,501		50,421		71,980		79,388	9,592
Operating income from continuing operations			7,921		9,759		10,710		8,185	989
Net income before discontinued operation, and cumulative effect of change in accounting policy			5,866		5,500		6,078		4,713	569
Loss from discontinued operation, net of tax			710		422		1,342			
Cumulative effect of change in accounting policy (transitional adjustment of goodwill impairment upon the adoption of SFAS 142)					42					
Net income			5,155		5,036		4,736		4,713	569
-Basic net income per share before discontinued operation and cumulative effect of change in accounting policy <sup>(3)</sup>			0.467		0.438		0.484		0.375	0.045
-Basic net income per ADS before discontinued operation and cumulative effect of change in accounting policy <sup>(4)</sup>			4.673		4.382		4.842		3.752	0.453
-Basic net income per share after discontinued operation and cumulative effect of change in accounting policy <sup>(3)</sup>			0.411		0.401		0.377		0.375	0.045
-Basic net income per ADS after discontinued operation and cumulative effect of change in accounting policy <sup>(4)</sup>			4.107		4.012		3.773		3.752	0.453
<b>Balance sheet Data:</b>										
<b>Hong Kong GAAP (As restated)<sup>(2)</sup></b>										
Bank balances and cash	44,717		18,413		14,433		9,220		4,655	562
Property, plant and equipment, net	52,864		75,748		107,487		118,105		118,904	14,366
Total assets	113,057		128,278		149,628		149,838		145,629	17,595
Net assets	58,336		62,884		67,219		69,615		72,810	8,797
Short-term debt and current portion of other long-term debt	8,501		7,933		15,330		18,173		20,015	2,418
Obligations under finance lease-current portion			8		17		25		938	113
Obligations under finance lease-non current portion			101		101		100		489	59
Other long-term debt	27,151		36,337		37,686		36,213		26,137	3,158
Shareholders equity	57,452		62,054		66,653		69,615		72,810	8,797

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	As of or for the year ended December 31									
	2000		2001		2002		2003		2004	2004
	RMB		RMB		RMB		RMB		RMB	US\$(1)
(in millions, except number of shares and per share data)										
<b>US GAAP (As restated)<sup>(2)&amp;(5)</sup></b>										
Property, plant and equipment, net					118,787		118,171		118,701	14,342
Total assets					164,636		150,477		146,615	17,715
Obligations under finance lease-current portion					17		25		938	113
Obligations under finance lease-non current portion					101		100		489	59
Other long-term debt					45,520		36,213		26,137	3,158
Shareholders' equity					64,215		65,946		69,442	8,390
<b>Other Financial Data:</b>										
<b>Hong Kong GAAP:</b>										
Net cash provided by operating activities	9,344		11,078		13,054		22,565		23,819	2,878
Net cash used in investing activities	(30,551)		(46,125)		(5,166)		(19,051)		(18,958)	(2,291)
Net cash provided by (used in) financing activities	59,921		8,743		(11,868)		(8,778)		(9,401)	(1,136)
<b>US GAAP (As restated)<sup>(5)</sup>:</b>										
Net cash provided by operating activities			15,320		18,235		25,993		24,510	2,961
Net cash used in investing activities			(62,971)		(10,261)		(20,295)		(19,668)	(2,376)
Net cash provided by (used in) financing activities			21,015		(12,773)		(11,397)		(9,440)	(1,141)

(1) The translation of RMB into US dollars has been made at the rate of RMB8.2765 to US\$1.00, the noon buying rate in New York City for cable transfer in RMB as certified for customs purposes by the Federal Reserve Bank of New York on December 31, 2004. The translations are solely for the convenience of the reader.

(2) The adoption of HK SSAP12 Income Tax (revised) in 2003 represents a change in accounting policy which has been applied retrospectively so that the comparative data presented have been restated to conform to the changed policy.

(3) See Notes 16 and 40 to the financial statements included in this Form 20-F on how basic and diluted net income per share are calculated under HK GAAP and US GAAP, respectively.

(4) Net income per ADS is calculated by multiplying net income per share by 10, which is the number of shares represented by each ADS.

(5) The US GAAP amounts as of December 31, 2004 and 2003 and for each of the years in the three-year period ended December 31, 2004 are presented as if the acquisitions of Unicom New Century, Unicom New World and Unicom International had been in existence since the beginning of the earliest period presented.

**Historical Exchange Rates Information**





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We publish our financial statements in Renminbi, or RMB, the legal tender currency in the People's Republic of China, or PRC. In this annual report, references to US dollars or US\$ are to United States dollars and references to Hong Kong dollars, HK dollars or HK\$ are to Hong Kong dollars. Solely for the convenience of the reader, this annual report contains translations of certain RMB and Hong Kong dollar amounts into US dollar amounts and vice versa at specified rates. These translations should not be construed as representations that the RMB or Hong Kong dollar amounts actually represent such US dollar amounts or could be converted into US dollar amounts at the rates indicated or at all. Unless otherwise stated, the translations of RMB and Hong Kong dollars into US dollars and vice versa have been made at the rate of RMB8.2765 to US\$1.00 and HK\$7.7723 to US\$1.00, the noon buying rates in New York City for cable transfers payable in RMB or Hong Kong dollars as certified for customs purposes by the Federal Reserve Bank of New York on December 31, 2004.

The noon buying rates on June 24, 2005 were RMB8.2765 to US\$1.00 and HK\$7.7719 to US\$1.00, respectively. The average noon buying rates for 2000, 2001, 2002, 2003 and 2004 were RMB8.2784, RMB8.2772, RMB8.2771, RMB8.2772 and RMB8.2768, respectively, to US\$1.00, and HK\$7.7936, HK\$7.7996, HK\$7.7996, HK\$7.7864 and HK\$7.7899, respectively, to US\$1.00, calculated as the average of the noon buying rates on the last day of each month during each applicable year. The following table sets forth the high and low noon buying rates between RMB and the US dollar (in RMB per US dollar) and Hong Kong dollar and the US dollar (in Hong Kong dollar per US dollar) for each month during the previous six months:

Period	High	Low	High	Low
	(RMB per US\$1.00)		(HK\$ per US\$1.00)	
December 2004	8.2767	8.2765	7.7821	7.7698
January 2005	8.2765	8.2765	7.7994	7.7775
February 2005	8.2765	8.2765	7.7999	7.7984
March 2005	8.2765	8.2765	7.7998	7.7987
April 2005	8.2765	8.2765	7.7995	7.7946
May 2005	8.2765	8.2765	7.7995	7.7767

### B. Capitalization and Indebtedness



Not applicable.

*c.* **Reasons for the Offer and Use of Proceeds**



Not applicable.

*D.* **Risk Factors**



**Risks Relating to Our Business**





*Our cellular businesses face intense competition from China Mobile Communications Corporation, or China Mobile, China Telecom Corporation Limited, or China Telecom, and China Network Communications Group Corporation, or China Netcom. Such competition may result in slower subscriber growth, lower tariffs and higher customer acquisition costs for us, which would adversely affect our results of operations, financial condition and growth prospects.*



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Our cellular businesses face intense competition from China Mobile. China Mobile is the largest cellular operator in China and in our cellular service areas and has competitive advantages over us in customer base, overall network coverage and quality, financial resources, network management, technical expertise and brand recognition. We are experiencing intense competition from China Mobile in many of our cellular service areas, and such competition may continue and further intensify. In particular, continued price competition between China Mobile and us in many service areas has accelerated the decline of the average revenue per user per month, or ARPU, of our cellular services, and adversely affected our profitability.

Our cellular services also compete with the local wireless telecommunications services of China Telecom and China Netcom, known as Little Smart services, that are based on their fixed line networks and primarily utilize the personal handyphone system, or PHS, technology. They are offered as extensions of fixed line services and, with such features as calling-party-pays arrangements, carry significantly lower tariffs than cellular services. The Little Smart services were previously offered primarily in small- to medium-sized cities, but have been introduced in most major cities nationwide since 2003. According to public reports, currently these services have attracted over 70 million users in China and their subscriber base is continuing to grow. In addition, both China Telecom and China Netcom have indicated their interests in developing 3G wireless telecommunications services in the future, which could impose direct competition with our cellular business.

Increased competition from the cellular services of China Mobile and the Little Smart services of China Telecom and China Netcom may lead to slower subscriber growth, lower usage of our services, continued price pressure and higher costs of customer acquisition, which would adversely affect our results of operations, financial condition and growth prospects.

*Our CDMA services have yet to gain a broad market acceptance in China and there is uncertainty over whether our CDMA services will succeed in gaining a broader market acceptance.*



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We launched our CDMA services in January 2002 and introduced CDMA 1X wireless data services in March 2003. Prior to the introduction of our CDMA services, digital cellular services in China were mostly based on the global system for mobile communications, or GSM, technology. The majority of cellular subscribers in China today continues to be GSM subscribers. CDMA cellular services compete with GSM services for cellular subscribers, who may be reluctant to switch to CDMA cellular services because of the need to obtain a new CDMA handset and phone number. CDMA services are also perceived to have limitations in international roaming due to the lack of CDMA networks in many countries. As of March 31, 2005, the total number of our CDMA subscribers has reached 29.43 million in our service areas. Nevertheless, CDMA technology and services have yet to gain broader market acceptance in China.

Whether our CDMA services can gain broader market acceptance will continue to be subject to a number of uncertainties, including:

whether we can effectively retain our existing subscribers and attract sufficient new CDMA cellular subscribers;

whether we can effectively reduce the cost of CDMA handsets and marketing expenses and strengthen the management of the purchase and distribution processes of the CDMA handsets;

whether we can effectively promote our CDMA services and successfully execute our strategy of expanding market share among industry-specific customers and the young population; and

whether we can optimize the CDMA network utilization rates and generate more revenues from value-added services by capitalizing the technological advantages of CDMA 1X.

Any of these uncertainties may adversely affect the growth and profitability of our CDMA cellular services and our overall business results of operation and financial condition.

*Our CDMA and GSM businesses may compete with each other, which may adversely affect the growth and profitability of these businesses..*





Although we are committed to coordinating the development of our CDMA and GSM businesses, these two businesses may compete with each other for our financial, management, human and other resources as well as cellular subscribers. For example, while we have focused on the development of our CDMA business in recent years, our investments on our GSM network has been relatively limited, which has hindered us from improving our GSM network in certain of our services areas. In addition, since we have started expanding our CDMA services to the mass market, our CDMA business may compete with our GSM business for cellular subscribers, especially mid- and low-end cellular subscribers. A portion of our CDMA subscribers were former subscribers of our GSM services. If the development of our CDMA and GSM services is not coordinated effectively or we cannot obtain adequate resources for both our GSM and CDMA cellular services, the growth and profitability of these businesses and our results of operations, financial condition and growth prospects may be adversely affected.

*Our churn rates may increase.*



In 2004, the monthly average churn rate of our CDMA cellular services increased to 1.5% from 1.0% in 2003. The increase in the churn rate of our CDMA cellular services was primarily due to the following factors:

intense competition from the GSM services of our main competitor and the Little Smart services;

the termination of CDMA services by some CDMA subscribers at the end of their contract periods under the CDMA handset promotional packages we began to offer in 2002;

the increase in the proportion of cost-sensitive subscribers among new subscribers as a result of continuing expansion of our CDMA cellular services in the mass market; and

an increase in the proportion of subscribers to our pre-paid CDMA services which are characterized by a higher churn rate than post-paid services.

While the monthly average churn rate of our GSM cellular services slightly decreased to 2.3% in 2004 from 2.4% in 2003, there is no assurance that it will not increase in the future due to increased competition. Increased churn rate may adversely affect our market share and increase our costs of additional customer acquisitions and bad debt, which would adversely affect our results of operations, financial condition and growth prospects.

*Failure or inability to continue to expand and upgrade our networks timely and effectively and changes in telecommunications technology and technological standards could hinder our growth.*



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The growth of our businesses depends on whether we are able to continue to expand the coverage and capacity of our networks, to upgrade the technology and to improve the quality of our networks in a timely and effective manner. We also need to continue to improve the quality of our existing networks in order to enhance the quality of our telecommunications services.

In addition, the telecommunications industry in China and elsewhere in the world is subject to rapid and significant changes in technology and technological standards, including, among others, the migration from second generation mobile telecommunications to third generation mobile telecommunication, or 3G, and the development of voice-over-internet protocol technology, or VOIP. Such changes may render our networks and systems obsolete or inadequate. As a result of such changes, we may need to make significant changes and upgrades to existing networks and infrastructure or build new networks, which may require substantial capital expenditures and other resources.

Our ability to expand and upgrade our networks is subject to a number of uncertainties, including our ability to achieve the following on a timely basis and on acceptable terms:

obtain adequate financing;

retain experienced management and technical personnel;

obtain relevant government permits and approvals and gain access to office towers, residential buildings and other sites for network construction;

enter into interconnection and other arrangements with other operators;

obtain adequate network equipment and software; and

manage the technology migration in an effective manner.

Difficulties we may encounter in expanding and upgrading our networks, if not adequately resolved on a timely basis, could adversely affect our competitive position, results of operations, financial condition and growth prospects.

*Our long distance, data and Internet businesses remain relatively small* comparing to the fixed line operators, and competition from China Telecom, China Netcom and other cellular service providers may adversely affect our growth and profitability in these businesses.





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The fixed line operators of China Telecom and China Netcom currently hold a dominant market position in the public switched long distance telephony and data services markets in China in their respective service areas. They are also the dominant providers of Internet protocol telephony, or IP telephony, and Internet access services in China. China Telecom and China Netcom have competitive advantages over us in customer base, financial resources, network coverage and last-mile access. Our IP telephony services compete with other service providers including China Satellite Communication, or China SatCom and China Railway Communications Co. Ltd., or China Railcom. In 2004, the increasingly intense competition has contributed to the decrease in average realised tariff rates for long distance services and a 19.1% decrease in our operating revenue from long distance business. The growth of our long distance, data and Internet businesses has been further hindered by our lack of licenses to operate local telephony networks as well as our lack of sufficient network number resources. Competition from China Telecom, China Netcom and other service providers may continue to adversely affect the growth and profitability of our long distance, data and Internet businesses and consequently our overall results of operations, financial condition and growth prospects.

*In order to accelerate the growth of our CDMA business, we offered CDMA handset promotional packages, which increased our operating expenses in the short-term and may adversely affect our profitability.*



In order to accelerate the development of the CDMA business and subscriber growth during the product introduction period, we began to offer certain CDMA handset promotional packages in the second half of 2002. Under those arrangements, CDMA handsets were provided to the subscribers for their use at no additional cost to them during the specified contract periods as long as such subscribers agreed to incur a minimum amount of service fees during the contract period. The cost of the handsets provided to subscribers under these contractual arrangements, treated as deferred customer acquisition costs, were deferred, to the extent recoverable, and amortized over the contractual periods to match with minimum contract revenue. As of December 31, 2004, amortization of such deferred customer acquisition costs amounted to approximately RMB6,121 million and the carrying amount of such costs amounted to RMB4,745 million for our wholly-owned operating subsidiaries, China Unicom Corporation Limited, or CUCL, and Unicom New World. These promotional packages tend to increase our operating expenses. In addition, some of those subscribers terminated our CDMA services at the end of their contractual periods and therefore increased our churn rate. While we substantially reduced the use of such arrangements since 2003, the carrying amount of the deferred customer acquisition costs remain significant. As of March 31, 2005, the carrying amount of such costs amounted to RMB4,408 million for us. As a result, although the use of these CDMA promotional packages has accelerated the growth of our CDMA business, they may adversely affect the profitability of our CDMA business and our overall results of operations.

In order to control the costs of our CDMA promotional packages, we have adopted the policy to centralize the purchases of CDMA handsets. As a result, we usually maintain a significant level of inventory of CDMA handsets, which is subject to the risk of inventory obsolescence. As of December 31, 2004, we maintained an inventory of CDMA handsets of RMB1,881 million.

*Obstacles in interconnection with networks of other operators could jeopardize our operations.*



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The effective provision of our cellular, long distance telephony and other services requires the interconnection between our networks and the networks of China Telecom, China Netcom, China Mobile and other operators. Any obstacles in existing interconnection arrangements or any significant change of their terms, as a result of natural events, accidents, or for regulatory, technological, competitive or other reasons, could lead to temporary service disruptions and increased costs that can seriously jeopardize our operations and adversely affect our growth and profitability. Difficulties in the execution of new interconnection arrangements on a timely basis and on acceptable terms, including the inability to promptly establish additional interconnection links or increase interconnection bandwidths as required, could also adversely affect our operations, growth and profitability.

*Unicom Group, as our controlling shareholder, can exert influence on us and cause us to make decisions that may not always be in the best interests of our other shareholders.*



Unicom Group indirectly controls an aggregate of 77.37% of our issued share capital as of May 31, 2005. As our controlling shareholder, it is able to influence our major business decisions through its control of our board of directors. Some of our executive directors and executive officers also serve as directors or executive officers of Unicom Group. In addition, our operations depend on a number of services provided by Unicom Group. It leases to us, on an exclusive basis, capacity on the CDMA network located in our cellular service areas, provides us with access to international gateways, supplies us with SIM cards and calling cards and provides equipment procurement services, customer services, and certain value-added services to us. Unicom Group and we also provide a number of services to each other, including interconnection and roaming services, sales agency and collection services and provision of premises. See A. History and Development of the Company – Our Relationship with Unicom Group under Item 4 of this annual report. The interests of Unicom Group and our interests in these transactions may differ and Unicom Group may cause us to make decisions that conflict with the interests of our other shareholders.

*The internal reorganization of Unicom Group for the A Share offering has created a two-step voting mechanism that will require the approval of the minority shareholders of both our Company and the A Share Company for significant connected transactions between us and Unicom Group.*





In October 2002, Unicom Group completed an internal reorganization of its shareholding in our company and the initial public offering in China of the ordinary shares, or A Shares, of its newly established subsidiary, China United Telecommunications Corporation Limited, or A Share Company. As part of this restructuring, a portion of Unicom Group's indirect shareholding in our company was transferred to the A Share Company, whose business is limited to indirectly holding the equity interest of our company without any other direct business operations. A voting mechanism was established to allow public shareholders of the A Share Company to indirectly participate in our shareholders' meetings and a two-step voting mechanism was established for the approval of connected transactions. See A. History and Development of the Company – Further Restructuring of Unicom Group and Initial Public Offering of the A Share Company in 2002 under Item 4 below. As a result, significant connected transactions between us or our subsidiaries and Unicom Group or its subsidiaries will require the separate approval of the independent minority shareholders both of our company and of the A Share Company. Connected transactions approved by our independent minority shareholders nevertheless cannot proceed if they are not approved by the independent minority shareholders of the A Share Company. This adds another necessary step of approval process for those transactions.

*Our inability to fund our capital expenditure requirements may adversely affect our growth and profitability.*



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Although we have gradually reduced our capital expenditure in recent years, we continue to have a reasonable level of capital expenditure requirements. We expect to require approximately RMB18.23 billion for capital expenditure in 2005. As of December 31, 2004, the sum of our long-term and short-term interest bearing debt exceeded the amount of our cash, cash equivalents and short-term bank deposits by RMB40.83 billion. See Liquidity and Capital Resources – Capital Expenditures under Item 5. In the future we may be unable to obtain the necessary financing on a timely basis and on acceptable terms, and our failure to do so may adversely affect our financial position, competitive position, growth and profitability. Our ability to obtain acceptable financing at any time may depend on a number of factors, including:

- our financial condition and results of operations,
- the condition of the economy and the telecommunications industry in China,
- conditions in relevant financial markets in China and elsewhere in the world, and
- our ability to obtain any required government approvals for our market financings.

*Fluctuations in the value of the Renminbi could adversely affect our share price and profitability and changes in the interest rate could adversely affect our cost of financing.*



*Substantially all of our revenues and operating expenses are denominated in Renminbi, while a portion of our borrowings, equipment purchases and other capital expenditures are denominated in foreign currencies. Although the exchange rate between Renminbi and US dollars has been stable, the exchange rate of the Renminbi may become volatile against the US dollar or other currencies in the future. Fluctuations of the Renminbi could adversely affect the value in foreign currency terms of cash flow generated from our operations or any dividends payable on our shares and ADSs, and therefore the price of our shares and ADSs. Any future Renminbi devaluations could also increase our equipment acquisition costs and operating expenses or lead to significant fluctuations in the exposure of our foreign-currency-denominated liabilities, thereby adversely affecting our profitability.*





*Most of our bank loans are borrowed from domestic banks at interest rates that vary in accordance with the standard guidance interest rates announced by relevant Chinese government authorities. In addition, we entered into a US\$700 million term loan facility in September 2003 and a US\$500 million term loan facility in February 2004, both carrying variable interest rates based on the US\$ LIBOR. As a result, a significant increase in interest rates would increase our cost of new debt and the interest cost of our outstanding borrowings, which could have a material adverse effect on our financial position.*



*Our doubtful debt ratio may increase.*



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China has yet to develop an effective credit control system, and with more intense competition in the market, our doubtful debt ratio for cellular services in our service areas, calculated as the amount of provision for doubtful debt divided by revenue from cellular services may increase. As of December 31, 2004, such ratio is 2.9%, compared to 2.9% in 2003 and 2.7% in 2002. If the ratio further increases, our results of operations and financial condition could be adversely affected.

*Investor confidence and the market prices of our shares and ADSs may be adversely impacted if we or our independent registered public accounting firm is unable to conclude that our internal control over financial reporting is effective as of December 31, 2006 as required by Section 404 of the Sarbanes-Oxley Act of 2002.*



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We are subject to the SEC's reporting obligations. The SEC, as directed by Section 404 of the Sarbanes-Oxley Act of 2002, adopted rules requiring each public company to include a report of management on the company's internal control over financial reporting in its Annual Report on Form 10-K or Form 20-F, as the case may be, that contains an assessment by management of the effectiveness of the company's internal control over financial reporting. In addition, the company's independent registered public accounting firm must attest to and report on management's assessment of the effectiveness of the company's internal control over financial reporting. These requirements will first apply to our Annual Report on Form 20-F for the fiscal year ending December 31, 2006. Our management may not conclude that our internal control over financial reporting is effective. Moreover, even if our management concludes that our internal control is effective, our independent registered public accounting firm may disagree. If our independent registered public accounting firm is not satisfied with our internal control over our financial reporting or the level at which our controls are documented, designed, operated or reviewed, or if the independent registered public accounting firm does not agree with our interpretation or understanding of the relevant requirements, rules or regulations, then it may decline to attest to our management's assessment or may issue an adverse opinion. Any of these possible outcomes could result in an adverse reaction in the financial marketplace due to a loss of investor confidence in the reliability of our consolidated financial statements, which ultimately could negatively impact the market prices of our shares and ADSs.

### **Risks Relating to the Overall Telecommunications Industry in China**





*Regulatory or policy changes relating to telecommunications industry may adversely affect our results of operations, financial condition and business prospects.*



The Chinese government currently regulates many aspects of the telecommunications industry in China. Potential deregulation or restructuring of the telecommunications industry or changes in regulations and policies and their implementation could lead to changes in the overall industry environment. These changes may include, among others, new regulatory measures relating to issuance of licenses for cellular business, calling-party-pays arrangements or other tariff adjustments, fulfillment of telecommunications service providers' universal service obligations and the associated expenses, usage of numbers or frequency resources and the associated fees, or standards and mechanisms of interconnection settlement, and could significantly affect our results of operations, financial condition and business prospects. For example, if the Chinese government deregulates or reduces state tariff rates applicable to some of our services or modifies other regulations of the telecommunications industry in China, our results of operations and financial condition may be adversely affected.

The Chinese government has restructured the telecommunications industry through a number of initiatives that were rolled out in stages in the past and may initiate further industry restructuring in the future. Potential restructuring of the PRC telecommunications industry, if any, may affect the overall business environment and the operations of telecommunications operators in China, including us. We cannot predict the timing for, and any implications and effect of, any future restructuring of the PRC telecommunications industry, or give any assurance that we will not be adversely affected by any such industry restructuring.

*New entrants in the telecommunications industry in China, including potential 3G operators, may further intensify industry competition and adversely affect our results of operations.*

Since mid-1990s, the Chinese government has taken various measures, including licensing more providers of telecommunications services, to encourage competition in the telecommunications industry. Currently, the Chinese telecommunications market has six basic telecommunications service providers—China Telecom, China Mobile, China Netcom, China Satcom, China Railcom, and our company—and thousands of value-added service providers. In addition, the government may grant additional telecommunications service licenses in the future, including additional licenses to provide cellular services.

The Chinese government has not publicly announced its decisions on whether it will grant any 3G licenses, and if so, the timing of the grant of the 3G licenses, the number of 3G licenses to be granted, any technical requirements, or the selection of preferred technologies. The issuance of 3G licenses to cellular service providers may significantly change the overall competition environment of the wireless telecommunications industry. While we have been preparing for developing 3G business, we cannot assure you that we will be granted the requisite approvals and licenses by the Chinese government in a timely manner, or at all. Even if we are granted a 3G license, we cannot assure you that we will successfully operate the 3G business and effectively compete with other 3G or other cellular services providers.

After its accession to the World Trade Organization, or WTO, in December 2001, China promulgated the Administrative Regulations on Telecommunications Companies with Foreign Investment, implementing its commitments to the WTO. Those commitments include the gradual reduction of foreign ownership restrictions in the telecommunications industry and the step-by-step opening of the telecommunications market in China to foreign operators. When the government licenses additional telecommunications service providers in the future, licensees may include operators with foreign investment. Foreign-invested operators entering into China's telecommunications market may have competitive advantages over us in financial resources, network management and technical expertise.

Increased competition from new entrants in China's telecommunications services industry could impede the growth of our businesses, further increase competition for skilled and experienced employees, result in or exacerbate price competition and increase our customer acquisition costs and other operating expenses, and thereby adversely affect our results of operations, financial condition and growth prospects.

*The telecommunications sector in China may not sustain its pace of rapid growth, which may adversely affect the growth and profitability of our business.*



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The telecommunications industry in China has experienced rapid growth in the last several years, especially in the cellular communications sector. The total number of cellular subscribers in China increased from 43.2 million at the end of 1999 to 334.8 million by December 31, 2004. Cellular penetration increased from 3.0% to 25.9% nationwide during the same period. The growth in cellular subscribers may slow down as cellular penetration continues to increase in our cellular service areas. In addition, ARPU for the cellular communications market in China continues to decline. For example, ARPU of our GSM subscribers declined from RMB56.7 in 2003 to RMB49.4 in 2004. Any slow-down in the growth in China's telecommunications sector may adversely affect the growth and profitability of our business.

*The Chinese government may require us, along with other telecommunication service providers in China, to provide universal services with specified obligations, and we may not be compensated adequately for providing such services.*





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Under the Telecommunications Regulations promulgated by the State Council, telecommunications service providers in China are required to fulfill universal service obligations in accordance with relevant regulations to be promulgated by the Chinese government, and the MII has the authority to delineate the scope of universal service obligations. The MII may also select universal service providers through a tendering process. The MII, together with government finance and pricing authorities, is also responsible for formulating administrative rules relating to the establishment of a universal service fund and compensation schemes for universal services.

While the scope of specific universal services obligations is not yet clear, we believe that such services may include mandatory provision of basic telecommunications services in less economically developed areas in China and mandatory contribution to a universal service fund. In addition, as part of the transitional measures prior to the formalization of a universal service obligation framework, the MII has recently required major telecommunication service providers in China, including Unicom Group, to participate in a project to provide telephone services in a number of remote villages in China. However, it is currently uncertain as to whether we will be required by the MII to maintain and expand network facilities and provide telephone services as part of such transitional measures. Furthermore, to the extent we are required to do so, it is currently uncertain whether we will be adequately compensated by the government or be able to realize an adequate return on investments for expanding networks to, and providing telecommunications services in, those less economically developed areas due to potentially higher capital expenditure requirements, lower usage by customers and lack of flexibility in setting our tariffs. We also cannot predict whether we will be required to make contribution to the universal service fund. Either of these events may adversely affect our financial condition and results of operations.

*Actual or perceived health risks associated with the use of mobile devices could impair our ability to retain and attract customers, reduce cellular service usage or result in litigation.*



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Concerns have been expressed in some countries that the electromagnetic signals emitted by wireless telephone handsets and base stations may pose health risks at exposure levels below existing guideline levels, and interfere with the operation of electronic equipment. In addition, cellular operators have been subject to lawsuits alleging various health consequences as a result of cellular handset usage or proximity to base stations or seeking protective or remedial measures. While we are not aware that such health risks have been substantiated, there can be no assurance that the actual, or perceived, risks associated with the transmission of electromagnetic signals will not impair our ability to retain customers and attract new customers, reduce cellular service usage or result in litigation.

**Risks Relating to China**



*If the Chinese government revises the current regulations that allow a foreign investment enterprise to pay foreign exchange in current account transactions, our subsidiaries' ability to satisfy their foreign exchange obligations and to pay dividends to us in foreign currencies may be restricted.*





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The ability of our wholly-owned operating subsidiaries, CUCL and Unicom New World, to satisfy their foreign exchange obligations and to pay dividends to us depends on existing and future foreign exchange regulations in China. The Renminbi is currently convertible by foreign investment enterprises in China to settle transactions under the current account, which include trade and service related foreign exchange transactions and payments of dividends and interest on foreign loans. Renminbi currently cannot be freely converted without regulatory approval for transactions under the capital account, which include outbound foreign investment and principal payments on foreign loans. CUCL and Unicom New World, which hold substantially all of our assets and through which we conduct substantially all of our business, are foreign investment enterprises in China. This status allows them to purchase foreign exchange at designated foreign exchange banks for settlement of current account transactions without the approval of the State Administration for Foreign Exchange. However, the relevant Chinese government authorities may in the future impose limitation on the ability of foreign investment enterprises to purchase foreign exchange to satisfy their foreign exchange obligations or to pay dividends in the future. In that event, our subsidiaries' ability to satisfy their foreign exchange obligations and to pay dividends to us in foreign currencies may be restricted.

*Uncertainties in the Chinese legal system could limit the legal protections available to us and to foreign investors.*



Our wholly-owned operating subsidiaries, CUCL and Unicom New World, are organized under the laws of China and are generally subject to laws and regulations applicable to foreign investment enterprises in China. The Chinese legal system is a civil law system based on written statutes. Unlike common law systems, it is a system in which decided legal cases may be cited for reference but have limited precedential value. Since 1979, the Chinese government has promulgated laws and regulations dealing with economic matters such as foreign investment, corporate organization and governance, commerce, taxation and trade. However, because these laws and regulations are relatively new, and because of the limited volume of published cases and their non-binding nature, interpretation and/or enforcement of these laws and regulations involves uncertainties. Therefore, the Chinese legal system may not afford the same legal protection available to investors in the United States or elsewhere.

#### **Item 4. Information on the Company**



A.

## **History and Development of the Company**

A.



**Industry Restructuring and Grant of New Licenses**





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Since 1993, the Chinese government has implemented a number of measures to restructure and introduce competition in the telecommunications industry. Prior to June 1994, China Telecom was the sole provider of telecommunications services in China. In June 1994, Unicom Group was established in accordance with the State Council's approval to introduce competition in the telecommunications industry. Since then, the Chinese government has approved Jitong Network Communications Company Limited, or Jitong, and China Netcom Corporation Ltd., or CNCL, to provide IP telephony, Internet and data services. It has also approved China Railcom to provide most telecommunications services other than cellular services.

In 1999, the State Council approved a plan to restructure the former China Telecom along four business lines: fixed line, cellular, paging and satellite communications. As a result of the restructuring, China Telecom retained the fixed line, data and Internet businesses, while China Mobile assumed the cellular business previously operated by China Telecom. In 2002, the Chinese government further separated China Telecom into two companies, with the southern company retaining the name of China Telecom and assets and businesses in 21 provinces in southern and western China and the northern company retaining assets and businesses in 10 provinces in northern China and merging with CNCL and Jitong to form China Netcom. As a result of the Chinese government's efforts to introduce competition in the telecommunications industry, there is currently more than one service provider in most of the sectors within the telecommunications industry. See **B. Business Overview – Competition** below.

#### **History of Unicom Group**



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As part of its efforts to introduce orderly competition to the telecommunications sector in China, the State Council approved the establishment of Unicom Group in December 1993 and authorized it to build and operate cellular networks and local and long distance networks. Unicom Group first developed a nationwide cellular network using GSM technology and a nationwide long distance telephony network.

In May 1997, the State Council granted approval to Unicom Group to provide data services. The MII licensed Unicom Group to begin to provide Internet services in July 1999 and IP telephony services on a trial basis in 12 cities in April 1999 and on a nationwide basis in March 2000. Unicom Group also offers local telephony services in the municipalities of Chengdu, Chongqing and Tianjin. It offers satellite transmission services through its subsidiary, China United Telecommunications Satellite Communication Co. Ltd., or Unisat.

### **The Restructuring of Unicom Group and Our Initial Public Offering in 2000**



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We are a company limited by shares incorporated under the Companies Ordinance of Hong Kong on February 8, 2000. Our registered office and principle executive offices are located at 75th Floor, The Center, 99 Queen's Road Central, Hong Kong (telephone number: 852-2126-2018).

Under a reorganization agreement, dated April 21, 2000, between Unicom Group and CUCL, Unicom Group transferred to CUCL certain of its assets, rights and liabilities in preparation for our initial public offering, or IPO.

Under an equity transfer agreement, dated April 21, 2000, among us, Unicom Group, China Unicom (Hong Kong) Group Limited and China Unicom (BVI) Limited, or Unicom BVI, Unicom Group transferred to us its 100% equity interest in CUCL, which became our wholly-owned operating subsidiary in China. In return, we issued 9,725 million shares to Unicom BVI, then an indirect wholly-owned subsidiary of Unicom Group.

In June 2000, we successfully completed our IPO, raising approximately US\$5.65 billion. Upon completion of our IPO, our shares became listed and traded on the Hong Kong Stock Exchange and ADSs representing our shares became listed and traded on the New York Stock Exchange.

**Further Restructuring of Unicom Group and Initial Public Offering of the A Share Company in 2002**





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After our IPO, Unicom BVI, which was a wholly-owned subsidiary of China Unicom (Hong Kong) Group Limited, or Unicom HK, a wholly-owned subsidiary of Unicom Group, directly held 77.47% of our outstanding shares. In October 2002, Unicom Group completed an internal restructuring of its shareholding in our company. Unicom HK transferred the total issued capital of Unicom BVI held by it to Unicom Group and Unicom BVI became a direct wholly-owned subsidiary of Unicom Group. Unicom Group then transferred 51% of its equity interest in Unicom BVI to the A Share Company, a newly established holding company and subsidiary of Unicom Group. The A Share Company's business is limited to indirectly holding the equity interest of our company without any other direct business operations.

Following the restructuring, Unicom Group successfully completed the IPO of the A Shares of the A Share Company in mainland China and the listing of the A Shares on the Shanghai Stock Exchange. After the IPO of the A Share Company, the A Share Company transferred all of its net offering proceeds to Unicom Group in return for an additional 22.84% equity interest in Unicom BVI. As of May 31, 2005, Unicom Group holds a 69.32% equity interest in the A Share Company. The A Share Company in turn holds 82.09% of the total equity interest in Unicom BVI, with the remaining 17.91% held directly by Unicom Group. Unicom BVI continues to hold 77.37% of our outstanding shares and Unicom Group remains our ultimate controlling shareholder. See also the chart on page 19 below for the current shareholding structure of our company.

In accordance with the articles of association of the A Share Company and Unicom BVI, before Unicom BVI votes on a certain proposal at our shareholders' meeting, the A Share Company must first convene its shareholders' meeting to consider the same proposal and has the right to direct Unicom BVI to vote the shares in our company indirectly held by the A Share Company through Unicom BVI. Unicom Group can similarly direct the voting in respect of its direct equity interest in Unicom BVI. This mechanism for voting is designed to allow public shareholders of the A Share Company to indirectly participate in our shareholders' meeting.

The voting mechanism described above, however, will not apply to the approval process for any connected transactions between us or our subsidiaries and Unicom Group or its subsidiaries, on which Unicom BVI will not be permitted to vote under the Listing Rules of the Hong Kong Stock Exchange. Instead, our significant connected transactions would require the separate approvals of the public shareholders both of our company and of the A Share Company. According to the two-step voting arrangements we and the A Share Company have established, each connected transaction between us or our subsidiaries and Unicom Group or its subsidiaries will consist of an initial agreement and a further agreement. The initial agreement would be entered into by Unicom Group or its subsidiaries (excluding the A Share Company and its subsidiaries) on the one hand and the A Share Company or Unicom BVI on the other hand. This agreement would contain the following terms:

the closing of the initial agreement would be subject to the (i) successful transfer of all rights and obligations of the A Share Company or Unicom BVI under the initial agreement to us or our subsidiaries, and (ii) the approval of the further agreement by our independent shareholders, and

Unicom Group or its subsidiaries (excluding the A Share Company and its subsidiaries) would agree and acknowledge that all rights and obligations under the initial agreement can be transferred to us or our subsidiaries without any further consent requirements.

The initial agreement will constitute a connected transaction of the A Share Company and, if certain thresholds are met, will require the approval of the public or independent shareholders of the A Share Company under the rules of the Shanghai Stock Exchange. The further agreement would be entered into by the A Share Company or Unicom BVI on the one hand and us or our subsidiaries on the other hand, and would provide for the transfer of all rights and obligations of the A Share Company or Unicom BVI on the one hand under the initial agreement to us or our subsidiaries on the other hand. The further agreement will constitute a connected transaction of our company and, if certain thresholds are met, will require the approval of our public or independent shareholders under the Listing Rules of the Hong Kong Stock Exchange. We expect, to the extent the nature of a particular connected transaction allows, the two-step voting arrangements to apply as described above. However, there may be circumstances where the nature of the connected transaction requires the application of the two-step voting arrangements to be adjusted. This may arise where we or our subsidiaries are the providers, rather than recipients, of certain services. In this event, the two-step voting arrangements will need to be adjusted so that the process as described above is effectively reversed, such that the initial agreement is entered into by us or our subsidiaries rather than Unicom Group or its subsidiaries (excluding the A Share Company and its subsidiaries) with the A Share Company or Unicom BVI. Unicom Group or its subsidiaries (excluding the A Share Company and its subsidiaries), rather than us or our subsidiaries, will be party to the further agreement. The arrangements (including the conditions) will apply correspondingly. This two-step structure will be used in all future connected transactions between us and Unicom Group and will effectively require the separate approvals of the public or independent shareholders both of our company and of the A Share Company for such connected transactions.

#### **Restructuring and Acquisition of Unicom New Century**



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On December 31, 2002, in accordance with the two-step approach outlined above, we successfully completed the acquisition from Unicom Group of Unicom New Century, which holds cellular telecommunications businesses (including GSM assets and businesses and CDMA businesses) in the following nine provinces, autonomous regions and municipalities in China: Jilin, Heilongjiang, Jiangxi, Henan, Shaanxi and Sichuan provinces, Guangxi Zhuang Autonomous Region, Xinjiang Uygur Autonomous Region and Chongqing municipality. The total purchase price was HK\$4,523,181,304 (approximately RMB4.8 billion), payable in cash.

### **Acquisition of Unicom New World and the Sale of Guoxin Paging**



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On December 31, 2003, we successfully completed the acquisition from Unicom Group of Unicom New World, which holds cellular telecommunications businesses (including GSM assets and businesses and CDMA businesses) in the following nine provinces and autonomous regions in China: Shanxi, Hunan, Hainan, Yunnan, Gansu and Qinghai provinces and Inner Mongolia, Ningxia Hui and Tibet autonomous regions. The total purchase price was HK\$3,014,886,000 (approximately RMB3.2 billion), payable in cash. On the same date, we also completed the sale of the entire equity interests of Guoxin Paging to Unicom Group for a total sale price of HK\$2,590,917,656 (approximately RMB2.75 billion), and such proceeds were applied to our general working capital. Both the acquisition of Unicom New World and the sale of Guoxin Paging were completed in accordance with the two-step approach outlined above.

### **Merger between CUCL and Unicom New Century**



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On July 30, 2004, Unicom New Century was merged into CUCL and legally dissolved upon the completion of such merger. As a result, CUCL extended its cellular businesses to 21 provinces, autonomous regions and municipalities in China.



**Acquisition of China Unicom International Limited**



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In September 2004, we acquired from Unicom Group of Unicom International, a limited liability company established in Hong Kong engaging in voice wholesale business, telephone cards business, line leasing services, managed bandwidth services and mobile virtual network services. Unicom's wholly-owned US subsidiary, China Unicom USA Corporation, or Unicom USA, carries wholesale business of voice traffic between the United States and mainland China. The total purchase price was HK\$37,465,996 (approximately RMB39.74 million), payable in cash.

### **Establishment of China Unicom (Macau) Company Limited**



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On October 15, 2004, we set up China Unicom (Macau) Company Limited, or Unicom Macau, in Macau Special Administrative Region of the PRC, or Macau. In March 2005, the Macau government granted Unicom Macau a CDMA license, which will allow Unicom Macau to provide roaming services to our CDMA subscribers as well as CDMA users of other service providers who visit Macau during the first year of its operation. After the first year of its operation, Unicom Macau will be eligible to provide cellular services to local residents upon receiving approval from local telecommunications regulatory authority.

Set forth below is our shareholding structure and subsidiaries as of December 31, 2004.

### **Our Relationship with Unicom Group**

Unicom Group continues to own and manage the international gateways that provide international connections to our long distance network. Unicom Group also continues to operate the following telecommunications networks:

its cellular networks in Guizhou province,

its local telephony networks in Chengdu, Chongqing and Tianjin municipalities,

the satellite transmission networks operated through Unisat, and

the paging networks operated through Unicom Paging and Guoxin Paging.

Unicom Group holds the licenses required for our telecommunications businesses and we derive our rights to operate our businesses from our status as a majority owned subsidiary of Unicom Group. Under the respective reorganization agreements entered into by CUCL, Unicom New Century and Unicom New World with Unicom Group referred to above, Unicom Group undertook to hold and maintain all licenses received from the MII in connection with our businesses solely for our benefit during the term of the licenses and at no cost to us. In addition, Unicom Group undertook to take all actions necessary to obtain and maintain for our benefit such governmental licenses or approvals as we shall require to continue to operate our businesses. Unicom Group also agreed not to engage in any business which competes with our businesses except for the then-existing competing businesses of Unicom Group and to grant us a right of first refusal in relation to any government authorization, license or permit, or other business opportunity to develop any new telecommunications technology, product or service. Finally, Unicom Group also gave us an undertaking not to seek an overseas listing for any of its businesses or the businesses of its subsidiaries in which we are engaged or may engage in the future, except through us.

In connection with the restructuring of Unicom Group and the acquisitions of Unicom New Century, Unicom New World and Unicom International, we entered into a number of agreements with Unicom Group pursuant to the two-step process described in *Further Restructuring of Unicom Group and the Initial Public Offering of A Shares* above. These include arrangements for interconnection and roaming services between the telecommunications networks owned by us and Unicom Group and for the provision or sharing of telecommunications and ancillary services and facilities between us and Unicom Group. Unicom Group also retains its interests in its other subsidiaries that provide ancillary services to us, including the procurement of telecommunications equipment and the supply of SIM cards and calling cards. In March 2005, we entered into several new agreements with Unicom Group to replace the existing arrangements. See *B. Related Party Transactions* under Item 7.

Unicom Group has constructed nationwide cellular networks based on CDMA technology. The first phase of the construction was completed at the end of 2001. We entered into lease agreements with Unicom Group to lease a portion of the network capacity and began to offer CDMA cellular services on an exclusive basis in our cellular service areas in early 2002. In 2003, Unicom Group completed the second phase of the CDMA network construction, which included the upgrade of the network to CDMA 1X technology. Wireless data services that utilize CDMA 1X technology have been introduced throughout our service areas. In 2004, Unicom Group substantially completed the construction of the third phase of the CDMA network, which increased the total network capacity to approximately 72 million subscribers. In March 2005, we entered

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into a new CDMA lease agreement with Unicom Group to replace the then existing CDMA lease agreement. Unicom Group operates its CDMA networks outside of our cellular service areas, in Guizhou province. We also have an option to acquire the CDMA networks from Unicom Group. See **B. Related Party Transactions – Leasing of CDMA Network Capacity** under Item 7.



**Capital Expenditures and Divestitures**

See **Liquidity and Capital Resources- Capital Expenditures** under Item 5 for information concerning our principal capital expenditures for the previous three years and those planned for 2005. We have not undertaken any significant divestitures.

**B. Business Overview**



**General**



We are an integrated telecommunications operator in China, offering a wide range of telecommunications services, including cellular, international and domestic long distance, data and Internet services based on our advanced, uniform nationwide network system.

Prior to the acquisition of Unicom New World on December 31, 2003, we offered cellular communications services based on both GSM and CDMA technologies in 21 provinces, autonomous regions and municipalities in China. After the acquisition of Unicom New World, our cellular service area encompassed a total of 30 provinces, autonomous regions and municipalities (i.e., all provinces, autonomous regions and municipalities in China except for Guizhou province). See A. History and Development of the Company Acquisition of Unicom New World and the Sale of Guoxin Paging above under this Item 4. As a result, our operating results for the year ended December 31, 2004, which include the operating results of Unicom New World, are not necessarily comparable to our operating results for the year ended December 31, 2003, which does not include the operating results of Unicom New World.

We and China Mobile are the two cellular service providers in our cellular service areas. We had a total of 84.27 million GSM cellular subscribers in our cellular service areas at the end of 2004, representing a 31.8% increase from 63.92 million subscribers at the end of 2003. Our GSM cellular business is our largest business, which accounted for 59.8% of our total operating revenue in the year ended December 31, 2004. We had approximately 27.81 million CDMA cellular subscribers in our cellular service areas as of December 31, 2004, representing a 64.5% increase from 16.91 million subscribers as of December 31, 2003. At the end of 2004, our market share was 35.6% in our cellular service areas, relatively stable compared to the market share at the end of 2003.

We provide traditional public switched and IP telephony international and domestic long distance, data and Internet services nationwide in China. All of these services were launched in 2000, with the exception of our IP telephony long distance service, which was launched in 1999. These businesses currently represent a relatively small portion of our overall business, but are growing in absolute terms. Our long distance, data and Internet businesses accounted for 6.9% of our total operating revenue in 2004, compared to 8.4% in 2003.

Outgoing public switched and IP telephony long distance calls totaled 10.10 billion and 13.95 billion minutes, respectively, in 2004, compared to 8.44 billion and 11.39 billion minutes, respectively, in 2003. Our market share slightly decreased from approximately 14.0% in 2003 to 12.7% in terms of total outgoing long distance call minutes in 2004. Our incoming international long distance calls (including incoming calls from Hong Kong, Macau and Taiwan) totaled 2.75 billion minutes in 2004, up from 1.91 billion minutes in 2003.

Our data and Internet business maintained steady growth in 2004. Our broadband data and Internet services currently cover over 300 cities nationwide. As of December 31, 2004, the bandwidth of our data network, international interconnection bandwidth and domestic interconnection bandwidth had reached 136Gbps, 3.34Gbps and 14.88Gbps, respectively. Our Internet subscribers grew to 13.63 million by the end of 2004 from 12.43 million in 2003.

Our fiber optic transmission network continued to expand in 2004. As of December 31, 2004, the total cable length of our transmission network reached 712,000 km, including 120,000 km for our backbone transmission network, representing an increase of 25.0% and 4.7%, respectively, from the end of 2003.

### **Recent Developments**

As of March 31, 2005, the total number of our GSM subscribers in all of our cellular service areas has increased to 86.98 million, including 44.05 million post-paid subscribers and 42.93 million pre-paid subscribers. As of March 31, 2005, we also had a total of 29.43 million subscribers to our CDMA services. Average minutes of usage, or MOU, per subscriber per month for GSM services in our combined service areas were 186.5 minutes for the three months ended March 31, 2005. Average MOU per subscriber per month for CDMA services in combined service areas were 275.5 minutes for the three months ended March 31, 2005. ARPU for GSM services in our combined service areas was RMB46.9 for the three months ended March 31, 2005. ARPU for CDMA services in our combined service areas was RMB77.5 for the three months ended March 31, 2005.

For the three months ended March 31, 2005, outgoing public switched long distance calls totaled 2.63 billion minutes, including 2.59 billion minutes of domestic long distance calls and 0.04 billion minutes of international long distance calls (including calls to Hong Kong, Macau and Taiwan). Outgoing IP telephony long distance calls totaled 3.51 billion minutes for the first three months of 2005, including 3.48 billion minutes of domestic long distance calls and 0.03 billion minutes of international long distance calls (including calls to Hong Kong, Macau and Taiwan). As of March 31, 2005, our Internet subscribers reached 10.03 million.

### **Cellular Services**



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Our cellular business is our largest business, with our GSM and CDMA businesses together having contributed 93.0% of our total operating revenue in 2004. We offer cellular services in 30 provinces, autonomous regions and municipalities in China.

We offer both GSM and CDMA cellular services in our service areas. We began to offer GSM cellular services in 1995 and currently a majority of our existing cellular users subscribe to our GSM cellular services. We began to offer CDMA cellular services in 2002. In 2003, we introduced wireless data services that utilize CDMA 1X technology. We also offer GSM international roaming services in conjunction with 211 operators in 101 countries and regions and CDMA international roaming services in conjunction with 15 operators in 12 countries and regions. In August 2004, we launched dual mode cellular service under the brand name Worldwind, leveraging our existing GSM and CDMA networks to achieve seamless roaming worldwide.

We also offer short message services, or SMS, and a number of other value-added services to our cellular subscribers, including CDMA 1X wireless data services and GSM wireless data services, under the integrated service brand of uni and sub-brands of uni-Info , uni-Mail , uni-Magic , uni-Map , uni-Wap and Uni-Web , and U-Net , which represents various wireless internet access services for laptop or mobile han



In 2004, our market share in our cellular service areas grew slightly, from 34.6% in 2003 to 35.6% in 2004.

*GSM Cellular Services*



We centrally plan and oversee our provincial GSM cellular businesses, which are operated by provincial branches of our operating subsidiaries, CUCL and Unicom New World. We centrally manage the key aspects of network construction such as network planning and design and selection of major equipment. We also centrally devise the overall business strategies to be carried out by the provincial operating branches.

Our GSM cellular networks reach all cities, county centers, major towns, major highways and railways in our cellular service areas. We continue to selectively deploy GSM systems that operate in the 1800 MHz frequency band in high-density population and high call volume centers to supplement our GSM networks operating in the 900 MHz frequency band. In 2004, we focused on optimizing the operational efficiency and stability of our GSM networks, and will continue to manage our GSM networks to support the development of our various cellular services.

*Post-paid Services and Pre-paid Services*



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We offer two main categories of GSM cellular services: post-paid and pre-paid services that target different consumer segments. Generally, we promote our pre-paid services to migrant population and temporary residents as well as lower-usage subscribers and target our post-paid services at long-term residents in our GSM cellular service areas.

To subscribe for our post-paid services, a customer generally needs to produce proof of local residency or a guarantee from a local resident and sign a service contract. A post-paid subscriber pays a monthly fee and per-minute usage and roaming charges. In many of our cellular service areas, we require most post-paid subscribers to pay a deposit directly to us or to give a direct debit authorization to one of the commercial banks that collect service charges for us.

To subscribe for our pre-paid services, a customer simply purchases a SIM card with a pre-paid amount of service charges. The customer can add to the pre-paid balance by purchasing rechargeable cards. A customer of pre-paid services does not need to register with us. In addition, pre-paid services do not have monthly fees, but carry higher per-minute usage and roaming charges. This fee structure is generally more attractive to lower-usage subscribers.

We market pre-paid services under the service brand of Ruyi Tong . These services are generally supported by intelligent networks built by us. The intelligent networks enable us to offer nationwide roaming services and monitor in real time the account balance of pre-paid subscribers. We also offer pre-paid services in some service areas that are based on the local billing systems and use local service brands.

*Subscribers and Usage*



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The following table sets forth selected historical information about our GSM cellular operations and our subscriber base for the periods indicated.

	CUCL and Unicom New Century only, as of or for the year ended December 31,		Unicom New World only, as of or for the year ended December 31,	CUCL(5) and Unicom New World, as of or for the year ended December 31	CUCL(5) and Unicom New World, as of or for the three months ended March 31,
	2002	2003	2003	2004	2005
Number of subscribers (in thousands)	53,465	63,923	8,647	84,267	86,982
Post-paid	29,718	32,458	7,105	42,844	44,048
Pre-paid	23,747	31,465	1,542	41,423	42,934
Estimated market share in our service areas <sup>(1)</sup>	29.8%	27.4%	27.1%	26.8%	26.2%
Average churn rate <sup>(2)</sup>	15.5%	29.1%	46.9%	27.6%	6.5%
Average minutes of usage per subscriber per month <sup>(3)</sup>	165.49	173.70	204.55	188.9	186.5
Average revenue per subscriber per month (in RMB) <sup>(4)</sup>	67.34	56.74	58.34	49.4	46.9
SMS Volume (in billions)	8.495	25.034	2.959	32.39	8.72

(1) Market share in a given area is determined by dividing the number of our GSM subscribers in the area by the total number of cellular subscribers in the area. *Source:* Ministry of Information Industry.

(2) Average churn rate is the rate of subscriber disconnections from our GSM cellular network, which we have determined by dividing the sum of voluntary and involuntary deactivations during the period by the average of the number of our GSM subscribers during the period.

(3) Average minutes of usage per subscriber per month is calculated by dividing the total minutes of usage during the period by the average of the number of our GSM subscribers during the period, and dividing the result by the number of months in the relevant period.

(4) Average revenue per subscriber per month, or ARPU, is calculated by dividing the sum of GSM cellular services revenue during the relevant period by the average of the number of our GSM subscribers during the period, and dividing the result by the number of months in the period.

(5) Includes Unicom New Century, which merged into CUCL on July 30, 2004.

*Subscriber Increase:* Our subscriber count continued to grow rapidly. As of December 31, 2004, the total number of GSM subscribers in our cellular service areas increased to 84.27 million, including 42.84 million post-paid subscribers and 41.42 million pre-paid subscribers. Our share of the cellular market in terms of total cellular subscribers in our GSM cellular service areas was 26.8% as of December 31, 2004. We attracted 35.5% of the net cellular subscriber additions in those service areas during 2004. We believe that this growth was attributable to a number of factors, including, among others, (i) continued growth of the Chinese cellular telecommunications market, driven by economic



growth and reduction in the cost of cellular handsets and services, (ii) relatively flexible marketing, sales and distribution, (iii) relatively competitive pricing of our services and (iv) our continuing focus on customer service.

*Pre-paid Subscribers:* The rate of increase in our pre-paid subscribers has generally exceeded the rate of increase in our post-paid subscribers in recently years. As of December 31, 2004, we had 41.42 million pre-paid subscribers in our cellular service areas, representing 49.2% of our total subscriber base, the same percentage as at the end of 2003. Pre-paid subscribers represented 71.9% of our net subscriber additions in our cellular service areas during 2004.

*MOU and ARPU:* Our total minutes of usage, or MOU, and average revenue per subscriber per month, or ARPU, were 178.16 billion minutes and RMB49.4, respectively, in 2004. The average MOU per subscriber per month was 188.9 minutes in 2004, an increase of 15.2 minutes from 173.7 minutes in 2003. The increase in MOU was attributable to increased tariff competition with our competitor, which resulted in the provision of more free minutes to subscribers. The decreasing tariffs as a result of such competition also encouraged higher usage among subscribers. Our ARPU continued to decline from RMB56.7 in 2003 to RMB49.4 in 2004. The decline in ARPU was attributable to intensified market competition and regional promotional activities that led to a decline in effective tariffs. Our pre-paid subscribers in general have lower MOUs and ARPUs compared to our post-paid subscribers. For the year ended December 31, 2004, the average MOU per subscriber per month and ARPU were 125.3 minutes and RMB40.0 respectively, for our pre-paid subscribers, compared to 247.5 minutes and RMB58.1, respectively, for our post-paid subscribers.

*Churn Rate:* For the year ended December 31, 2004, the churn rate for GSM services in our cellular service areas decreased from 29.1% in 2003 to 27.6% as a result of our emphasis on customer retention. Our calculation of churn rate reflects those subscribers who switch to services of other operators and those whose services we disconnect as a result of account inactivity or payment delinquency.

The Chinese government eliminated connection fees in 2001 and, as competition continues to intensify, our churn rate from subscribers voluntarily discontinuing our services may increase in the future. The churn rate for our pre-paid services is generally higher than that for our post-paid services because of the migrant and temporary nature of most pre-paid subscribers. It is also difficult for us to develop and maintain customer relationships with pre-paid subscribers from whom we do not require registration.

*Payment Delinquency:* Payment delinquency stabilized in 2004. As of December 31, 2004, the doubtful debt ratio for GSM cellular services in our cellular service areas, calculated as the amount of provision for doubtful debt divided by revenue from GSM cellular services, is 2.8%, same as the ratio at the end of 2003 for CUCL and Unicom New Century. In some of our cellular service areas we require our post-paid subscribers to deposit service charges and maintain a certain level of account balances with us or with commercial banks that collect service fees for us. We classify the creditworthiness of our subscribers into various levels and have adopted other credit control measures. We also closely manage payment delinquencies through confirmation of customer address and other registration information, expansion of collection channels, advance notification of inadequate deposits, close monitoring of call patterns and account balances and prompt termination of services.

*Tariffs*



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Generally we charge our post-paid cellular subscribers the following categories of tariffs: basic monthly fees, usage charges for both incoming and outgoing calls, roaming charges, long-distance call charges and charges for value-added services. Pre-paid subscribers do not pay monthly fees but pay higher per-minute usage and roaming charges.

The cellular tariffs are subject to regulation by various government authorities, including the MII, the National Development and Reform Commission and provincial price regulatory authorities. The following table summarizes the present State guidance tariff rates for post-paid and pre-paid cellular services:

	Post-paid Services	Pre-paid Services
	RMB	RMB
Basic monthly fee	50	0
Basic usage charge (per minute)	0.4	0.6
Domestic roaming charge (per minute)	0.6	0.8

Source: MII.

Intense competition in our cellular service areas has resulted in tariff discounts and service promotions offered by both us and our main competitor from time to time, which may lower effective tariffs. These discounts and promotions have taken many forms, including promotional tariff rates, free call minutes, off-peak discounts or discounts for high-usage subscribers and package service plans with fixed monthly fees. While various features of our package service plans are coordinated on a nationwide basis, the tariff structure of the various plans are determined by us based on the local competitive environment. See **D. Risk Factors Risks Relating to the Overall Telecommunications Industry in China** regulatory or policy changes relating to telecommunications industry may adversely affect our results of operations, financial condition and business prospects under Item 3.

We have introduced a number of package service plans in our cellular service areas. Under these plans, subscribers pay a fixed monthly fee for a specified number of call minutes. The plans vary in the level of the fixed monthly fee, the number of specified call minutes and the tariff rates for call minutes in excess of the specified call minutes. The terms of these plans also vary depending on the local markets and generally offer some price discounts to similar plans of our main competitor. We have also introduced in selected cities promotional plans for certain qualified subscribers, which allow such subscribers to receive incoming calls without incurring per-minute usage charges in exchange for a fixed monthly fee.

In 1997, the Chinese government granted us preferential treatment by allowing us to reduce our tariffs by up to 10% below the State guidance tariff rates. In the past, this preferential treatment has helped us capture a significant number of cellular subscribers by allowing us to market our cellular services at discounted rates. As we and our main competitor, introduced various package service plans and other promotional programs, the tariff structure has become more complex. While we continue to maintain tariff levels that are generally lower than those of our main competitor, the more complex tariff structure has, to some extent, made our price advantages less obvious to subscribers compared to previous tariff schemes that were largely based on simple per-minute charges. In 2004, as we continued to offer package service plans in our service areas, we have significantly reduced the variety of such plans and stopped offering service plans that were not profitable.

*CDMA Cellular Services*



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Our controlling shareholder, Unicom Group, currently has the exclusive license to offer CDMA cellular services in China. It has constructed CDMA networks nationwide through its wholly-owned subsidiary Unicom Horizon. We have leased capacity on the network and operate the CDMA network in our cellular service areas. After a trial period of three months, we formally launched our CDMA services in April 2002. In 2003, Unicom Group completed the second phase of the CDMA network construction, which included the upgrade of the network to CDMA 1X technology, and we introduced wireless data services that utilize CDMA 1X technology. In August 2003, we introduced pre-paid CDMA services. In 2004, Unicom Group substantially completed the third phase of the CDMA network construction. In August 2004, we launched the Worldwind CDMA and GSM dual-mode handset cellular services.

*Unicom Group's Construction of CDMA Networks*





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In May 2001, Unicom Group began to build CDMA networks nationwide. The networks are expected to be expanded in phases. The number and size of each phase will depend upon actual and forecast CDMA subscriber growth and anticipated capacity requirements. In the first phase of the construction, which was completed by the end of 2001, the networks achieved a nationwide coverage of approximately 330 cities in China, with a total capacity of 15.81 million subscribers. The portion of this network within our cellular service areas has a total capacity of approximately 15.62 million subscribers.

Through a competitive bidding process, Unicom Group was able to obtain highly attractive terms for its CDMA equipment supply contracts. The construction of the first phase of its CDMA networks utilized to a significant extent the existing GSM infrastructure, such as base stations and related equipments, switching centers and related equipments, transmission capacity and relevant equipments.

In 2003, Unicom Group completed the second phase of the CDMA network construction, which included the upgrade of the network to CDMA 1X technology. The second phase of the construction also added capacity for 20.69 million additional subscribers, bringing the total capacity of the nationwide CDMA networks to approximately 36.50 million subscribers. The portion of the CDMA networks within our cellular service areas has a capacity of approximately 20.38 million subscribers. In addition, the second phase of the construction focused on improving the breadth and depth of network coverage, by deepening coverage to the level of almost all of the county-level towns and cities and increasing indoor coverage.

In 2004, Unicom Group substantially completed the third phase of the CDMA network construction, which increased the total CDMA network capacity to approximately 72.74 million subscribers, with approximately 71.81 million of capacity within our service areas. Such level of capacity improved our CDMA nationwide network coverage and telecommunications quality, including both outdoor and indoor coverage, as well as the data-processing capacity of our CDMA 1X services. After the substantial completion of the third phase of network construction, Unicom Group has built a CDMA network with relatively comprehensive nationwide coverage.

*Our Lease of CDMA Networks from Unicom Group*



Our wholly-owned operating subsidiary, CUCL, entered into a lease agreement with Unicom Group and its subsidiary Unicom Horizon, dated November 22, 2001, which sets forth the principal terms of the network capacity leasing arrangement between us and Unicom Group. Unicom New Century and Unicom New World have also entered into lease agreements, dated November 20, 2002 and November 20, 2003, respectively, with Unicom Group and Unicom Horizon on similar terms and conditions. We entered into a new, consolidated lease agreement, or the New CDMA Lease, with Unicom Group and Unicom Horizon on March 24, 2005 to replace the three lease agreements, or the Old CDMA Leases, entered into in the past individually by CUCL, Unicom New Century and Unicom New World. We lease network capacity from Unicom Group and operate these CDMA networks in our cellular service areas on an exclusive basis and receive all revenue generated from the operation. We may terminate the lease arrangements upon giving at least six months' prior notice to Unicom Group.

Under the Old CDMA Leases, the term of each lease was for an initial period of one year and could be renewed for further one-year terms at our option. We leased network capacity in our cellular service areas on a quarterly basis during the first year and, thereafter, would lease network capacity on an annual basis, with the ability to request to adjust lease capacity pursuant to the Old CDMA Leases. See B. Related Party Transactions – Leasing of CDMA Network Capacity under Item 7. We have leased capacity for 31 million subscribers in our cellular service areas in 2004.

Under the OLD CDMA Leases, we were required to make quarterly lease payments to Unicom Group for the actual amount of network capacity we leased. The lease fee was charged on a per line basis and determined so as to enable Unicom Group to recover its total investment in constructing the network in seven years together with a rate of return on its investment of 8%. To the extent that we had not leased the full capacity of the CDMA network in the particular period, we did not have to compensate Unicom Group for unused capacities not leased by us. The quarterly lease fee for the first two phases of the CDMA network in our cellular service areas was RMB56.4 and RMB61.5 per subscriber line leased in 2004, respectively.

The New CDMA Lease has an initial term of two years commencing from January 1, 2005, during which (i) the lease fee for the first year will be 29% of the audited service revenue generated by our CDMA cellular business and (ii) the lease fee for the second year will be 30% of the audited service revenue generated by our CDMA business. We lease all constructed network capacity from Unicom Group under the New CDMA Lease. The term of the New CDMA Lease may be renewed at our option, with the length of the renewed term to be agreed upon.

In addition to leasing network capacity, we also have the option, exercisable at any time during the lease period and for an additional year thereafter, to purchase the CDMA network in our cellular service areas. The acquisition price will be negotiated between Unicom Horizon and us. It will be based on the appraisal value of the CDMA network determined in accordance with applicable PRC laws and regulations and take into account the then prevailing market conditions and other factors. However, the purchase price will not exceed an amount which will, taking into account all lease fee payments made by us to Unicom Horizon and lease fee discounts as a result of delay of delivery, enable Unicom Horizon to recover its total network construction costs, together with an internal rate of return of 8%. The exercise of the purchase option will be subject to the relevant laws, regulations and listing rules in Hong Kong and the PRC, particularly those governing connected transactions, including approvals of our minority shareholders. See B. Related Party Transactions – Leasing of CDMA Network Capacity under Item 7 for a more detailed description of the New CDMA Lease.

*Services*



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The CDMA services we offer in our cellular service areas include basic voice and value added services such as call forwarding and voicemail, caller identity display, SMS services and CDMA 1X data services. In addition to post-paid CDMA services, we offer pre-paid CDMA services under the service brand of Ruyi133 in our cellular service areas. The features of our pre-paid and post-paid CDMA services are similar to pre-paid and post-paid GSM services. See B. Business Overview Cellular Services GSM Cellular Services Post-paid Services and Pre-paid Services under this Item 4. We have begun operations of the CDMA 1X networks in all of the cities in our cellular service areas.

In August 2004, we launched CDMA and GSM dual-mode cellular services under the brand name Worldwind, leveraging our existing GSM and CDMA networks to achieve seamless roaming worldwide. As of December 31, 2004, we sold approximately 200,000 Worldwind dual-mode handsets and had approximately 160,000 subscribers of the dual-mode cellular services. Worldwind services, which are available to our subscribers who use either a dual-mode handset or a dual-mode user card, have the following features:

Users can switch between our GSM and CDMA networks in China, thereby offering wireless coverage in areas of the country covered by any one of these networks;

When roaming in areas outside of China, users can use the cellular services of local operators, whether they are GSM or CDMA, who signed roaming agreements with us; and

Our GSM users who sign up for Worldwind can continue to use the basic GSM services, while enjoying the additional benefits of the CDMA 1X services.

*Subscriber Base*





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The following table sets forth selected historical information about our CDMA cellular operations and our subscriber base for the periods indicated.

	CUCL and Unicom New Century only, as of or for the year ended December 31,		Unicom New World only, as of or for the year ended December 31,	CUCL(5) and Unicom New World, as of or for the year ended December 31,	CUCL(5) and Unicom New World, as of or for the three months ended March 31,
	2002	2003	2003	2004	2005
Number of subscribers (in thousands)	6,245	16,910	2,036	27,814	29,432
Post-paid	6,245	16,046	1,934	25,824	27,227
Pre-paid		864	102	1,991	2,205
Estimated market share in our service areas <sup>(1)</sup>	3.5%	7.2%	6.4%	8.8%	8.9%
Average churn rate <sup>(2)</sup>	0.8%	11.5%	25.9%	17.9%	4.1%
Average minutes of usage per subscriber per month <sup>(3)</sup>	328.1	337.5	335.4	292.3	275.5
Average revenue per subscriber per month (in RMB) <sup>(4)</sup>	172.2	128.4	123.4	85.3	77.5
SMS Volume (in billions)	0.516	6.231	0.623	11.83	3.41

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- (1) Market share in a given area is determined by dividing the number of our CDMA subscribers in the area by the total number of cellular subscribers in the area. *Source:* Ministry of Information Industry.
- (2) Average churn rate is the rate of subscriber disconnections from our CDMA cellular network, which we have determined by dividing the sum of voluntary and involuntary deactivations during the period by the average of the number of our CDMA subscribers during the period.
- (3) Average minutes of usage per subscriber per month is calculated by dividing the total minutes of usage during the period by the average of the number of our CDMA subscribers during the period, and dividing the result by the number of months in the relevant period.
- (4) Average revenue per subscriber per month, or ARPU, is calculated by dividing the sum of CDMA cellular services revenue during the relevant period by the average of the number of our CDMA subscribers during the period, and dividing the result by the number of months in the period.
- (5) Includes Unicom New Century, which merged into CUCL on July 30, 2004.

As of December 31, 2004, our total CDMA subscriber base in our cellular service areas reached 27.81 million, representing an increase of 64.5% from 16.91 million subscribers at December 31, 2003. Among the total CDMA subscribers, post-paid subscribers increased by 60.9% from 16.05 million as of December 31, 2003 to 25.82 million as of December 31, 2004, while prepaid subscribers increased by 130.4% from 0.86 million as of December 31, 2003 to 1.99 million as of December 31, 2004. Pre-paid subscribers represented 7.2% of the total number of CDMA subscribers in 2004. We believe the rapid growth in our CDMA subscriber base was primarily attributable to:

World, expansion of our CDMA cellular services areas as a result of the acquisition of Unicom New

the advantages of the CDMA technology, including the lower radio transmitting power of CDMA handsets as compared to GSM handsets, better voice quality and enhanced security,

improved network coverage and quality, and

increased brand awareness and our promotions and marketing efforts.

*MOU, ARPU and Churn Rate*



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In 2004, total MOU for our CDMA services was 82.96 billion minutes, an increase of 89.8% from 43.70 billion minutes in 2003, and ARPU for our CDMA services was RMB85.3, a decrease from RMB128.4 in 2003. Average MOU per subscriber per month for our CDMA services was 292.3 minutes, 54.7% higher than the average MOU of 188.9 minutes for GSM services, while our CDMA ARPU was 72.7% higher than the ARPU of RMB49.4 for our GSM subscribers. The reasons for the increase in MOU and the decrease in ARPU for our CDMA services in 2004 are similar to the reasons for similar trends in GSM services. See B. Business Overview Cellular Services GSM Cellular Services MOU and ARPU under this Item 4.

The churn rate for our CDMA services is calculated in the same way as the churn rate for our GSM services and was 17.9% in 2004, higher than the 11.5% in 2003, but significantly lower than the 27.6% churn rate for our GSM services. Loss of CDMA subscribers was primarily attributable to the following reasons:

- (i) the termination of some CDMA subscribers at the end of their contract periods under the CDMA handset promotional packages we began to offer in 2002;
- (ii) increased competition as the focus of growth gradually shifts from new subscribers to increased usage; and

(iii) an increasing percentage of our CDMA subscribers are subscribing to pre-paid CDMA services, which are characterized by a higher churn rate than post-paid services and led to some subscribers switching from post-paid services to pre-paid services.

*Payment Delinquency*





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As of December 31, 2004, the doubtful debt ratio for CDMA cellular services in our cellular service areas, calculated as the amount of provision for doubtful debt divided by revenue from CDMA cellular services, is 2.7%, compared to 2.4% in 2003 for CDMA cellular services in the service areas of CUCL and Unicom New Century. We have taken various measures to control payment delinquency for our CDMA services, which measures are similar to the ones taken to control payment delinquency for our GSM services. See B. Business Overview Cellular Services GSM Cellular Services Payment Delinquency under this Item 4.

### *Tariffs and Promotion*



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The tariff rates for our CDMA services are generally the State guidance rates for cellular services without the 10% discount we are permitted to adopt for GSM services. However, we have adopted other promotional programs. Generally we charge our post-paid cellular subscribers the following categories of tariffs: basic monthly fees, usage charges for both incoming and outgoing calls, roaming charges, long-distance call charges and charges for value-added services. Pre-paid subscribers do not pay monthly fees but pay higher per-minute usage and roaming charges.

To accelerate the growth in our CDMA subscriber base, we began offering special handset promotional packages in the second half of 2002. Under the handset promotional packages, CDMA mobile handsets purchased by us from handset suppliers were given to certain CDMA subscribers for their use at no additional cost during specified contract periods, ranging from 6 months to 2 years. In return, subscribers were required to incur a minimum amount of service fees during the contract period. If the contractual subscribers can fulfill the minimum contract spending amounts, they will not need to repay the remaining costs of the CDMA handsets.

Due to the high cost of the handset promotional packages, we have attempted to reduce the use of such packages, and concentrated instead on alternative promotional programs to develop our CDMA services. We focused on expanding the sales and marketing channels for our CDMA services by significantly increasing the number of sales agents. We emphasize improving our customer services and introducing new value-added data services to our CDMA subscribers. We also launched several marketing campaigns in 2004, which included increased advertising for our CDMA services, promotion of various customized package service plans that gave subscribers more choices, promotion of our CDMA 1X value-added services and promotion of our Worldwind CDMA and GSM dual-mode services. In addition, we have adopted the policy to centralize the purchases of CDMA handsets to control the costs of our CDMA promotional packages.

*See D. Risk Factors – Risks Relating to Our Business – Our CDMA services have yet to gain a broad market acceptance in China and there is uncertainty over whether our CDMA services will succeed in gaining a broader market acceptance.* under Item 3.













*SMS Services and Other Value-added Services*



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We began to offer SMS services in 2000. SMS volume has been increasing rapidly. A total number of 32.39 billion short messages were transmitted by GSM subscribers and 11.83 billion short messages by our CDMA subscribers in our cellular service areas in 2004. Our SMS services are offered under a uniform service brand of uni-Info and mainly include the following services: SMS transmission and receipt through handsets, content provider-assisted SMS, business SMS platform, voice SMS and other information services. We continue to promote the use of SMS as a convenient and cost effective method of business and personal communication. The SMS platforms of our GSM and CDMA networks are interconnected with each other. Our SMS platforms are also interconnected with the SMS platforms of China Mobile's GSM network, China Telecom's Little Smart network, and China Netcom's Little Smart network.

On August 1, 2001, Unicom Group and we launched our nationwide GSM wireless data services under the service brand of uni-Info. The Uni-Info services are presently based on a nationwide wireless information services platform. Uni-Info offers a variety of services in the categories of games, downloads and other entertainment services, information and notification services, personal information management and transactions services. We and Unicom Group cooperate with a number of national and regional content providers that supply our subscribers with Uni-Info services.

In March 2003, we launched CDMA 1X wireless data services under the uniform service brand of uni, with individual services offered under various sub-brands, including uni-Info, uni-Wap, uni-Mail, uni-Magic, uni-Map and uni-Web. uni-Info services are similar to the GSM services offered under the same brand described above. uni-Wap services allow users to connect to and browse the Internet on their CDMA handsets. uni-Mail services allow users to (i) send and receive e-mails, either from other e-mail accounts or from the Internet and (ii) download and read attachments to the e-mail sent to the user's handset. uni-Magic services allow users to download pictures, games, entertainment services, business information and other forms of image. uni-Map services provide location-based information to users' handsets. Retail users can find locations and research information with respect to a particular location. This service also offers industrial applications, such as the logistics industry and sea rescue services. uni-Web services offer wireless data transmissions with higher transmission rate and more stable connectivity than the GPRS services offered by our main competitor. In addition to the uni brand value-added services, we also offer the U-Net wireless internet services, which provide wireless internet access to laptop computers and mobile handheld devices equipped with a wireless internet card.

In late 2003, we began to provide personalized ring tone service under the brand name Cool Ring Tong, which allows a cellular subscriber to select personalized ring tones that his or her callers will hear after dialing his or her cell phone number. This new value-added service has grown rapidly since its introduction. Also in 2004, we introduced Music Street, a value-added service that allows our cellular subscribers to send music and other types of voice messages, record voice messages and listen to music by dialing designated service numbers.

In 2004, in order to develop our CDMA 1X value added services, we took the following measures:

Through the improvement of the uni services, more staff training, advertising and promotions, trial programs and our various other efforts, we strengthened marketing efforts for our CDMA 1X services;

We improved the content of our CDMA 1X services, through strengthening service support of and cooperation with content providers and service providers, in order to increase the appeal of these services;

Through cooperation with partners in specific industries, we launched new applications such as Unicom Police Applications , Unicom Horizon Maritime Applications and Stock-in-Palm ;

Through promotional packages and the establishment of free trial zones in our retail stores, we sought to reduce the obstacles for subscriber usage of our CDMA 1X services;

We introduced CDMA 1X services specifically catering to the youth to support the launch of the Up New Power service brand that is designed for the youth market; and

We introduced more information services in order to increase the usage of our CDMA 1X services.

We have designed a fee structure under which we earn transmission fees from the use of our GSM and CDMA value added services and retain a certain percentage of application fees charged by content providers that we collect for them.

**Long Distance, Data and Internet Services**



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We offer international and domestic long distance services in China based on both the traditional public switched telephony standard and the IP telephony standard. Our long distance services are based on our advanced, uniform nationwide network system. We leverage our ability to integrate our long distance services with a broad range of services to target different customer segments. We have also developed a nationwide video-conferencing network that reaches over 300 cities. We launched our data and Internet services throughout China in 2000. Similar to our long distance services, our data and Internet services are supported by our advanced, unified nationwide network system.

The following table sets forth the total number of outgoing call minutes for our long distance services and our data and Internet services for the periods indicated.

	As of or for the year ended December 31,			
	2002		2003	2004
Public switched telephony (in billions of minutes):				
Domestic	6.23		8.31	9.94
International	0.14		0.13	0.16
Total	6.37		8.44	10.10
IP telephony (in billions of minutes):				
Domestic	6.75		11.25	13.81
International	0.13		0.14	0.14
Total	6.88		11.39	13.95
Data Services				
Bandwidth leased to customers (2Mbps)	1,466		7,194	9,007
Internet Services				
Dial-up subscribers (in thousands)	7,270		12,385	13,563
Dedicated access subscribers	22,596		47,750	61,569

*Public Switched Telephony Services*





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We offer public switched long distance, or PSTN, services to business and residential customers who register their telephone numbers with us. They can access our services by dialing a prefix of 193 . We also distribute pre-paid long distance calling cards that purchasers can use to access our services by dialing a prefix of 193300 . For some corporate and government customers, we also offer our public switched long distance services over dedicated lines, frequently as part of our integrated offerings of long distance and data services. We also offer long distance services to our cellular subscribers.

The following table sets forth selected information about our public switched long distance telephony services for the periods indicated.

	As of or for the year ended on December 31,	
	2003	2004
Number of cities reached	329	332
Minutes of outgoing long distance calls (in billion)	8.44	10.10
Market share of outgoing long distance call minutes <sup>(1)</sup>	14.33%	13.6%
Minutes of incoming international calls (in billion)	1.78	2.47

(1) *Source:* MII. In calculating market share, the total minutes of outgoing long distance calls include ours and those of the incumbent operators.

Tariff rates for public switched long distance telephony services of incumbent fixed line operators are set by the Chinese government. Other fixed line operators, including us, can adopt tariffs that are different from the State tariff rates upon approval by the MII as long as they do not offer services at tariff rates below cost. The following table sets forth our present tariff rates (including rates applicable to domestic and international long distance calls made by our cellular subscribers):

	Regular Tariff Rates	Discount Rates
	RMB per six seconds	
Public switched Domestic Long Distance:	0.06	0.03
Public switched International Long Distance:		
To Hong Kong, Taiwan and Macau	0.18	0.15
To all other international destinations	0.72	0.38

The discount period is every day from 10pm to 7am of the following day, with two more hours for the Tibet and Xinjiang autonomous regions. Effective August 21, 2001, we adjusted the discount rates set forth in the table above as follows:

RMB0.04 per six seconds every day from 8pm to 10pm;

RMB0.03 per six seconds every day from 10pm to 7am of the following day; and

RMB0.04 per six seconds on public holidays and weekends from 7am to 8pm.

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Settlement of outgoing and incoming international calls with international operators is conducted through negotiated contracts such individual international operators, which contracts must be approved by the MII.

We have adopted a number of measures to increase the number of our registered long distance customers, including, among others, organizing sales agents to promote our services in residential areas, and cross-selling our long distance services with our cellular services at our service centers.

*IP Telephony Services*

We offer domestic and international long distance IP telephony services through interconnection of our IP network with the Internet and other telecommunications networks based on a manageable IP network configuration to enhance service quality. The following table sets forth selected information about our IP telephony services for the periods indicated.

	As of or for the year ended December 31,		
	2002	2003	2004
Number of cities reached	337	337	341
Minutes of outgoing IP telephony calls (in billion)	6.88	11.39	13.95
Domestic	6.75	11.25	13.81
International, Hong Kong, Macau & Taiwan	0.13	0.14	0.14
Market share of outgoing IP calls minutes <sup>(1)</sup>	11.7%	13.8%	12.1%
Minutes of incoming international calls (in billion)	0.16	0.13	0.28

(1) Source: MII.

Our IP telephony services include the following services:

IP telephony services using the 17910 access code, which allows users to dial long distance phone numbers as follows: 17910 + IP card number + password + long distance number . There are three types of such services: (a) users can register for an IP card, pay the accumulated charges on the card on a monthly basis after receipt of a bill from us, (b) users can purchase an IP card with a pre-paid value, which can be re-filled after the user has used up the value on the card, or (c) users can purchase an IP card with a one-time-only pre-paid value.

IP telephony services using the 17911 access code, which allows users to dial long distance phone numbers as follows: 17911 + long distance number . There are two types of such services: (a) users can register for our services at any of our offices or our designated agents' offices free of charge, or (b) users can purchase a pre-paid IP card from us, input the card number and password the first time the IP card is used, and thereafter dial international or domestic long distance calls only with the 17911 prefix.

Dedicated IP telephony services users of these services only need to dial the long distance phone number to be connected.

Direct IP telephony services Pursuant to authorization from the MII, we are providing fixed long distance direct-dialing IP telephony services nationwide. As of December 31, 2004, we have set up more than 20,000 IP convenient stores nationwide. IP convenient stores are fixed-line long distance call centers in locations with a high concentration of callers who do not otherwise have access to fixed or wireless telephony services. These call centers provide long distance telephony services to customers on a pre-paid basis.



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In February 2001, the Chinese government ceased regulatory control of tariffs for IP telephony long distance calls and allowed operators to set their own rates. The following table sets forth our present tariff rates for our IP telephony services (including rates applicable to IP long distance calls made by our cellular subscribers).

		<b>Our Tariff Rates (RMB)</b>	
IP Telephony Domestic Long Distance		0.30 per minute	
IP Telephony International Long Distance			
To Hong Kong, Taiwan and Macau		1.5 per minute	
To U.S. and Canada		2.6 per minute	
To other international destinations		3.6 per minute	

Effective September 1, 2001, we adjusted our tariff rates for our IP telephony services for certain international destinations. The tariff rate for calls to 14 countries, including India, was adjusted to RMB4.60 per minute, and the tariff rate for calls to the U.S. and Canada was adjusted to RMB2.40 per minute.

We rely primarily on our network of sales agents to sell IP telephony cards. We also market registered IP telephony services and IP telephony services through dedicated lines.

*Data Services*



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We presently provide data services in over 300 cities in China. We target high volume business or government users of integrated voice, data and video communications and offer them data services as part of our integrated offerings of long distance, data and Internet services. As of December 31, 2004, the total leased bandwidth of our ATM and FR data services was 9,007 x 2 Mbps.

Our data service offerings mainly consist of broadband, managed data services, including:

Frame relay, or FR, services, which provide high speed and cost effective data communications services linking remote business sites using FR technology;

Asynchronous transfer mode, or ATM, services, which employ ATM technology and are able to handle high bandwidth, integrated voice, video, data and Internet traffic; and

Broadband video-conferencing and video-telephony services, which are provided under the brand name of Uni-Video . These services currently include video-conferencing, video-telephony, video conference room leasing and video public telephony services. These services are based on our existing unified data network platform. Two or more users can use our services by connecting to the Internet or our video network through video-conferencing terminals or computer terminals.

The following table sets forth selected information about our data services for the periods indicated.

	As of or for the year ended December 31,			
	2002		2003	2004
Number of cities reached	297		316	328
Bandwidth leased to customers	1,466		7,194	9,007



We provide data services through an advanced, unified nationwide network system, the backbone of which is our advanced nationwide fiber optic transmission network. This network is the second largest fiber optic transmission network in China. We have also built metropolitan area networks in many cities throughout China. These networks provide local transmission capacity for our different services. See – Networks – Transmission Network below.

We believe that our ability to offer integrated access to customers premises is important to the success of our data services. We continue to build integrated access networks linking major office buildings to our networks in major cities. See – Networks – Long Distance, Data and Internet Networks below.

Our charges for ATM and FR services include one-time, up-front charges for installation materials (currently RMB500 per port for ATM services and RMB300 per port for FR services) and testing (currently RMB500 per circuit or port for ATM services and RMB300 per circuit or port for FR services), a monthly port fee and a monthly circuit fee. Our tariff charges are generally offered at a 10% discount from the State guidance tariffs.

The following table sets forth our tariff rates for monthly port fees for FR data services of selected bandwidths.

FR Services Port Fee (RMB per month)		
Bandwidth (bps)		Port Fee
64k		260
128k		300
256k		400
384k		450
512k		500
768k		650
1M		750
2M		1,000

The following table sets forth our tariff rates for monthly permanent virtual circuit (PVC) fees for FR data services of selected bandwidths and selected distance categories.

Bandwidth	FR Services PVC Fee (RMB per month)							
	Local (intra-district)	Local (inter-district)	Domestic long distance	Hong Kong, Macau & Taiwan	International long distance (Asia)	International long distance (outside of Asia)		
8kbps	290	440	990	1,550	8,800	9,400		
16kbps	390	540	1,190	1,800	10,000	10,500		
32kbps	450	650	1,300	2,000	11,500	11,500		
48kbps	500	750	1,500	2,300	13,000	13,500		
64kbps	550	800	1,700	2,600	14,500	14,600		
128kbps	700	1,000	2,100	3,400	18,000	18,400		
256kbps	800	1,150	2,200	3,500	19,000	19,600		

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384kbps	850	1,350	2,300	3,800	20,000	20,500
516kbps	1,000	1,450	2,500	4,100	22,300	23,100
768kbps	1,150	1,600	2,700	4,600	25,800	26,550
1Mkbps	1,250	2,000	3,000	5,200	28,900	30,050
2Mkbps	1,500	2,200	4,000	7,000	39,000	39,000

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The following table sets forth our tariff rates for monthly port fees for ATM services of selected bandwidth.

ATM Services Port Fee (RMB per month)			
Bandwidth			Port Fee
256K			400
512K			500
1M			750
2M			1,000
4M			2,000
6M			3,000
8M			4,000
10M			5,000
12M			6,000
34M			7,000
45M			8,000
100M			9,000
155M			10,000

The following table sets forth our tariff rates for monthly circuit fees for ATM data services of selected bandwidths and selected distance categories.

Bandwidth	ATM Services Circuit Fee (RMB per month)						
	Local (intra-district)	Local (inter-district)	Domestic long distance	Hong Kong, Macau & Taiwan	International long distance (Asia)	International long distance (outside of Asia)	
256Kbps	800	1,150	2,200	3,500	19,000	19,600	
512Kbps	1,000	1,450	2,500	4,100	22,300	23,100	
1Mbps	1,250	2,000	3,000	5,200	28,900	30,050	
2Mbps	1,500	2,200	4,000	8,000	39,000	39,000	
4Mbps	2,000	3,000	6,000	12,900	72,200	72,200	
6Mbps	2,500	5,500	9,000	19,800	105,400	105,400	
8Mbps	3,500	8,500	12,000	26,700	138,700	138,700	
10Mbps	5,000	11,500	15,500	30,600	157,800	157,800	
15Mbps	7,000	15,000	22,000	40,000	205,000	205,000	
20Mbps	7,500	17,500	29,000	49,000	252,300	252,300	
25Mbps	8,000	21,000	36,000	59,000	300,000	300,000	
30Mbps	9,000	24,000	42,000	69,000	348,500	348,500	
40Mbps	10,000	29,000	52,000	88,500	416,000	416,000	
50Mbps	10,500	32,000	60,000	108,200	486,600	486,600	
60Mbps	11,000	33,000	68,000	122,600	567,900	567,900	
70Mbps	11,500	35,000	76,000	137,000	649,100	649,100	
80Mbps	12,000	36,000	84,000	151,300	730,400	730,400	
90Mbps	12,500	37,000	92,000	165,700	811,600	811,600	
100Mbps	13,000	37,500	100,000	180,100	892,900	892,900	
110Mbps	13,500	38,000	107,500	187,300	933,500	933,500	
130Mbps	13,800	38,500	122,500	201,600	1,014,800	1,014,800	
155Mbps	14,500	39,000	130,000	216,000	1,096,000	1,096,000	

Effective April 2003, we began charging our corporate customers fees for our Uni-Video services based on package service plans, including up-front charges for testing, a monthly fee and telecommunications charges. Retail customers of our Uni-Video services purchase re-chargeable cards to pay for such services.

Our target customer groups are government offices, financial institutions, multinational or multi-regional corporations, large- and medium-sized enterprises in China, and Internet service providers and Internet content providers that provide telecommunications services. We market our data services through our dedicated teams and our sales agents.

*Internet Services*

We offer the following Internet services:

**Dedicated Internet Access.** We began to offer business customers high speed Internet access through dedicated lines in 2000. As of December 31, 2004, we had a total of 61,569 subscribers for dedicated Internet access. We package this service with voice and data services to provide integrated communications solutions to our business customers and cooperate with cable operators and real estate developers to offer broadband access to residential customers.

**Dial-up Internet Access.** We began to offer dial-up Internet access services to customers in 2000. As of December 31, 2004, the total number of our dial-up subscribers increased to 13.56 million from 12.38 million in 2003.

**Ruyi Mailbox Services.** This service allows our cellular subscribers to use their cellular phone numbers as e-mail address. As of December 31, 2004, the number of Ruyi Mailbox subscribers increased to 14.69 million from 7.81 million in 2003.

**IDC Services.** We have built Internet data centers (or IDC) in 10 cities including Shanghai, Beijing, Guangzhou and certain provincial capitals, and provide server hosting, server rental, virtual servers and other IDC services to commercial customers and virtual IDC operators.

**Others.** Other Internet services we offer include a chain of Internet cafes (Unicom's Internet Plaza services), international Internet Protocol-Virtual Private Network (or IP-VPN), Virtual Private Data Network (or VPDN), Virtual Internet Service Provider (or VISP), Uninet international roaming and corporate e-mail services.

The following table sets forth selected historical information about our Internet service operations and our subscriber base for the periods indicated.

	As of December 31,		
	2002	2003	2004
Number of cities reached by our dedicated Internet access services	317	323	327
Number of cities reached by our dial-up Internet access services	305	325	328
Number of subscribers of dedicated Internet access services	22,596	47,750	61,569
Number of subscribers of dial-up Internet access services (in thousand)	7,270	12,385	13,563

Our tariff charges for registered dial-up access include a network usage fee and a fixed telecommunications fee (charged to users of our PSTN long distance services only). In addition, those registered accounts that charge based on usage volume include an up-front account set-up fee and those accounts that charge based on monthly usage include a monthly fee. Our tariff charges for dial-up access through pre-paid cards include only a network usage fee and a fixed telecommunications fee. The following table sets forth the various tariff charges for our dial-up access services:

	Registered Accounts					Pre-Paid Cards
	Volume-Based Service Plan	Monthly Service Plans				
Account Set-up Fee (RMB)	100					
Monthly Fee (RMB)			50		100	
Network Usage Fee						
Local Fee (RMB/Hour)	2.7		2.2		1.8	2.5
Roaming Fee (RMB/Hour)	3.0		3.0		3.0	2.8
Telecommunications Fee (RMB/Minute)	0.02		0.02		0.02	0.02

The network usage fee is discounted, at an amount equal to half of the amounts set forth above, on legal holidays and weekends and on weekdays from 11 p.m. to 8 a.m. of the following day.

Our tariff charges for dedicated Internet access include a network usage fee, an account set-up fee and a fixed telecommunications fee. Network usage fee is calculated based on monthly service plans. The account set-up fee is RMB100. The fixed telecommunications charge is based on the relevant tariff for the particular type and bandwidth of leased lines used to access the Internet. The following table summarizes the monthly network usage fees for selected bandwidths denoted as R .

	Network usage fees (RMB per month)
R<64Kbps	2,700-3,600
64Kbps<R<128Kbps	3,600-4,900
128Kbps<R<256Kbps	4,800-6,600
384Kbps <R<512Kbps	8,500-12,000
1024Kbps<R<2Mbps	18,000-27,000
8Mbps <R<10Mbps	59,400-70,000
20Mbps<R<34Mbps	165,900-195,200
34Mbps <R<45Mbps	210,000-250,000
45Mbps<R<100Mbps	428,400-504,000
100Mbps<R<155Mbps	664,100-781,200

Our provincial and local branches are permitted to make tariff decisions within the range set forth above. For customers who lease a high number of dedicated access lines, we provide discounts of up to 20% of the tariffs set forth in the table above.

We charge a monthly usage fee for our Ruyi Mailbox services, which is currently RMB6 per month. We do not charge for SMS notifications of e-mail receipt. Other e-mail functions performed through SMS are charged based on the SMS tariff rates for our uni-Info services.





The network code for our nationwide dial-up Internet services is 165 . We distribute dial-up Internet access services through a variety of methods. A customer can pre-register for our dial-up services or purchase dial-up passwords with a pre-paid amount of on-line charges that can be used nationwide to access the Internet. We also have arrangements with some commercial banks that allow the banks' customers to access our dial-up services using their bank account numbers, with on-line charges being automatically debited from their bank accounts.

*Leased Line Services*

We began to lease transmission lines to large business customers and other telecommunications operators in April 2000. Our leased line services provide customers with dedicated digital links directly connecting customer sites. As of December 31, 2004, we had a total leased bandwidth of an equivalent of 51,598 x 2 Mbps circuits, representing a 95.1% increase from 26,449 x 2 Mbps circuits at the end of 2003.

Leased line tariffs are primarily based on the bandwidths of the lines leased and the distance of transmission. The following table sets forth State tariff rates for monthly fees of selected types and bandwidths of leased lines and selected distance categories:

	State Tariff Rates (RMB per month)		
	Local (intra-district)	Local (inter-district)	Long distance
Digital Line (2 Mbps)	2,000	4,000	6,000
Digital Line (34 Mbps)	16,000	31,000	47,000
Digital Line (155 Mbps)	44,000	88,000	132,000

Source: MII.

Similar to public switched long distance telephony services, operators other than incumbent operators, including us, can adopt tariffs that are different from the above State tariff rates upon approval by the MII as long as they do not offer services at tariff rates below cost. We generally offer leased line services at a 10% discount to the State tariff rates and market these services to institutional customers through our own dedicated teams and our sales agents.

***Sale and Lease of Other Network Elements***

We have substantially completed the construction of our nationwide transmission network. See – Networks – Transmission Network below. We have started to offer some network elements such as optic fibers or fiber channels for lease to other telecommunications operators or corporate customers.

**Interconnection and Roaming Arrangements**



*Interconnection*



Interconnection refers to various arrangements that permit the connection of our telecommunications networks to other networks. Our cellular and long distance networks interconnect with Unicom Group's cellular networks. Under current arrangements, settlement between Unicom Group and us is based on an internal settlement standard that takes into account either the internal costs of the relevant networks or the government standard applicable between third-party operators, whichever is the more favorable to us.

Unicom Group's cellular networks, our cellular networks and our long distance networks interconnect with the fixed telephone networks of China Telecom, China Netcom and China Railcom. Unicom Group's cellular networks and our cellular networks also interconnect with China Mobile's cellular networks. Our Internet network interconnects with the Internet networks of China Telecom and China Netcom. Although we continue to encounter some difficulties in the execution of our interconnection arrangements with other operators in some service areas, the situation improved in 2004 due to improved regulatory supervision by the Chinese government in this area.

In October 2003, the MII issued regulations relating to settlement between telecommunications networks. These new regulations contain provisions regarding revenue sharing methods and settlement mechanisms for interconnection arrangements between us and other operators. These interconnection arrangements under the new regulations are described in – Regulatory and Related Matters – Interconnection Arrangements below.

Unicom Group entered into interconnection arrangements with China Telecom, China Netcom and China Mobile with the following agreements, which equally apply to us.

Framework interconnection and settlement agreement between Unicom Group and the former China Telecom, dated September 30, 2001, the rights and obligations of which were divided and continued after the former China Telecom was split into China Telecom and China Netcom pursuant to an agreement among Unicom Group, China Telecom and China Netcom, dated April 23, 2003. These interconnection and settlement arrangements with China Telecom and China Netcom were superseded by the interconnection and settlement agreement between Unicom Group and China Telecom, dated March 29, 2004 and the interconnection and settlement agreement between Unicom Group and China Netcom, dated April 2, 2004. The 2004 agreements contained more detailed provisions relating to interconnection quality, pursuant to new MII directives in this area.

Agreement between Unicom Group, China Telecom and China Netcom, relating to the continuation and division of rights and obligations of the parties under Unicom Group's prior interconnection agreement with the former China Telecom, dated April 23, 2003.

Interconnection and settlement agreements between Unicom Group and China Mobile relating to the interconnection between Unicom Group's GSM and CDMA cellular networks and China Mobile's GSM cellular networks, both dated November 14, 2001, which were amended by the parties on December 31, 2003.

Interconnection and settlement agreement between Unicom Group and China Mobile regarding the interconnection of point-to-point short messaging services, dated April 1, 2002.

Interconnection and settlement agreement between Unicom Group and China Mobile regarding the interconnection between China Mobile's GSM cellular networks and Unicom's telecommunications networks, including its local fixed line telephony networks, domestic long distance telephony networks, international telephony



networks and IP telephony network, and the interconnection between China Mobile's international gateways and IP telephony network and Unicom Group's cellular networks and local fixed line telephony networks, dated December 31, 2003.

Agreement between Unicom Group and China Mobile regarding the mutual provision of open service platforms, dated November 5, 2003.

Unicom Group has also entered into the following interconnection arrangements, which equally apply to us.

Interconnection and settlement agreements between Unicom Group and China Railcom relating to the interconnection of Unicom Group's cellular networks and local fixed line telephony networks and China Railcom's local fixed line telephony networks, domestic long distance networks and IP telephony networks, dated January 25, 2002 and April 9, 2002.

Supplemental agreements between Unicom Group and China Railcom, which allows each party to offer its domestic and international long distance telephony services and IP telephony services to the cellular or fixed line telephony service subscribers of the other party, dated April 23, 2003.

Interconnection and settlement agreement between Unicom Group and China Satellite Communications Corp, or China Satcom, relating to the interconnection between Unicom Group's networks and China Satcom's Global Star satellite mobile communications network, dated September 27, 2003.

Framework interconnection and settlement agreement between Unicom Group and China Satcom relating to the interconnection between Unicom Group's cellular networks and China Satcom's IP telephony networks, dated September 24, 2003.

Interconnection agreement among major Internet operators, including Unicom Group, and three national Internet switching centers relating to the interconnection of Internet backbone networks, dated December 20, 2001.

Interconnection and settlement agreement between Unicom Group and China Telecom relating to the provision of point-to-point SMS services between Unicom Group's and China Telecom's networks, dated October 10, 2004.

Interconnection and settlement agreement between Unicom Group and China Netcom relating to the provision of point-to-point SMS services between Unicom Group's and China Netcom's networks, dated October 11, 2004.

See B. Related Party Transactions - Provision of Ongoing Telecommunications and Ancillary Services and Premises - CDMA Interconnection and Roaming Arrangements under Item 7 below for the interconnection and settlement arrangements between Unicom Group and us.

*Roaming*

We have entered into roaming arrangements with Unicom Group. In addition, as of December 31, 2004, our cellular subscribers can roam on cellular networks in Europe, North America and other Asian countries and regions through Unicom Group's international roaming agreements with 211 GSM operators in 101 countries and regions and 15 CDMA operators in 12 countries and regions. Unicom Group has agreed to arrange for us to participate in its future international roaming arrangements.

A cellular subscriber using roaming services is charged at our roaming usage rate for both incoming and outgoing calls, plus applicable long distance tariffs. Under our roaming agreement with Unicom Group, our subscribers who roam on Unicom Group's networks are charged for each call made or received. We collect this tariff, retain RMB0.20 and pay the remaining amount to Unicom Group. On the other hand, when Unicom Group's subscribers roam on our networks, Unicom Group collects the roaming tariff, retains only RMB0.04 and pays us the remaining amount.

The following table is a summary of roaming settlement between Unicom Group and us:

	Roaming Tariff	Paid to Unicom Group	Retained by Us
For our subscribers roaming on Unicom Group's networks			
GSM pre-paid users (RMB/minute)	0.60	0.40	0.20
GSM post-paid users (RMB/minute)	0.60	0.40	0.20
CDMA users (RMB/minute)	0.60	0.40	0.20

	Roaming Tariff	Paid to Us	Retained by Unicom Group
For Unicom Group's subscribers roaming on our networks			
GSM pre-paid users (RMB/minute)	0.60	0.56	0.04
GSM post-paid users (RMB/minute)	0.60	0.56	0.04
CDMA users (RMB/minute)	0.60	0.56	0.04

With respect to international roaming, we settle roaming revenue with international operators through Unicom Group in accordance with roaming agreements between Unicom Group and each of the international operators.

See B. Related Party Transactions Provision of Ongoing Telecommunications and Ancillary Services and Premises Roaming Arrangements under Item 7 below for further information regarding the roaming arrangements between Unicom Group and us.

**Networks**



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We operate an advanced network system to support our integrated operations. The backbone of the system is a nationwide fiber optic transmission network, which serves as the common platform for our cellular, long distance, data and Internet networks. In addition, we continue to develop management and network support systems to enhance the quality and reliability of our networks and improve our customer service and operating efficiency. We generally utilize a centralized network planning and equipment selection process, which ensures uniform nationwide design and network compatibility.

### *Transmission Network*





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We own and operate an advanced nationwide fiber optic transmission network (except for the Tibet autonomous region, in which we lease capacity from other operators). As of December 31, 2004, our fiber optic transmission network reached 326 cities with a total cable length of approximately 712,000 km, of which fiber optic backbone transmission network accounted for approximately 122,000 km.

Our fiber optic transmission network is designed for broadband capacity with superior security and reliability, which supports our integrated telecommunications services and allows us to lease capacity to other telecommunications operators and corporate customers. The network deploys:

synchronous digital hierarchy, or SDH, architecture with protective two- or four-fiber rings, a self-healing system that allows for instantaneous rerouting, automatically protects service circuits and minimizes down time in the event of a fiber cut or equipment malfunction;

dense wave division multiplexing, or DWDM, technology, a means of increasing transmission capacity by transmitting signals over multiple wavelengths through a single fiber; and

digital cross connection, or DXC, system, a specialized high-speed data channel exchange and connection system that effectively manages the routing and channeling of our services.

Our SDH fiber rings have transmission bandwidths of 2.5 Gb/s in most routes and 10 Gb/s for the fiber ring that covers the eastern and southern coastal areas of China. We deploy mainly transmission equipment and technology supplied by Siemens, Nortel, Lucent, Alcatel, Huawei, ZTE and other vendors.

Concurrent with the construction and expansion of our domestic backbone transmission network, we also seek to expand our international bandwidth. Through our participation in the Asia Pacific Cable Network No. 2 Project (APCN 2), a trans-pacific submarine cable project that connects major countries and regions in eastern Asia and southeastern Asia and links them to North America through Japan, and our membership in the US-Japan Sub-marine Cable Organization, we are linked with 11 operators in Japan, U.S., South Korea, Singapore and Taiwan with 155x30 Mbps capacity. We also lease 3669 Mbps of international broadband transmission capacity. We have also opened transmission lines on land with the main operators in Hong Kong and Macau, with 15 Gbps and 622 Mbps of transmission capacity. As of the end of 2004, we have 20 Gbps of international broadband transmission capacity. In addition, we have established fiber-optic interconnections among China, Mongolia and Russia, between China and North Korea and between China and Russia, with transmission capacity of 622Mbps, 622Mbps and 2.5Gbps, respectively.

As of March 31, 2005, our metropolitan area networks cover 341 cities throughout China, with a total length of approximately 681,000 km. These networks provide a unified, high-speed local transmission platform for our cellular, data and Internet services.

#### ***Cellular Networks***



A cellular network consists of:

cell sites, which are physical locations, each equipped with a base station that houses transmitters, receivers and other equipment used to communicate through radio channels with subscribers' cellular handsets within the range of a cell;

base station controllers, which connect to, and control, the base stations;

mobile switching centers, which control the base station controllers and the routing of telephone calls; and

transmission lines, which link the mobile switching centers, base station controllers, base stations and the public switched telephone network.

We own most of the GSM cellular transmission network at the local and provincial level. We lease a portion of our inter-provincial transmission capacity for our cellular networks as well as the CDMA cellular transmission network. We also use our own backbone fiber optic transmission network to provide transmission capacity for our cellular networks. We continue to focus on the management and operation of our cellular networks.

*GSM Cellular Networks.* The following table sets forth selected information regarding our GSM cellular networks in our service areas as of the dates indicated.

	As of December 31,		
	2002	2003	2004
Network subscriber capacity (in thousands of subscribers)	60,920	68,050	84,552
Base stations	48,111	56,653	81,819
Base station controllers	1,197	1,345	1,653
Mobile switching centers	405	426	493

Currently our GSM cellular network mainly operates at 900 MHz. We have deployed GSM technology that operates at 1800 MHz in some major metropolitan areas to supplement the capacity of our existing cellular network. We have the right to use 6 x 2 MHz of spectrum in the 900 MHz frequency band and 10 x 2 MHz in the 1800 MHz frequency band for our GSM network.

Our cellular networks are supported by an advanced SS7 signaling system, which fosters efficient use of network capacity, reduces call set up time and enhances transmission capabilities. We have also installed intelligent networks that enable us to provide pre-paid services and a wide range of call features and value-added services.

*CDMA Cellular Network.* Unicom Group completed the construction of the first phase of its nationwide CDMA network at the end of 2001. The first phase of the CDMA network has a total capacity of 15.62 million subscribers in our service areas. In 2003, Unicom Group completed the second phase of the CDMA network construction, which added an additional capacity of 20.69 million subscribers nationwide and included the upgrade of the network to CDMA 1X technology. The CDMA networks constructed in the second phase did not share as much infrastructure with the GSM network. Wireless data services that utilize CDMA 1X technology were introduced in major cities in our cellular service areas in March 2003. In 2004, Unicom Group substantially completed the third phase of the CDMA network construction, adding an additional capacity of approximately 36.23 million subscribers nationwide and significantly improving the coverage and quality of the CDMA network. We lease CDMA network capacity in our cellular service areas and have the exclusive right to operate its network in those areas. We have the right to use 10x2 MHz of spectrum in the 800 MHz frequency band for our CDMA services.

#### *Long Distance, Data and Internet Networks*



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By the end of 2004, our public switched long distance network reached 332 cities, while the coverage of our Internet networks, including our IP telephony networks, included approximately 330 cities throughout China.

*Long Distance Network.* Our long distance network is supported by a nationwide billing system and an intelligent network, which allows us to provide multiple services. Our cellular subscribers can access these services directly through our cellular networks, but our other customers typically access our long distance telephony, IP telephony and Internet services through the public switched telephone networks of China Telecom and China Netcom. As of December 31, 2004, the total network capacity for our IP telephony services reached 22,422E1, or a voice capacity of 20 billion minutes per year. E1 is the European format for digital transmission and carries signals at 2Mbps.

*Data and Internet Networks.* Our broadband data and Internet networks utilize a unified IP and ATM design, which is particularly suited for real-time, multimedia applications such as video and voice. ATM switches perform high-speed switching of voice and data traffic and minimize time delay and congestion. They can also prioritize applications that least tolerate time delay, such as telephony and video, over less time-sensitive applications such as e-mails and file transfer. As of December 31, 2004, the international and domestic interconnection bandwidths have reached 3.34Gbps and 14.88Gbps, respectively.

*Internet Network.* Our Internet network, branded as Uninet, is also centrally designed and has a nationwide uniform architecture. It is supported by a nationwide, advanced billing system that facilitates roaming access and delivery of virtual ISP services and other value added services.

*Broadband Video Network.* Our broadband video network utilizes the H.323 technological standard and two-tier network structure. H.323 is a widely used multi-media conferencing protocol approved by the International Telecommunications Union. As of December 31, 2004, it can provide video conference and video telephone services and currently reaches 330 cities nationwide as well as the United States and Hong Kong.

*Integrated Access Networks.* We believe that the key to the success of our data services is our ability to offer integrated access to customers' premises. We are building integrated access networks in many cities throughout China. We focus the construction of our access networks on linking major office buildings to our metropolitan area transmission networks. We rely mainly on fiber optic cables to link office buildings to our networks and have offered narrow-band wireless access at the 3.5 GHz frequency band in approximately 23 provincial capitals and 14 provinces.

*Integrated Management and Network Support Systems*





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We have developed various management and network support systems to support our various networks. Our customer service, billing and settlement systems are integrated into a single system. In addition, we are in the process of developing an integrated information and management system (UNI-IT), which includes management support systems (MSS), business support system (BSS) and enterprise resource planning systems (ERP).

### **Marketing, Sales and Distribution**



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We centrally plan our nationwide marketing and sales strategies, but the implementation of these strategies is carried out at the provincial level by operating branches tailored to their specific markets. In 2004, we focused on the concept of "effective growth" by pursuing earning-driven and cost-effective marketing and sales strategies.

*Marketing*



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We focus on developing a strong brand image for our company that conveys our strengths in high quality and comprehensive services, nationwide coverage, integrated offerings, advanced technology and customer focus. We market all of our services under the China Unicom brand name. We emphasized brand management in 2004, by developing a customer-oriented branding system based on our product profile so as to standardize our operations and ensure consistency in our promotional activities.

Our marketing strategy utilizes our image as an integrated telecommunications service provider and leverages on our integrated services and nationwide sales and distribution network. By using direct sales forces and sale agents and active market analysis and through service centers, large department stores and chain stores, our marketing strategy can be targeted at different customer segments and tailored according to the demands of different markets, enabling us to timely adjust our services. In addition, we also seek to enter into strategic alliances in order to further expand the breath and depth of our marketing and sales efforts. In September 2004, we entered into a wireless Internet joint marketing agreement with Intel, HP, IBM, Lenovo and Digital China to develop the industry value chain for our U-Net services based on the CDMA 1X network.

We seek to formulate effective marketing strategies through customer relations management and analysis of customer segmentation, customer demand and consumption trends.

*Cellular services:* We promote our CDMA services as cellular services with such advantages as better voice quality, better security, lower handset radio transmitting power and, in the case of CDMA 1X services, high data transmission rates and comprehensive value added wireless data services. In 2004, we focused on developing the CDMA industry value chain. Under the principle of open, cooperate and win-win, we strengthened support for and streamlined our relationship with service and content providers. We have also adopted the policy to centralize our purchasing of the Cool Phone handsets and certain other models of CDMA handsets in an attempt to lower the entry barrier of our CDMA services caused by high handset price and make the CDMA services more attractive and affordable to the mass market. In addition, our CDMA-1X services continued to develop. By offering trial packages of the CDMA-1X services and requiring users of our promotional packages to have a minimum monthly spending on value-added services, we promoted usage of the CDMA-1X wireless data service.

We also continued to expand the subscriber base for our GSM services, which is mainly based on voice and SMS services. Our marketing strategies for GSM services focused on the continued development of the voice and SMS services as well as promoting the Cool Ring Tong service and the Music Street service.

Recognizing the importance and the needs of our institutional customers and utilizing our advantages of being an integrated telecommunications operator, we formulated marketing strategies for our cellular services that were specific to our institutional customers. In 2004, we emphasized the development of advanced and customized industrial applications for our institutional customers. By offering industrial solutions, our business extended from the provision of basic telecommunications services to comprehensive information services. For example, we launched several industry-specific applications based on the CDMA-1X network, including Unicom Horizon Police Application, Unicom Horizon Maritime Application and Stock-in-Palm.

In 2004, we consolidated our brands of wireless data value-added services under one uniform brand, uni, and aimed to build it into a new media portal brand for content consumption, with emphases on entertainment, life and commerce. Meanwhile, the U-Net brand was positioned to be a high-end brand for wireless Internet access for laptop users.





In addition we have started promoting the following customer-oriented cellular services brands in 2004: (i) Ruyi Tong , which is designed for the mass market and features voice services on either the GSM or the CDMA network, the uni-Info value-added services and SMS services, (ii) New Horizon , which targets mid- to high-end users as well as institutional and business customers, offering CDMA-based voice services, the uni value-added services and industry-specific applications, (iii) Worldwind , which features dual-mode voice services and the uni services, and (iv) UP New Power , which is designed for the youth market, with either GSM- or CDMA-based voice services, SMS services as well as the uni-Wap value-added services. We believe that development of these customer oriented service brands will help us adapt to the changing market condition and improve customer loyalty.

*Long distance, data and Internet services:* In 2004, we focused on institutional customers, including financial institutions, large corporations, multi-national corporations, government entities and Internet service providers and Internet content providers, in order to provide them one-stop solutions. For example, we provided integrated long-distance, Internet and data services under the Uni-One brand to institutional customers. Our marketing efforts with respect to retail customers included the marketing of co-branded long distance telephony cards. Under these arrangements, our institutional partners purchased such cards from us and distributed the cards to their employees or customers, thereby facilitating the sale of our long distance telephony services. We have also focused on the marketing of our long distance, Internet and data services to our existing cellular customers, as well as coordinating the marketing of these services with the marketing efforts of our cellular services.

*Service Bundling and Cross-Marketing:* A key element of our sales and distribution strategy is to promote our strengths as a provider of a broad range of integrated services. This strategy is implemented by our service centers, independent sales agents and direct sales forces, which distribute and support our various product offerings. For example, we cross-sell our long distance services to our cellular subscribers. In addition, based on the specific demands of our industry and institution clients, we provide customized communications solutions by bundling VPN, IP telephony, Uni-Video broadband video-telephony and Uninet services.

#### ***Sales and Distribution***



*Customer Segmentation:* We have two main categories of customers – institutional customers, comprised of mainly corporate and government customers, and individual customers. We have set up dedicated direct sales and service departments for institutional customers, both at our headquarters and at our provincial and local branches. We focus on promoting our integrated solutions to these institutional customers. For individual customers, we conduct our sales through our own service centers and the retail outlets of independent sales agents.

*Distribution Network:* We have a diversified distribution network comprising self-owned sales outlets, agent/distributor sales outlets and direct sales forces. We distribute our services to our individual customers through our self-owned sales outlets as well as other retail outlets. We distribute our services to large customers through our direct sales forces and agents. We have developed a nationwide distribution network of service centers and retail outlets, of which only a small portion are owned by us and the others are owned by independent agents or distributors. As of December 31, 2004, we had a total of approximately 80,300 sales outlets, of which over 5,600 were self-owned. These service centers and retail outlets distribute our cellular, long distance, data and Internet services and provide post-sales services such as customer inquiry, customer complaint and collections. We generally maintain a flat distribution structure, but utilize a multi-level distribution system in some service areas, in which our top-level distributors further distribute to lower level distributors and sales agents. In 2004, we have reduced the levels of such distribution system to control distribution costs. We have also established direct sales and customer service teams at various levels to conduct one-on-one sales to high-usage institutional customers. These direct sales and customer service teams focus is to utilize our cellular, domestic and international long distance, data and Internet services as integrated telecommunications services in order to provide differentiated and comprehensive solutions for our customers. In 2004, we also expanded the use of new distribution channels such as Internet and telephone marketing.

*Strategic Cooperation with China Post:* Our controlling shareholder, Unicom Group, entered into a strategic cooperation arrangement with China Post in 2001. This arrangement allows us to supplement our existing distribution network with China Post's extensive nationwide network. China Post also provides billing, collection and other services to our customers. The arrangement uses a revenue-based commission structure for most services. We and China Post have also agreed to use each other's services and offer each other preferential treatment. We have entered into provincial-level cooperation agreements with China Post in our service areas.

#### **Customer Service**

We provide specialized, differentiated and one-stop services to our customers, based on the customer service resources of Unicom Group. Our customer care and service centers in each service area can be accessed by our customers by dialing a nationwide hotline number 10010. Our customer service system is a unified platform providing customer services for all of our businesses. This system is based on the paging centers, and also relies on other systems, including operations, billing, account management and network management. This integrated system allows us to provide personalized and diversified services through customer service representatives or automated systems, including service inquiry, billing inquiry, response to customer complaints and suggestions, service initiation and termination, payment reminder services and emergency services, to different types of customers on a 24-hour basis. Our customers can access our customer services through various means, including telephone calls, faxes, e-mails and SMSs. To better serve our customers, we provide such value-added services as 10011 bill inquiry hotline, 10018 club member service hotline, 13010199999 international roaming service hotline, bill payment through commercial banks, free copies of detailed statements, Internet account inquiry, a single rechargeable card for all of our services and mobile service centers in remote areas of China. To better meet market demand, we continue to seek innovation in our customer services, in order to provide more pro-active, comprehensive and targeted customer services.

In addition, we also analyze our customer segments in detail, and tailor our services to the requirements of different customer segments. While we are focused on retention of our retail customers, we pay regular visits and provide one-on-one personalized services to our institutional customers and VIP customers and, through customer clubs, provide high-quality and differentiated services for high-net-worth individual customers and important institutional customers. For mass-market customers, we offer standardized services that aim at enhancing customer experience. In 2004, we launched the Satisfaction at Unicom campaign, which aimed at further improving customer satisfaction and promoting our corporate image.

We emphasize customer service and customer relations management and have taken various measures to improve customer satisfaction. Such measures include establishing and improving the customer service network, standardizing the content, manner and criteria of service and improving training of customer service representatives. We established our customer service workflow using a consistent set of standards in order to timely resolve problems for our customers. We have also strengthened our analysis and research of customer consumption behavior, consumption cycle and satisfaction levels in order to understand their consumption pattern and influence their consumption trend.

**Billing and Collection**





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We are able to leverage our strengths as an integrated service provider to offer integrated billing and collection services. For example, we provide our business customers a single bill covering multiple services for ease of payment. We also integrate the billing systems for different services and distribute unified recharge cards that can be used to recharge various pre-paid services, including pre-paid cellular services, long distance telephony services and Internet dial-up services. Our billing system can distinguish between customers based on the marketing method and service package plans applicable to each customer. These additional functions would allow us to analyze customer data in more detail, thereby improving our ability to analyze the age of our accounts and control bad debts. The following table sets forth our billing and collection methods for each of our business segments:

Business Segment	Billing	Collection
Post-paid GSM and CDMA services	Centralized at the provincial level and generally by monthly billing.	Subscribers may pre-deposit their service charges with us or commercial banks or China Post that collect payment for us, make payment in person at our service centers or branches of China Post, or through commercial banks.
Pre-paid GSM and CDMA services	Centralized on our nationwide intelligent network	Subscribers can purchase and/or re-charge pre-paid cards through various channels. They can also re-charge cards by telephone.
PSTN long distance telephony services	Through nationwide long distance telephony settlement center and regional billing centers located in Beijing, Shanghai and Guangzhou, which coordinates billing with local settlement centers	Subscribers mainly go to our service centers, commercial banks and branches of China Post for payment.
IP telephony services	Through our nationwide data settlement center and various provincial-level settlement systems	Subscribers mainly go to our service centers, commercial banks and branches of China Post for payment.
Uni-Video services	For each corporate customer, billing is either through the local service centers in the locations of the branches of the customer or centralized at one local service center chosen by the corporate customer. Retail customers purchase pre-paid re-chargeable cards for our services.	Our corporate customers can pay either at the local service centers in the locations of the branches of such customer or at one local service center designated by the customer.
Internet services	Centralized at the provincial level. Billing methods include monthly billing, volume-based billing and billing according to contractual provisions.	Subscribers may go to our service centers, commercial banks, and branches of China Post or use the Internet for payment.
Unicom's Internet Plaza	Customers of the Internet cafes either pay by membership or pay hourly rates.	N/A
Leased lines	Monthly billing in accordance with contractual provisions	Customers mainly pay at our service centers or at commercial banks.

*Bad Debt Controls*



*Cellular Services.* Post-paid subscribers must register with us before they can begin using our cellular services. Customer registration allows us to better manage customer credit. If subscribers do not pay their bills on time, we charge a late fee and will either call or send SMSs to the delinquent subscribers to remind them to pay. We generally suspend a post-paid subscriber's account if the account is more than 30 days overdue and terminate the account if it is overdue for more than three months after that. When an account is terminated, we will seek other remedies to collect the overdue payment, including personal visits to the subscriber to collect payments or taking legal actions. At the same time, we encourage our subscribers to pre-deposit service charges with us, to be deducted against charges incurred in the future, or use our pre-paid services. In 2004, we began developing a customer's credit management system at the provincial branch level to enhance verification of the personal information of new subscribers and tighten credit control for new subscribers. We believe these measures will improve our bad debt control.

*Domestic and International Long Distance Services.* We actively encourage customers to use our pre-paid services. In addition, we perform credit checks on potential customers. For high-volume users, we open telephone banking accounts at commercial banks, set credit limits on such accounts and settle with such customers on a monthly basis.

*Internet services.* We send e-mails to delinquent customers and use other methods to collect payment from delinquent customers. Accounts for individual customers which are delinquent for 20 days are suspended, and such accounts will be terminated if they are delinquent for more than 40 days. For corporate customers, our actions are based on the credit history of each delinquent customer.

#### **Research and Development**



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We focus on technology innovation in coordination with the various business departments, in order to provide technical support to the development of our various businesses. In July 2004, our first technology invention patent, the CDMA R-UIM technology for the CDMA cellular communication network, was granted approval by the State Intellectual Properties Bureau of the PRC. Major projects of our research and development efforts in 2004 include:

the tracking and research of the latest technology trends in light of the gradual transition to 3G cellular communications technology and next-generation networks and our position as a provider of integrated services, including participation in the Chinese Next Generation Internet (CNGI) network construction project (led by the National Development and Reform Commission) and the 3G cellular technology testing project (led by the MII);

the investigation into coordinated development of the GSM and CDMA networks and the transition to next-generation networks, including the development and testing of GSM and CDMA dual-mode handset, the testing of GSM and CDMA commercial networks, the testing of the enhanced CDMA1X network technology and other research and development of new technologies; and

the development of new businesses, including CDMA 1X network mobile IP business, support for selected institutional users of our dedicated ATM line services and new applications for institutional customers.

**Competition**





*The Chinese telecommunications market has six basic telecommunications service providers – China Telecom, Unicom Group, China Mobile, China Netcom, China Satcom and China Railcom – and thousands of value-added service providers. As a relatively new entrant into this competitive landscape, we believe we owe our recent development to the following:*



**Integrated service offerings and a uniform and advanced telecommunications network** We offer integrated cellular, domestic and international long distance, data and Internet services, and have a nationwide, uniform communications network that support voice, data and Internet communications and allow us to provide integrated services to our customers and utilize our network resources in a cost-effective manner.

**Advanced technologies** CDMA technology offers high bandwidth utilization, better voice quality, high data transmission capabilities, better security, lower handset radio transmitting power, and can cost-effectively and timely transition to 3G cellular telecommunications. We are the only provider for CDMA services in 30 provinces, municipalities and autonomous regions in China, and our CDMA network has been upgraded to CDMA 1X technology, which has higher data transmission capabilities. Our GSM services utilize 2G technology that is widely accepted internationally and we believe our GSM network coverage and voice quality meet international standards. Our uniform network platform (Unione) utilizes ATM+IP technology solutions to offer quality support to our voice, data, Internet, video conference, video telephony and mobile data services.

**Unique service offerings** Through our advanced integrated network platform and the implementation of our innovative marketing strategies, we introduced Worldwind CDMA and GSM dual-mode cellular services and a series of value-added services such as CDMA 1X data services, Uni-Video services and Ruyi Mailbox services, in order to satisfy the differentiated demand of our various customer segments.

**Professional and quality customer service** Using the customer service resources of Unicom Group, we have built up a strong brand image in customer service that can be characterized as professional, differentiated and one-stop service.

However, the development of our business is also affected by certain competitive disadvantages, including:

**Market position** As a relatively new entrant to the market, we are still behind the traditional operators in such areas as market share and branding. Due to our late entry, we still need to strengthen our market position through expenditures to capture mid- to high-end customers. In addition, we are reliant on the dominant operators in terms of interconnection and settlement.

**Financial resources** Comparing to the dominant operators, our capital scale is relatively small, our debt ratio is relatively high, and our share of the market operating revenue and profit is relatively low.

Network coverage and network number resources While we have made significant improvements in network construction in recent years, network coverage in certain areas still need improvement. In addition, we do not have sufficient network number resources, which has affected the development of our PSTN long distance telephony, IP telephony, data and Internet services.

*Cellular Competition*



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Our main competitor in the cellular communications business is China Mobile. China Mobile continues to have competitive advantages over us in brand name, market share, financial resources and network management experience. To compete against China Mobile, we continue to improve our network coverage and voice quality, enhance network quality, develop value-added services (such as our CDMA 1X wireless data services), improve customer service and customize our package service plans to meet our various subscribers' specific needs. We also seek to leverage our position as a fully integrated telecommunications operator to provide one-stop telecommunications solutions for our subscribers. In addition, we seek to compete against China Mobile's GPRS wireless data services by the development of our CDMA 1X wireless data services, which offers such advantages as better voice quality, better security, high data transmission rates and comprehensive value-added wireless data services.

Our cellular services also compete with the wireless local communications services of China Telecom and China Netcom, known as Little Smart, which are based on their fixed line networks and primarily utilize PHS technology. These services were previously offered primarily in small- to medium-sized cities, but have been introduced in most cities nationwide. The Little Smart services reportedly have attracted a substantial subscriber base in China and compete with us mostly in the lower end of the cellular market. Although many cellular users use Little Smart services as a supplement, rather than an alternative, to their existing cellular services, the availability of Little Smart services has reduced the overall usage volume of our cellular services. The main advantage of Little Smart services is their lower tariff rates. However, they generally have limited network coverage and roaming capability.

Since the launch of our CDMA cellular services in 2002, we have pursued a strategy of coordinated development of our GSM and CDMA cellular businesses. While our GSM cellular business focuses on the mass market, with customers who are more price-sensitive and require basic voice and message services, our CDMA services primarily focuses on customers who require voice and data services and place a premium on high-technology, high-speed and high-security services. Accordingly, usage fees and package service plans for our CDMA cellular services are generally higher than those for our GSM cellular services. In 2004, most of our CDMA new subscribers were users migrating from the GSM services of our competitor, first-time cellular users, and users who previously subscribed to our CDMA services.

### *Long Distance Telephony Competition*



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The Chinese government restructured the fixed line incumbent China Telecom in 2002. Pursuant to the restructuring, the telecommunications assets of the former China Telecom in 10 northern provinces in China were split off in May 2002 and merged with CNCL and Jitong to form China Netcom. China Telecom retained the telecommunications assets in the remaining 21 provinces and the brand name of China Telecom. Currently, both China Netcom and China Telecom provide fixed line telecommunications services. In addition, China Railcom is also licensed to provide public switched long distance services in China and launched its long distance services in China in 2001.



China Telecom and China Netcom are the dominant providers and our primary competitors in the public switched long distance business in their respective service areas. They have advantages over us in their respective service areas in brand name, market share, financial resources, service area coverage, extensive access networks and experience in fixed line telecommunications business. However, the separation of China Telecom into two companies along geographic lines weakened the competitiveness of the resulting entities on a nationwide basis.

We started to provide public switched long distance telephony services in 2000 and reached a market share of 12.7% in terms of total outgoing long distance call minutes in 2004. Since our network has been constructed recently and is equipped with the latest technology and advanced features, it enables us to offer a variety of high-quality services. Our long distance telephony services are also supported by a centralized billing system. Our services are hindered by our lack of fixed line telephone number resources.

Our IP telephony services currently face intense competition from China Telecom, China Netcom, China Mobile, China Railcom and China Satcom. Currently, China Telecom and China Netcom are the market leaders in their respective service areas. Since the MII deregulated the tariffs of this market in 2001, competition in this market has been intensifying.

***Data and Internet Competition***



China Telecom, China Netcom and China Railcom are our major competitors in the data services business in their respective service areas. Other competitors include China Satcom. While China Telecom, China Netcom, China Railcom, China Mobile, China Satcom and we are the only Internet backbone operators in China, there are many retail Internet service providers throughout China. China Telecom and China Netcom have leading positions in the Internet access market and are the largest wholesale Internet service providers in their respective service areas. Our data and Internet networks have nationwide access, which offers convenience and flexibility to our institutional customers, whereas the respective networks of China Telecom and China Netcom only extend to their respective service areas. We have obtained approval to operate and franchise a nationwide chain of Internet cafes and, to date, have opened a number of upscale Internet cafes in several cities.

The advanced features and design of our backbone network allow us to provide nationwide high quality virtual private network services, which are specifically tailored to the high-usage corporate customers and retail Internet service providers that we target. We are also building advanced metropolitan area networks and integrated access networks that allow us to connect to key commercial buildings throughout China. We also continue to cooperate with medium- to small-sized Internet service providers and other companies that have broadband access to concentrated residential areas to expand our broadband services.

#### **Trademarks**



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We conduct our businesses under the Unicom name and logo. Unicom Group is the registered proprietor in China of the Unicom trademark in English and the trademark bearing the Unicom logo. Unicom Group has also applied and became the registered proprietor of the trademark of the word Unicom in Chinese. Unicom Group has granted us the right to use these trademarks on a royalty-free basis, and to license to us any trademark that it registers in China in the future which incorporates the word Unicom.

**Regulatory and Related Matters**



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The telecommunications industry in China is subject to a high degree of government regulation. The primary regulatory authority of the Chinese telecommunications industry is the MII. The State Council, the National Development and Reform Commission (the former State Development Planning Commission), the Ministry of Commerce (formerly, the Ministry of Foreign Trade and Economic Cooperation) and other governmental authorities also maintain regulatory responsibilities over certain aspects of the Chinese telecommunications industry.

The MII, under the supervision of the State Council, is responsible for, among other things:

formulating and enforcing industry policies and regulations, as well as technical standards,

granting telecommunications service licenses,

supervising the operations and quality of service of telecommunications service providers,

allocating and administering telecommunications resources such as spectrum and number resources,

together with other relevant regulatory authorities, formulating tariff standards for telecommunications services,

formulating interconnection and settlement arrangements between telecommunications networks, and

maintaining fair and orderly market competition among service providers.

The MII has established a Telecommunications Administration Bureau in each province, which is mainly responsible for enforcement of telecommunications policies and regulations in that province.

The MII is in the process of drafting a telecommunications law that, once adopted by the National People's Congress, will become the basic telecommunications statute and provide the principal legal framework for telecommunications regulations in China. It is currently uncertain when the law will be adopted and become effective.

### *Telecommunications Regulations*





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The State Council promulgated the Telecommunications Regulations, which became effective as of September 25, 2000. The Telecommunications Regulations are substantially consistent with, and are primarily intended to streamline and clarify, the existing rules and policies for the telecommunications industry. They provide the current primary regulatory framework for China's telecommunications industry in the interim period prior to the adoption of the proposed telecommunications law.

The Telecommunications Regulations are intended to develop a transparent and fair regulatory environment to foster orderly competition and encourage development in the telecommunications industry. The Telecommunications Regulations address all key aspects of the telecommunications industry, including entry into the industry, scope of business, tariff setting, interconnection arrangements, quality of services, technology standards and allocation of telecommunications resources.

*Entry into the Industry*

The Telecommunications Regulations adopt the existing regulatory distinction between basic and value added telecommunication services. An addendum to the Telecommunications Regulations sub-categorizes basic and value added telecommunication services. In February 2003, the MII revised the addendum to the Telecommunications Regulations; and the revised addendum took effect in April 2003. Basic telecommunications services include, among others, fixed line local and domestic long distance telephony services, international telecommunications services, IP telephony services, mobile voice and data services, Internet and other public data transmission services, lease or sale of network elements, and paging services. Value added telecommunications services include, among others, e-mail, voice mail, electronic data interchange, Internet access, Internet content and video conferencing services. Providers of any basic telecommunications services as well as providers of value added services in two or more provinces autonomous regions and municipalities in China must apply for licenses from the MII. Licenses for basic telecommunications services will be granted through a tendering process.

After its accession to the WTO in December 2001, China promulgated the Administrative Regulations on Telecommunications Companies with Foreign Investment, effective on January 1, 2002, implementing its commitments to the WTO. Those commitments include the gradual reduction of foreign ownership restrictions in the telecommunications industry and the step-by-step opening of the telecommunications market in China to foreign operators. However, the presence or absence of foreign investments in an applicant for telecommunications licenses will presumably bear no direct relation to the decision on whether to issue licenses, in as much as the issuance of new licenses is governed by a separate set of rules and regulations. The specific market-opening commitments China made to the WTO regarding fixed line services, mobile services and value-added telecommunication services are as follows.

For fixed line services:

- (1) Within three years after accession: foreign service providers will be permitted to establish joint venture enterprises and provide services in and between the cities of Shanghai, Guangzhou and Beijing; foreign ownership in such joint ventures shall be no more than 25%;
- (2) Within five years after accession: the services areas will be expanded to include services in and between an additional 14 cities of Chengdu, Chongqing, Dalian, Fuzhou, Hangzhou, Nanjing, Ningbo, Qingdao, Shenyang, Shenzhou, Xiamen, Xi'an, Taiyuan and Wuhan, or, the additional 14 cities; foreign ownership shall be no more than 35%; and
- (3) Within six years after accession: there will be no geographic restriction and foreign ownership shall be no more than 49%.

For mobile voice and data services:

- (1) Upon accession: foreign service providers will be permitted to establish joint venture enterprises and provide services in and between the cities of Shanghai, Guangzhou and Beijing; foreign ownership in such joint ventures shall be no more than 25%;

(2) Within one year after accession: the services areas will be expanded to include services in and between the additional 14 cities; foreign ownership shall be no more than 35%;

(3) Within three years after accession: foreign ownership shall be no more than 49%; and

(4) Within five years after accession: there will be no geographic restriction and the foreign ownership shall be no more than 49%.

For value-added telecommunication services:

(1) Upon accession: foreign service providers will be permitted to establish joint venture enterprises and provide services in and between the cities of Shanghai, Guangzhou and Beijing; foreign ownership in such joint ventures shall be no more than 30%;

(2) Within one year after accession: the services areas will be expanded to include services in and between the additional 14 cities; foreign ownership shall be no more than 49%; and

(3) Within two years after accession: there will be no geographic restriction, foreign ownership shall be no more than 50%.

The MII promulgated Measures on the Administration of Telecommunication Business Licenses, which took effect on January 1, 2002. Those rules apply to the application for, examination and approval of, telecommunications business licenses in China.

*Spectrum and Network Number Resources*



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The MII allocates all telecommunications-related frequencies, including those used in cellular, paging and microwave operations. The 800 MHz, 900 MHz and 1,800 MHz frequency bands have been reserved for mobile cellular applications and parts of the 150 MHz and 280 MHz frequency bands have been reserved for paging applications. The frequency assigned to a licensee may not be leased or transferred without obtaining the approval of the MII.

Since July 1, 2002, the standard spectrum usage fees for GSM networks and CDMA networks has been charged at the annual rate of RMB15 million per MHz of frequency per year (upward and downward frequencies are charged separately) progressively over a period of three years and a period of five years, respectively. The current allocation of spectrum usage fees between Unicom Group and us based on the number of subscribers remains unchanged.

The MII is also responsible for the administration of network number resources within China, including cellular network numbers and subscriber numbers. In January 2003, it issued the Administrative Rules for Telecommunications Network Numbers, which took effect on March 1, 2003. According to these rules, the telecommunications network number resources are properties of the Chinese government, and the use of number resources by any telecommunications operator is subject to the approval of MII. Users of number resources, including us, are required to pay a usage fee to the Chinese government. The rules also provide for procedures for application for the use, upgrade and adjustment of number resources by telecommunications operators.



In December 2004, the MII, the Ministry of Finance and the National Development and Reform Commission jointly issued the Provisional Administrative Measures with respect to the Collection of the Usage Fee of Telecommunications Network Number Resources, under which telecommunications companies are required to pay a usage fee to the PRC government by the 10th day of the first month of each quarter starting from 2005. Under these provisional measures, mobile telecommunications companies are required to pay an annual usage fee of RMB12 million for each network number. In addition, we are also required to pay usage fees for certain other network numbers totaling approximately RMB6 million a year. We are required to start paying usage fees in 2005.

*Tariff Setting and Price Controls*



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The levels and categories of our current tariffs are subject to regulation by various government authorities, including the MII, the National Development and Reform Commission (the former State Development and Planning Commission), and, at the local level, the relevant provincial Telecommunications Administration Bureaus and price regulatory authorities. Under the Telecommunications Regulations, telecommunications tariffs are categorized into State-fixed tariffs, State-guidance tariffs and market-based tariffs. For example, there are State-guidance tariffs for cellular services, fixed line telephony services and leased lines services that are set jointly by the MII and the National Development and Reform Commission. Tariffs for telecommunications services where adequate competition has already developed may be set by the service providers as market-based tariffs. In 1997, the Chinese government granted us preferential treatment by allowing us to vary our cellular tariffs by up to 10% from the state-guidance rates.

The government is required to hold public hearings before setting or changing important State-tariff rates, which are attended by telecommunication operators, consumers and others. Operators are required to provide complete and adequate cost data and other materials for those hearings.

In December 2000, the MII, the former State Development Planning Commission and the Ministry of Finance jointly issued a tariff adjustment circular, which provides for tariff adjustments for a wide range of telecommunications services. Effective from February 21, 2001, we have adopted these government tariff adjustments.

In June 2003, the Ministry of Finance and the MII jointly issued a circular to revoke certain fees including one-time installation fees charged to the fixed line telephone users and one-time activation fees charged to the cellular subscribers.

In June 2004, the MII and the National Development and Reform Commission jointly issued a notice aimed at further strengthening the regulatory oversight of telecommunications tariffs. The notice requires telecommunications services providers to strengthen their internal control and management of tariff setting activities. Specifically, the notice requires services providers to strictly comply with the relevant government regulation relating to the procedures for the approval and registration of telecommunications tariffs.

*Interconnection Arrangements*

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In 1999, the MII issued provisional regulations on interconnection and settlement arrangements. These regulations contain specific provisions regarding, among other things, revenue sharing methods and settlement mechanisms and interconnection agreements among telecommunications service providers. The Telecommunication Regulations reaffirmed the obligations of dominant telecommunications operators in China to provide interconnection with other operators. The MII adjusted the interconnection revenue sharing and settlement arrangements, effective from March 21, 2001, and further adjusted them on October 28, 2003. We have entered into interconnection and settlement agreements with China Telecom, China Netcom, China Mobile and China Railcom that implement the regulatory requirements.

The following table sets forth our interconnection revenue sharing and settlement arrangements with fixed line operators and China Mobile for local calls after the regulatory adjustment in 2003.

Network from which calls originated	Network at which calls terminated	Settlement Arrangement (under 2003 regulations)
Unicom's cellular network	Fixed line operators' public fixed line network	(1) Unicom collects the local cellular usage charge from its subscribers (2) Unicom pays RMB0.06 per minute to fixed line operators
Fixed line operators' public fixed line network	Unicom's cellular network	No revenue sharing or settlement
Unicom's cellular network	China Mobile's cellular network	(1) Each of Unicom and China Mobile collects the cellular usage charge from its subscribers (2) Unicom pays RMB0.06 per minute to China Mobile
China Mobile's cellular network	Unicom's cellular network	(1) Each of Unicom and China Mobile collects the cellular usage charge from its subscribers (2) China Mobile pays RMB0.06 per minute to Unicom

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The following table sets forth our interconnection revenue sharing and settlement arrangement with fixed line operators and China Mobile for domestic long distance calls after the regulatory adjustment in 2003.

Network from which calls originated	Network at which calls terminated	Settlement Arrangement (under 2003 regulations)
Unicom's cellular network at area A	Fixed line operators' public fixed line network at area B, if through the long distance network of such fixed line operator	(1) Unicom collects the domestic long distance tariff and local call tariff from its subscribers (2) Unicom keeps RMB0.06 per minute and pays the rest of the domestic long distance tariff to fixed line operators
Unicom's cellular network at area A	Fixed line operators' public fixed line network at area B, if through the long distance network of Unicom	(1) Unicom collects the domestic long distance tariff and local call tariff from its subscribers (2) Unicom pays RMB0.06 per minute to fixed line operators, and keeps the rest of the domestic long distance tariff
Fixed line operators' public fixed line network at area A	Unicom's cellular network at area B, if through the long distance network of Unicom	(1) Fixed line operators collect the domestic long distance tariff from their subscribers (2) Fixed line operators keep RMB0.06 per minute and pay the rest to Unicom
Fixed line operators' public fixed line network at area A	Unicom's cellular network at area B, if through the long distance network of such fixed line operator	(1) Fixed line operators collect the domestic long distance tariff from their subscribers. (2) Fixed line operators pay RMB0.06 per minute to Unicom and keep the rest
Fixed line operators' public fixed line network at area A	Fixed line operators' public fixed line network at area B, if through the long distance network of Unicom	(1) Fixed line operators on the originating end collect the domestic long distance tariff from their subscribers (2) Fixed line operators keep RMB0.06 per minute and pay the rest to Unicom (3) Unicom then pays RMB0.06 per minute to fixed line operators on the receiving end
Unicom's cellular network at area A	China Mobile's cellular network at area B, if through the long distance network of China Mobile	(1) Unicom collects the domestic long distance tariff and local call tariff from its subscribers (2) Unicom keeps RMB0.06 per minute and pays the rest of the domestic long distance tariff to China Mobile
China Mobile's cellular network at area A	Unicom's cellular network at area B, if through the long distance network of Unicom	(1) China Mobile collects the domestic long distance tariff and local call tariff from its subscribers (2) China Mobile keeps RMB0.06 per minute and pays the rest of the domestic long distance tariff to Unicom

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The following table sets forth our interconnection revenue sharing and settlement arrangement with fixed line operators for international long distance calls through their international gateways after the regulatory adjustment in 2003.

Type of calls	Settlement Arrangements (under 2003 regulations)
Outgoing calls from Unicom's cellular network, if through the international long distance network of fixed line operators	(1) Unicom collects the international long distance tariff and local call tariff from its subscribers (2) Unicom keeps RMB0.06 or RMB0.54 per minute (depending on whether through Unicom's domestic long distance network) and pays the rest of the international long distance tariff to fixed line operators
Incoming calls to Unicom's cellular network, if through the international long distance network of fixed line operators	(1) Unicom receives RMB0.06 or RMB0.54 per minute from fixed line operators (depending on whether through Unicom's domestic long distance network)

The following table sets forth our interconnection revenue sharing and settlement arrangements with other operators for IP telephony long distance calls through our network after the regulating adjustment in 2003.

Network from which calls originated	Network at which calls terminated	Settlement Arrangement (under 2003 regulations)
Unicom's cellular network at area A	Other operators' public telecommunications network at area B (if through Unicom's IP telephony network)	(1) Unicom collects the IP telephony long distance charges and local call tariff from its subscribers (2) Unicom pays RMB0.06 per minute to other operators on the receiving end
Other operators' public telecommunications network at area A	Other operators' public telecommunications network at area B (if through Unicom's IP telephony network)	(1) Unicom collects the IP telephony long distance charges from its subscribers (2) Unicom pays RMB0.06 per minute to other operators on the receiving end (3) No settlement between Unicom and other operators on the originating end

### *Technical Standards*

The MII sets industry technical standards for the Chinese telecommunications industry. Most of the standards set by the MII conform to the standards recommended by the International Telecommunications Union and other international telecommunications standards organizations. In cases where the MII has not set certain industry technical standards, we set our own enterprise technical standards. The MII also requires all network operators in China to purchase only telecommunications equipment certified by the MII, including cellular and paging equipment, radio equipment and interconnection terminal equipment.



*Universal Services*

Telecommunications service providers in China are required to fulfill universal service obligations in accordance with relevant regulations to be promulgated by the Chinese government, and the MII has the authority to delineate the scope of its universal service obligations. The MII may also select universal service providers through a tendering process. The MII, together with the finance and pricing authorities, is also responsible for formulating administrative rules relating to the establishment of a universal service fund and compensation schemes for universal services. These rules have not yet been promulgated and there are currently no regulatory requirements relating to the provision of universal services in China.

The MII has recently required major Chinese telecommunication service providers, including Unicom Group, to participate a project to provide telecommunications services in a number of remote villages in certain designated provinces in China as transitional measures prior to the formalization of a universal service obligation framework. The MII and other relevant government authorities are still in the process of finalizing the detailed regulations relating to the provision of such universal services. Such regulations, if promulgated, may require us to incur significant relevant expenses to fulfill our universal service obligations and therefore could materially adversely affect our financial condition and results of operations.

See **D. Risk Factors** **Risks Relating to the Overall Telecommunications Industry in China**. The Chinese government may require us, along with other telecommunication service providers in China, to provide universal services with specified obligations, and we may not be compensated adequately for providing such services. Under Item 3.

***Capital Investment***

On July 16, 2004, the State Council promulgated, effective immediately, the Decision on Reform of Investment System, or the Investment Reform Decision, which significantly modified the government approval process for major investment projects in China. The Investment Reform Decision eliminated the government approval requirements for investment projects that do not involve direct government funding unless the investment projects are in the restricted sectors specified in the annually adjusted catalogue released by the State Council. The 2004 catalogue, which was attached as an annex to the Investment Reform Decision, sets forth approval requirements for individual investment projects in restricted sectors. Within the telecommunications sector, the investment projects that require the approval of the National Development and Reform Commission include:

domestic backbone transmission networks (including broadcasting and television networks);

international telecommunications transmission circuits;

international gateways;

international telecommunications facilities for dedicated telecommunications networks; and

other telecommunications infrastructure projects involving information security.

**Others**

As a company with substantially all of our operations in China, we, along with our controlling shareholder, Unicom Group, are subject to various regulations of the PRC government in addition to those regulating the telecommunications industry. PRC regulatory authorities, such as the State Bureau of Taxation, National Audit Office, State Administration of Industry and Commerce and local price bureaus, exercise extensive control over various aspects of our businesses and conduct various regular inspections, examinations and/or audits on us and Unicom Group. As required by the relevant PRC laws and regulations, Unicom Group, as one of the key State-owned enterprises under the direct supervision of the SASAC, is also subject to routine audits by the National Audit Office, or the NAO, including the senior management departure audit which involves a review by the NAO of the economic responsibilities of a departing senior management member of Unicom Group.

In 2004, the NAO conducted a senior management departure audit of Unicom Group after the resignation of Mr. Yang Xian Zu, Unicom Group's former Chairman, in 2003. We understand that the results of that audit had no material adverse effect on our company.

As a result of the resignation of Mr. Wang Jianzhou, Unicom Group's former Chairman, in 2004, the NAO is currently conducting another senior management departure audit of Unicom Group. As this NAO audit has not yet been completed, we cannot predict at this time the results of this audit or the extent of its possible effect on our company.

In addition, as our controlling shareholder, Unicom Group under the direct supervision of SASAC, SASAC has an indirect influence over us. In particular, SASAC may designate certain nominees and request Unicom Group to propose the appointment of such nominees as our directors and senior management; SASAC may also request Unicom Group to remove our directors and senior management in accordance with relevant procedures provided by law and our articles of association.

**C. Organizational Structure**

We are incorporated in Hong Kong and are 77.37% indirectly owned by the Unicom Group and 22.63% owned by public shareholders as of May 31, 2005. See A. History and Development of the Company under Item 4. Set forth below are details of our significant subsidiaries:

Name of Subsidiary	Country of Incorporation	Ownership Interest
China Unicom Corporation Limited	China	100%
Unicom New World Telecommunications Corporation Limited *	China	100%
China Unicom International Limited	Hong Kong SAR	100%
China Unicom (Macau) Company Limited	Macau SAR	100%

\* Held through Unicom New World (BVI) Limited, our direct wholly-owned subsidiary.



**D. *Properties***

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Our principal executive offices are located in Hong Kong. We also maintain executive offices in Beijing. We own and lease a large number of offices, retail outlets, equipment rooms and base stations throughout China. For some of those properties we own or operate on, we have not obtained land use rights certificates or building ownership certificates. In some cases, we have not entered into formal lease agreements with the lessors or the lessors do not possess requisite title certificates. We believe that it is unlikely that we would be denied our right to use a large number of these properties at any given time. Our controlling shareholder, Unicom Group, has agreed to indemnify us against any loss or damages incurred by us that are caused by or arising from any challenge of, or interference with, our right to use these properties.

### **Item 5. Operating and Financial Review and Prospects**

You should read the following discussion and analysis together with the selected financial data set forth in Item 3 and the consolidated financial statements included in this annual report. The financial statements have been prepared in accordance with HK GAAP, which differs in certain respects from US GAAP. Note 40 to the consolidated financial statements summarizes the nature and effects of significant differences between HK GAAP and US GAAP as they relate to our financial statements and provides a reconciliation to US GAAP of our net income and shareholders' equity. In addition, Note 40 to our consolidated financial statements includes our condensed consolidated financial information prepared and presented in accordance with US GAAP for the relevant periods. Our consolidated financial statements present, and the discussion and analysis under this Item 5 pertain to, our consolidated financial position and results of operations as of December 31, 2003 and 2004 and for the years ended December 31, 2002, 2003 and 2004. On December 31, 2002 and 2003, we completed the acquisition of Unicom New Century from Unicom Group, and the acquisition of Unicom New World from Unicom Group and sale of Guoxin Paging to Unicom Group, respectively.

Our consolidated financial statements as of and for the year ended December 31, 2004 reflect the results of operations of both Unicom New Century (which was merged into CUCL in July 2004) and Unicom New World, but do not include the results of operations of Guoxin Paging. Our consolidated financial statements for the year ended December 31, 2003 reflect the results of operations of Unicom New Century and Guoxin Paging but do not include the results of operations of Unicom New World. Our consolidated year ended December 31, 2002 do not include the results of operations of Unicom New Century. In addition, in September 2004, we completed the acquisition of Unicom International from Unicom Group. Accordingly, the operating results of Unicom International for the period from the effective date of the acquisition to December 31, 2004 have been included in our consolidated statement of income for the year ended December 31, 2004. See –Acquisitions of Unicom New Century, Unicom New World and Unicom International and the Sale of Guoxin Paging below.

#### *Overview*





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We are an integrated provider of telecommunications services in China and offer a wide range of telecommunications services, including the following, which also constitute our major operating segments:

GSM cellular service in 21 provinces, 5 autonomous regions and 4 municipalities;

CDMA cellular service in 21 provinces, 5 autonomous regions and 4 municipalities;

Public switched international and domestic long distance service nationwide in China; and

IP telephony based international and domestic long distance and data and Internet services nationwide in China.

The table below sets forth operating revenue from our major businesses and the respective percentage of our total operating revenue in 2002, 2003 and 2004.

	For the year ended December 31,								
	2002			2003			2004		
	RMB in millions		% of Total Operating Revenue	RMB in millions		% of Total Operating Revenue	RMB in millions		% of Total Operating Revenue
Total operating revenue	40,577		100.0%	67,636		100.0%	79,332		100.0%
Total service revenue	38,333		94.5%	64,040		94.7%	76,310		96.2%
GSM	27,388		67.5%	40,304		59.6%	46,579		58.8%
CDMA	3,225		7.9%	16,623		24.6%	24,220		30.5%
Long distance revenue	2,766		6.8%	2,273		3.4%	1,848		2.3%
Data and Internet revenue	2,793		6.9%	3,437		5.1%	3,663		4.6%
Paging	2,161		5.4%	1,403		2.0%			
Sales from telecommunications products	2,244		5.5%	3,596		5.3%	3,022		3.8%

Our service revenue comes primarily from the following:

Usage fees for our GSM, CDMA, long distance and data and Internet services, including, for our cellular subscribers, roaming-out fees for calls made by them outside their local service areas. We recognize usage fee revenue when the service is rendered.

Monthly fees, of fixed amounts, charged to certain of our GSM, CDMA, data and Internet subscribers for access to the relevant service. We recognize monthly fee revenue in the month during which the services are rendered.

Interconnection revenue from other telecommunications operators, including Unicom Group, for calls made from their networks to our networks and roaming-in fees for calls made by cellular subscribers of other operators using our cellular networks. We recognize interconnection revenue when the relevant calls are made by subscribers.

Leased line rental revenue from leases of transmission lines on our networks to Unicom Group, business customers and other telecommunications carriers in China. We recognize leased line rental revenue on a

straight-line basis over the relevant lease term.

Other revenue primarily from valued-added services, such as short message services. We recognize revenue for valued-added services when the services are rendered.

Sales of telecommunication calling cards, representing pre-paid service fees, are recorded as advances from customers and recognized as revenue when the service is rendered upon actual use of the cards.

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Along with the rapid growth of China's telecommunications industry, particularly in the cellular communications sector, our total operating revenue in 2004 increased by 17.3% from 2003. This increase was primarily the result of the continued growth in revenue of our cellular business, including the strong growth of our CDMA service since its introduction in 2002, as well as the effect of including revenue attributable to Unicom New World, which we acquired effective December 31, 2003. We believe that the growth of our cellular businesses has resulted in developments in our revenue structure that reflect our strategy of targeting high growth, high margin areas of China's telecommunications industry. Service revenue from our cellular businesses as a percentage of total operating revenue increased from 84.2% in 2003 to 89.3% in 2004. Service revenue from long distance, data and Internet businesses declined to 6.9% of operating revenue in 2004, from 8.5% of our total operating revenue in 2003. We aim to further leverage our position as an integrated telecommunications operator in order to continue to drive the growth of our GSM and CDMA cellular businesses and long distance, data and Internet businesses.

The following table sets forth our major operating expense items and operating income, both in terms of amount and as a percentage of total operating revenue in 2002, 2003 and 2004.

	For the year ended December 31,									
	2002			2003			2004			
	RMB in millions	% of Total Operating Revenue		RMB in millions	% of Total Operating Revenue		RMB in millions		% of Total Operating Revenue	
Total Operating Revenue	40,577	100.0%		67,636	100.0%		79,332		100.0%	
Total Operating Expenses	33,253	82.0%		59,122	87.4%		71,376		90.0%	
Leased line and network capacities	1,583	3.9%		4,320	6.4%		7,398		9.3%	
Interconnection charges	3,230	8.0%		5,921	8.8%		7,517		9.5%	
Depreciation and amortization	11,256	27.7%		16,385	24.2%		19,063		24.0%	
Personnel	3,335	8.2%		4,575	6.8%		4,526		5.7%	
Selling and marketing	5,981	14.7%		15,157	22.4%		18,945		23.9%	
General, administrative and other expenses	5,632	13.9%		9,112	13.5%		10,448		13.2%	
Cost of telecommunications products sold	2,236	5.5%		3,652	5.4%		3,479		4.4%	
Operating income	7,324	18.0%		8,514	12.5%		7,956		10.0%	

Our major operating expenses include the following:

Leased line and network capacities charges, representing lease expenses for transmission capacity from other operators and CDMA network capacities from Unicom Group;

Interconnection expenses, representing amounts paid to other operators, including Unicom Group, for calls from our networks to their networks and roaming-out fees paid to other operators, including Unicom Group,

for calls made by our subscribers roaming in their networks;

Depreciation and amortization expenses, mainly relating to our property, plant and equipment and other assets;

Personnel expenses, representing staff salaries and wages, bonuses and medical benefits, contributions to defined contribution pension schemes and housing benefits;

Selling and marketing expenses, including commissions, promotion and advertising expenses and, beginning in 2002, amortization of deferred customer acquisition costs of certain CDMA contractual subscribers;

General, administrative and other expenses, primarily including operating lease expenses, repair and maintenance costs, provision for doubtful debts and provisions for impairment in the value of property, plant and equipment. Other components of general, administrative and other expenses include utilities, general office expenses and travel expenses; and

Costs of telecommunications products sold.

While we continue to aim to strengthen management, integrate our businesses and control costs to achieve greater overall efficiency, as a percentage of total operating revenue, total operating expenses in 2004 were 90.0% compared to 87.4% in 2003. This percentage increase was primarily due to increases in expenses for leased line and network capacities as well as interconnection charges.

For the first three months of 2005, our unaudited total revenue was RMB20.86 billion, including RMB12.07 billion from GSM cellular services, RMB6.65 billion from CDMA cellular services, RMB0.44 billion from long distance services, RMB0.83 billion from data and Internet services and RMB0.87 billion from the sale of telecommunications products. The financial data disclosed above was prepared in accordance with Hong Kong Financial Reporting Standards and Hong Kong Accounting Standards ( HKFRSs ), which became effective from January 1, 2005. Note 3

Principle accounting policy (a) Basis of presentation Recently issued accounting standards to our consolidated financial statements summarizes the significant differences between the HKFRSs adopted for the three months ended March 31, 2005 and HK GAAP for year ended December 31, 2002, 2003 and 2004.

*Acquisitions of Unicom New Century, Unicom New World and Unicom International and the Sale of Guoxin Paging*

In September 2004, we completed the acquisition from Unicom Group of Unicom International, a limited liability company established in Hong Kong engaging in voice wholesale business, telephone cards business, line leasing services, managed bandwidth services and mobile virtual network services in Hong Kong and the United States. The total purchase price was HK\$37,465,996 (approximately RMB39.74 million including direct costs of acquisition), payable in cash.

In December 2003, we acquired from Unicom Group the GSM cellular assets and businesses and CDMA businesses of Unicom New World in the following 9 provinces and autonomous regions in China: Shanxi, Hunan, Hainan, Yunnan, Gansu and Qinghai provinces and Inner Mongolia, Ningxia Hui and Tibet autonomous regions. The total purchase price was HK\$3,014,886,000 (approximately RMB3.2 billion), payable in cash. On the same date, we also completed the sale of the entire equity interests of Guoxin Paging to Unicom Group for a total sale price of HK\$2,590,917,656 (approximately RMB2.75 billion), and such proceeds were applied to our general working capital.

Under HK GAAP, we have adopted the purchase method to account for our acquisitions from Unicom Group of Unicom New World, which became effective on December 31, 2003, and Unicom International, which became effective in September 2004. Under the purchase method, in accordance with HK GAAP, our consolidated financial statements incorporate the results of operations of Unicom New World and Unicom International only from the effective dates of the respective acquisitions. Accordingly, the results of operations of Unicom International for the period from the effective date of the acquisition to December 31, 2004 have been included in our consolidated statement of income for the year ended December 31, 2004. Our consolidated balance sheet as of December 31, 2004 includes the financial position of Unicom International. Since the effective date of the Unicom New World acquisition was December 31, 2003, our consolidated financial statements of income for the years ended December 31, 2003 and 2002 included in this annual report do not include the results of operations of Unicom New World. Our consolidated balance sheet as of December 31, 2003 includes the financial position of Unicom New World. The difference between the cost of the acquisition and the fair value of the identifiable assets and liabilities acquired was recognized as goodwill, which is amortized on a straight line basis over its beneficial life.



Under US GAAP, the acquisitions of Unicom International and Unicom New World is accounted for as a transfer of businesses under common control. Under this method, the acquired assets and liabilities are accounted for at their historical cost under US GAAP and the consolidated financial statements prepared under US GAAP for all periods presented are retroactively restated as if Unicom International and Unicom New World had always been part of our company since inception. This method is reflected in the significant differences between HK GAAP and US GAAP provided in Note 40 to our consolidated financial statements.

Under HK GAAP, the sale of Guoxin Paging by us to the Unicom Group, which became effective on December 31, 2003, has been accounted for as a sale of discontinued operation. The difference between the sale proceeds and the carrying amount of net assets of Guoxin Paging as of December 31, 2003 was recorded as the loss on sale of discontinued operation in our consolidated income statement for the year ended December 31, 2003. The operating results of Guoxin Paging from January 1, 2003 to the effective date of the sale of Guoxin Paging were included in our consolidated income statement for the year ended December 31, 2003.

Under US GAAP, the sale of Guoxin Paging to Unicom Group is considered a transfer of business between entities under common control and accounted for at historical cost of the net assets transferred, after reduction, if appropriate, for an indicated impairment of value. In addition, under US GAAP, the results of operations of a component or segment of an entity that has been disposed of should be reported in discontinued operations as a separate component of income, separately from continuing operations, in the period in which the disposal occurred and in prior periods. Accordingly, all the operating results of Guoxin Paging have been grouped into and reported in the income statement as Discontinued operation Loss from discontinued operation under US GAAP.

On December 31, 2002, we completed the acquisition of Unicom New Century from Unicom Group. Similar to the treatment of the acquisition of Unicom New World described above, we adopted the purchase method under HK GAAP, under which the results of operations of Unicom New Century were included in our consolidated financial statements for the fiscal years ended December 31, 2004 and 2003 only. On July 30, 2004, Unicom New Century was merged into CUCL and legally dissolved upon the completion of such merger.

The acquisitions of Unicom New Century and Unicom New World and the sale of Guoxin Paging have had a material impact on our overall results of operations. In particular, our financial results in 2004 were significantly affected by the inclusion of the results of operations for Unicom New World we acquired effective December 31, 2003. By comparison, our financial results in 2003 did not include the results of operations of Unicom New World. See – Operating Results- Year Ended December 31, 2004 Compared to Year Ended December 31, 2003 below. These acquisitions have, among other things, significantly expanded the size of the telecommunications markets we serve and increased the number of our subscribers and usage of our services. As a result, our operating revenue and operating expenses have also increased significantly.

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The following are certain summary consolidated results of operation information for the years ended December 31, 2002, 2003 and 2004 and financial position information as of December 31, 2003 and 2004 for us and Unicom International, as separate entities and on a combined basis after the acquisition of each entity, prepared under US GAAP. The financial information prepared under US GAAP reflect retroactive restatement for the acquisition and reconciliation for other differences from HK GAAP to US GAAP.

	The Group (before the acquisition of Unicom International)	Unicom International	Elimination	The Group (after the acquisition of Unicom International)
	RMB 000	RMB 000	RMB 000	RMB 000
<b>For the year ended December 31, 2002</b>				
Results of operations:				
Operating revenue (Turnover)	50,415,248	24,322	(18,497)	50,421,073
Net income from continuing operations	5,492,804	7,351		5,500,155
Net loss from discontinued operation	(422,213)			(422,213)
Cumulative Effect to change in accounting policy	(42,175)			(42,175)
Net income	5,028,416	7,351		5,035,767
Basic earnings per share (RMB)	0.401			0.401
<b>As of/for the year ended December 31, 2003</b>				
Results of operations:				
Operating revenue (Turnover)	71,958,253	46,265	(24,208)	71,980,310
Net income from continuing operations	6,070,263	7,698		6,077,961
Net loss from discontinued operation	(1,341,840)			(1,341,840)
Net income	4,728,423	7,698		4,736,121
Basic earnings per share (RMB)	0.377			0.377
Financial position:				
Non-current assets	128,169,420	60,621		128,230,041
Current assets	22,243,284	97,186	(93,115)	22,247,355
Total assets	150,412,704	157,807	(93,115)	150,477,396
Non-current liabilities	40,593,548			40,593,548
Current liabilities	43,906,653	124,166	(93,115)	43,937,704
Total liabilities	84,500,201	124,166	(93,115)	84,531,252
Net assets	65,912,503	33,641		65,946,144
<b>As of/for the year ended December 31, 2004</b>				
Results of operations:				
Operating revenue (Turnover)	79,361,238	135,688	(108,612)	79,388,314
Net income	4,703,312	8,988	387	4,712,687
Basic earnings per share (RMB)	0.374			0.375
Financial position:				
Non-current assets	128,697,817	64,865		128,762,682
Current assets	17,865,977	148,991	(162,776)	17,852,192
Total assets	146,563,794	213,856	(162,776)	146,614,874

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Non-current liabilities	31,045,613	3,262		31,048,875
Current liabilities	46,118,868	167,972	(163,163)	46,123,677
Total liabilities	77,164,481	171,234	(163,163)	77,172,552
Net assets	69,399,313	42,622	387	69,442,322

*Critical Accounting Policies*



The preparation of our financial statements and this annual report requires us to make estimates and assumptions that affect the reported and disclosed amounts of assets and liabilities, including contingent assets and liabilities, as at the relevant dates and revenue and expenses for the relevant periods. We have identified the accounting policies and estimates below as critical to our business operations and an understanding of our results of operations and financial position. The impact and any associated risks related to these policies on our business operations are discussed throughout this Item 5 where such policies affect our reported and expected financial results. For a discussion of the application of these and other accounting policies, see Notes 2 and 3 to our consolidated financial statements included in this annual report. There can be no assurance that actual results will not differ from those estimates and assumptions.

#### **Deferral of CDMA Customer Acquisition Costs**

We have been operating the CDMA business since the beginning of 2002. In order to accelerate the development of the CDMA business and subscriber growth, we began to offer certain promotional packages in the second half of 2002. As part of the contractual arrangements with certain CDMA contractual subscribers under these special promotional packages, CDMA handsets were provided to the subscribers for their use at no additional charge during the specified contract periods, which range from 6 months to 2 years. In return, the subscribers are required to incur a minimum amount of service fees during the contract period. If the contractual subscribers can fulfill the minimum contract spending amounts by the end of the contract period, they will not be obliged to repay the remaining costs of the CDMA handsets given for their use. In addition, to secure contract performance, these subscribers are required under their contracts to (1) prepay certain non-refundable amounts of service fees or deposits, (2) maintain a bank deposit in one of the designated commercial banks to secure their minimum contract amounts, or (3) provide a guarantor who will compensate us for any loss in the event of the subscriber's non-performance of related contractual obligations.

We consider the costs of the CDMA handsets provided to contractual subscribers under these promotional packages as part of the customer acquisition costs for the development of these new CDMA contractual subscribers. Such customer acquisition costs are deferred, to the extent recoverable, and amortized over the contractual periods to match with the minimum contract revenue.

We determined our accounting policy of deferred customer acquisition costs of certain CDMA subscribers after a careful evaluation of our specific facts and circumstances, and believe that the capitalization of such costs appropriately matches the future contractual revenues due to (1) the historically high ARPUs and low churn, default or bad debt rates of these subscribers; (2) our established procedures and the relative low cost of enforcement of contracts in default; and (3) the existence of specified contract periods with minimum contract spending amounts and built-in contractual safeguarding measures such as non-refundable prepayments, bank deposits, and guarantees received, as well as penalty clauses imposed on subscribers.

Therefore, we believe that the deferred customer acquisition costs are recoverable from future revenue to be derived from these promotional packages, and the capitalization and amortization of these customer acquisition costs to match with future revenue is an appropriate accounting policy. Furthermore, we continuously assess and evaluate the recoverability of these deferred customer acquisition costs, based on the detailed review of historical subscriber churn rates and the estimated default rate. Based on our current assessment and evaluation, we believe that there is no significant problem in recovering the carrying amounts of the deferred customer acquisition costs as at December 31, 2004.

We have made the above recoverability assessments based on the current legal and operating environment relating to the subscribers' contract performance and other information currently available to us. Actual results may differ significantly from the current situation and our current estimates. If the situation changes significantly in the future, we may need to expense off additional non-recoverable deferred customer acquisition costs based on conditions at that time.

**Lease of CDMA Network Capacity**

We had entered into a CDMA network capacity lease agreement with Unicom Group and Unicom Horizon in December 2001. Pursuant to this CDMA lease agreement, Unicom Horizon agreed to lease the capacity of the CDMA network to us covering the nine provinces of Guangdong, Jiangsu, Zhejiang, Fujian, Liaoning, Shandong, Anhui, Hebei, Hubei and the three municipalities of Beijing, Shanghai and Tianjin. This lease became effective on January 8, 2002.

In addition, on December 31, 2002 and 2003, we acquired all the equity interests in Unicom New Century and Unicom New World, respectively, which together operate GSM and CDMA cellular businesses in another 12 provinces, one municipality and five autonomous regions in China. Each of Unicom New Century and Unicom New World had also entered into a CDMA lease agreement with Unicom Group and Unicom Horizon on similar terms and conditions. These lease agreements and the lease agreement entered in 2001 are collectively referred to as the Old CDMA Leases.

According to the terms of the Old CDMA Leases, the initial lease period is one year, renewable for additional one-year terms at our own option. We have the exclusive right to lease and operate the CDMA network capacity in the above regions. Also, we have the option to add or reduce the capacity leased by giving advance notice. The lease fee per unit of capacity is calculated on the basis that if full capacity is leased, it would permit Unicom Horizon to recover its investment in constructing the CDMA network in 7 years, together with an internal return of 8%. In January 2004, we renewed the Old CDMA Leases, for an additional one-year term.

Subsequently, on March 24, 2005, we have entered into the New CDMA Lease with Unicom Group and Unicom Horizon to replace the Old CDMA Leases. The New CDMA Lease has been approved by our minority shareholders on May 12, 2005 and became retroactively effective from January 1, 2005. Key terms of the New CDMA Lease, including exclusive operating rights and purchase option, are substantially similar to those contained in the Old CDMA Leases except that (i) the initial lease period is two years, with full CDMA constructed network capacity to be leased from Unicom Horizon, and (ii) the lease fee shall be determined based on the Company's CDMA service revenue. For more detailed discussions of the terms of the New CDMA Lease, see B. Related Party Transactions- Leasing of CDMA Network Capacity – Lease of CDMA Network Capacity New CDMA Lease under Item 7.

We have assessed the appropriate lease classification at the inception of the Old CDMA Leases and New CDMA Lease. Factors and related implications we have considered include whether we have taken the risks and rewards of ownership of the CDMA assets. Furthermore, we have considered whether the existence of the purchase option and the renewal options, combined with the related economic penalties, risks and benefits, have caused us to take on risks and rewards similar to those that an owner of these assets would bear.



Unicom Horizon has the legal ownership of the CDMA network, is directly responsible for the planning, financing and construction of the CDMA network, and directly enters into all contracts with suppliers and constructors. We believe we only bear the risks associated with the operation of our CDMA business during the relevant leasing periods and are free from any ownership risks of the CDMA network. According to the terms of the Old CDMA Leases, our initial lease period is only one year, with renewal for additional one-year terms at our own option. Similarly, according to the terms of the New CDMA Lease, our initial lease period is determined to be only two years. Accordingly, there is no pre-determined lease period and minimum network capacity to be leased in future periods. We have the option to determine whether we will renew and continue the leases and how much capacity to lease under the Old CDMA Leases and the New CDMA Lease. We also have the option to decide whether we will exercise the purchase option of CDMA network based on market environment and the future operating performance of the CDMA business subject to approvals obtained from our independent minority shareholders.

Accordingly, if the CDMA business turns out to be unsuccessful, we do not have the obligation to continue the CDMA lease arrangement or to exercise the purchase option. Or, we could continue to lease nominal capacity in order to ensure that no other operator takes possession of the assets to compete with us in our service areas.

In general, the classification of leases is dependent on whether the risks and rewards of ownership of the leased assets rest substantially with the lessor or the lessee. Leases that substantially transfer to the lessee all the risks and rewards of ownership of the leased assets are accounted for as finance leases; and leases where substantially all the risks and rewards of ownership of the leased assets remain with the lessor are accounted for as operating leases. When performing this assessment, we have considered the various factors above that required significant judgment.

From the inception of the Old CDMA Leases and the New CDMA Lease, there has been, and continues to be, a high degree of uncertainty related to the market condition and existing operating results of the CDMA business. It remains highly uncertain whether we will continue to lease the network in the future. We are also unable to determine whether or not we will exercise the purchase option. Given these uncertainties and due to the fact that the risks associated with the ownership of the CDMA assets substantially remain with Unicom Group and Unicom Horizon, we have accounted for the leasing of CDMA network capacity as operating leases under the Old CDMA Leases and continue to do so under the New CDMA Lease, so as to reflect the respective rights and obligations of the relevant parties to the lease agreements. At the end of the effective lease term, or if significant modifications are made to the lease agreement, we will reassess the appropriate classification based on the relevant facts and circumstances available at that time.

Based on the above assessment, only the operating lease expense has been recorded in our statements of income since the commencement of the Old CDMA Leases, whereas the carrying value of the CDMA assets and the related liabilities are not reflected in our balance sheet. For the years ended December 31, 2003 and 2004, we recorded lease expenses of approximately RMB3.52 billion and RMB6.59 billion, respectively, under the Old CDMA Leases.

**Impairment of Assets**

As of the end of each year, we conduct a full review of various information to identify indications that the carrying values of our property, plant and equipment, construction-in-progress and other long-term assets may be impaired. If such an indication exists, we will also estimate the related asset's recoverable amount. To the extent that the estimated recoverable amount of an asset is lower than its carrying amount, an impairment loss is recognized. The information used to identify indications of impairment might be subjective in nature and the interpretation and application of such information requires judgment, the result of which directly affects our estimate of any impairment provision considered necessary as at any given balance sheet date. To the extent our assumptions and estimations differ significantly from actual events and circumstances, we may need to make additional impairment provisions in the future.

In 2002, despite the fact that the revenue and subscriber number of the paging business continued to decline, it managed to maintain net cash inflows from operations. Our paging business did not improve significantly because the traditional paging business was still declining, whereas the new value-added paging businesses were at their initial development stage, and thus, the real value of the paging business was not yet fully realized. At that time, we were confident about the future prospects of these new value-added paging businesses, and we believed that they could generate sufficient future economic benefits to recover the carrying values of the existing paging assets. Consequently, we believed that it was not necessary to make additional impairment provision for 2002.

Later on, in the first half of 2003, we conducted a re-assessment of the recoverable amount of the paging assets based on the best estimates of the discounted net future cash flows expected to be generated from the paging business in the foreseeable future years. Management made key assumptions and estimations on the appropriate discount rate adopted (8% per annum), the period covered by the cash flow forecast, the impact of the continuous decline of traditional paging business, the future loss of subscribers, the expected trend in average revenue per subscriber, as well as incremental cash flows arising from new paging businesses and the effects of the adoption of cost reduction plans. All these assumptions and estimations were made based on historical trends adjusted for the current market situation (including the physical condition of these assets) and the forecast of the future development of the new value-added paging businesses.

In the first half of 2003, based on our updated analysis and the worsening decline of the traditional paging business, we expected that the related incremental future cash inflows to be generated from the new value-added paging services, despite their continuous growth, were unlikely to offset the effects of the rapid decline of the traditional paging business in the future. Consequently, based on the latest estimate of the discounted future net cash flows expected to arise from the continuing operations of the paging business, after considering the unexpected rapid decline of the traditional paging business in the first half of 2003, we concluded that the carrying amount of paging assets as at June 30, 2003 had exceeded their expected recoverable amounts. Accordingly, we recorded an additional impairment loss for property, plant and equipment of the paging business amounting to approximately RMB528 million in the first half of 2003. Subsequently, we sold the paging business to our ultimate parent company, Unicom Group, effective on December 31, 2003. The disposal loss of this discontinued operation, representing the difference between the sales proceeds and the carrying amount of the net assets of the paging business as of the effective date of the disposal which amounted to approximately RMB663 million, was recognized and charged to the statement of income in 2003.

**Provision for Doubtful Debts**

Accounts receivables are stated at cost, less provision for doubtful debts. We evaluate specific accounts receivable where there are indications that the receivable may be doubtful or is not collectible. We record a provision based on our best estimates to reduce the receivable balance to the amount that is expected to be collected. For the remaining receivable balances as of each period-end, we make a provision based on the aging pattern of the receivable amounts and by applying reasonable percentages to the outstanding receivables. We make such estimates based on our past experience, historical collection patterns, subscribers' credit worthiness and collection trends. For the general subscribers of our cellular, long distance, data and Internet services, we make a full provision for receivables aged over 3 months, which is consistent with our credit policy with respect to relevant subscribers.

Our estimates described above are based on our historical experience, subscribers' credit worthiness and collection trends. If circumstances change (e.g. due to factors including developments in our business and the external market environment), we may need to re-evaluate our policies on doubtful debts, and make additional provisions in the future.

### **Income Tax and Deferred Taxation**

Income tax is provided for based on income before tax for statutory financial reporting purposes, adjusted for income and expense items that are not assessable or deductible for tax purposes and taking into consideration any preferential tax treatment to which we are entitled.

Deferred taxation is provided in full, using the liability method, on temporary differences arising between the tax basis of assets and liabilities and their carrying amounts in the financial statements. Deferred tax assets are recognized to the extent that it is probable that future taxable profit will be available against which the temporary differences can be utilized.

In the preparation of our financial statements, we estimate our income tax provision and deferred taxation in accordance with the prevailing tax rules and regulations, taking into account any special approvals obtained from relevant tax authorities and any preferential tax treatment to which we are entitled in each location or jurisdiction in which we operate. This process involves estimation made by us about our current tax exposure together with an assessment of temporary differences resulting from different treatment of items for tax and accounting purposes in order to determine the amount of tax provisions for the period. We believe we have recorded adequate tax provisions based on our best estimates and assumptions. For the evaluation of temporary differences, we have assessed the likelihood that our deferred taxes could be deferred and recovered. Major deferred tax components include interests on loans from China-China-Foreign, or CCF, joint ventures, loss arising from terminations of CCF arrangements, provisions for doubtful debts and write-down of inventory to net realizable value and additional depreciation deductible for tax purpose. Due to the effects of these temporary differences on income tax, we have recorded deferred tax assets amounting to RMB1.20 billion and RMB0.54 billion as of December 31, 2003 and 2004, respectively. Deferred tax assets are recognized based on our estimates and assumptions that they will be recovered from taxable income from continuing operations in the foreseeable future.

We believe we have recorded adequate current and deferred taxes based on prevailing tax rules and regulations and our current best estimates and assumptions. In the event that future tax rules and regulations or related circumstances change, adjustments to current and deferred taxes may be necessary.

*Operating Results*

**Year Ended December 31, 2004 Compared to Year Ended December 31, 2003**



Our results of operations in 2004 were materially affected by our acquisitions of Unicom New World effective December 31, 2003. In particular, our operating revenue and operating expenses increased significantly in 2004, which was primarily due to the inclusion of the results of operations of Unicom New World. By comparison, our results in 2003 did not include the results of operations of Unicom New World. As a result, our results of operations in 2004 are not directly comparable with those in prior years. See – Acquisitions of Unicom New Century, Unicom New World and Unicom International and Sale of Guoxin Paging above. See also A. The History and Development of the Company – Acquisition of Unicom New World and Sale of Guoxin Paging under Item 4 above.

In 2004, our operating revenue continued to increase, by 17.3% from RMB67.64 billion in 2003 to RMB79.33 billion in 2004. This growth was principally due to the strong growth of our CDMA cellular business and continued growth of our GSM cellular business, as well as the inclusion of revenue attributable to Unicom New World, which we acquired effective December 31, 2003. Our cellular businesses continued to increase in their percentage contribution to our overall business. Our long distance, data and Internet businesses decreased in terms of operating revenues and in their contribution to our business.

Due to factors discussed below, in 2004 our operating expenses grew 20.7%. As a result, our operating income decreased by 6.6% to RMB7.96 billion, while our operating margin decreased to 10.0%, as compared with 12.5% in 2003. Operating margin in our GSM cellular business decreased from 21.2% in 2003 to 17.4% in 2004. While our CDMA cellular business sustained rapid growth in 2004, its operating loss increased by 102.6%. In our long distance and data and Internet businesses, operating income decreased 67.3% in 2004 and operating margin decreased to 5.3% in 2004 from 17.2% in 2003.

Our net income in 2004 increased by 4.0% to RMB4.39 billion, for reasons discussed below.

### *Operating Revenue*



Operating revenue from our GSM cellular business grew steadily in 2004 and continued to generate a majority of our total operating revenue, while operating revenue from our CDMA cellular business sustained fast growth in 2004, significantly increasing its share of our total operating revenue for the year. Our CDMA cellular business, introduced in January 2002, generated RMB26.34 billion in operating revenue in 2004, contributing 66.3% of our total operating revenue growth in that year. Operating revenues from our GSM and CDMA cellular businesses represented 93.0% of our total operating revenue in 2004, as compared with 88.3% in 2003. The share of operating revenue from the CDMA cellular business in our total operating revenue increased from 27.5% in 2003 to 33.2% in 2004, while the share of operating revenue from the GSM cellular business in our total operating revenue decreased from 60.9% in 2003 to 59.8% in 2004. Operating revenues from our long distance and data and Internet businesses slightly decreased from RMB5,732 million in 2003 to RMB5,527 million in 2004. Operating revenues from our long distance business and our data and Internet businesses represented 2.3% and 4.7%, respectively, of our total operating revenue in 2004, as compared with 3.3% and 5.1%, respectively, in 2003. The growth in our total operating revenue, however, was partially offset by the sale of our paging business, effective December 31, 2003. We believe the changes in our operating revenue composition reflect our focus on the development of our cellular businesses.

*Cellular Revenue*

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For the reasons discussed below, operating revenues from our GSM and CDMA cellular businesses (including revenues from sales of telecommunications products) together increased by 23.5%, from RMB59.75 billion in 2003 to RMB73.80 billion in 2004.

*GSM Cellular Business* Operating revenue from our GSM cellular business increased by 15.3%, from RMB41.17 billion in 2003 to RMB47.47 billion in 2004, primarily due to the continued increase in the total number of our total GSM cellular subscribers as a result of organic subscriber growth and the effect of our acquisition of Unicom New World. The total number of our GSM cellular subscribers increased by 31.8%, from 63.92 million as of December 31, 2003 to 84.27 million as of December 31, 2004. As a result of continuing cellular penetration expansion, an increase in the proportion of low-usage subscribers among new subscribers, an increased number of pre-paid subscribers, and increasing market competition negatively affecting effective pricing, ARPU from the GSM cellular business declined 12.9%, from RMB56.7 in 2003 to RMB49.4 in 2004. Post-paid ARPU decreased by 12.2%, from RMB66.2 in 2003 to RMB58.1 in 2004, while pre-paid ARPU decreased by 13.0%, from RMB46.0 in 2003 to RMB40.0 in 2004. The average MOU per subscriber per month increased 8.8%, from 173.7 minutes in 2003 to 188.9 minutes in 2004.

Revenue from pre-paid GSM cellular service was RMB18.09 billion in 2004, a 18.0% increase from RMB15.33 billion in 2003. Revenue from pre-paid services accounted for 38.8% of the service revenue from our GSM cellular business in 2004, an increase from 37.2% of the total service revenue from the GSM cellular business in 2003. Pre-paid subscribers accounted for 72.0% of our new customers in 2004, compared to 73.8% in 2003 primarily due to the lower percentage of pre-paid subscribers of Unicom New World compared to the percentage of our pre-paid subscribers before the acquisition.

The table below sets forth the revenue composition of our GSM cellular business and each revenue item's respective share of total GSM operating revenue in the years ended December 31, 2002, 2003 and 2004.

	2002			2003			2004		
	RMB in million	As percentage of total		RMB in million	As percentage of total		RMB in million	As percentage of total	
Operating Revenue	28,109	100.0%		41,166	100.0%		47,466	100.0%	
Service Revenue	27,388	97.4%		40,303	97.9%		46,579	98.1%	
Usage Fee	20,275	72.1%		29,072	70.6%		31,997	67.4%	
Monthly Fee	4,169	14.8%		7,042	17.1%		6,922	14.6%	
Interconnection Revenue	1,710	6.1%		1,927	4.7%		2,614	5.5%	
Others	1,234	4.4%		2,262	5.5%		5,046	10.6%	
Sales of Telecommunications Products	721	2.6%		863	2.1%		887	1.9%	

Due to the growth in total usage of our GSM cellular services (including the effects of our acquisition of Unicom New World) and the increasing proportion of pre-paid cellular subscribers (who do not pay monthly fees), usage fees for GSM cellular services increased by 10.1% from RMB29.07 billion in 2003 to RMB32.00 billion in 2004, and represented 68.7% of total GSM service revenue as compared with 72.1% in 2003. For the same reasons, monthly fees decreased by 1.7%, from RMB7.04 billion in 2003 to RMB6.92 billion in 2004, and represented 14.9% of total GSM service revenue as compared with 17.5% in 2003. Interconnection revenue increased by 35.7% from RMB1.93 billion in 2003 to RMB2.61 billion in 2004, and represented 5.6% of total service revenue as compared with 4.8% in 2003.



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While continuing to meet the diverse needs of our customers in the mass market, our GSM cellular business aims to actively pursue mid- to high-end customers through the development and promotion of value-added services. Revenue from our GSM value-added cellular services increased 134.8%, from RMB2.07 billion in 2003 to RMB4.86 billion in 2004. Its share of total GSM service revenue more than doubled from 5.0% in 2003 to 10.4% in 2004. Of the total revenue from GSM value-added cellular services, revenue from short messaging services increased 103% from RMB1.37 billion in 2003 to RMB2.79 billion in 2004, and its share of total GSM service revenue grew from 3.4% in 2003 to 6.0% in 2004. Revenue from value-added services contributed significantly to the increase of our total GSM cellular revenue and, we believe, will continue to enhance our competitiveness in this business.

*CDMA Cellular Business.* Since we launched CDMA cellular services in 2002, our CDMA subscriber base has expanded rapidly as the market became more familiar with our CDMA services. In 2004, the growth in our CDMA subscriber base greatly boosted revenue from the CDMA cellular business. Operating revenue from our CDMA cellular business reached RMB26.34 billion in 2004, a 41.8% increase over RMB18.58 billion in 2003. This increase was primarily due to the rapid expansion of our CDMA cellular business as well as the effect of including revenue attributable to Unicom New World, which we acquired effective December 31, 2003. Our CDMA marketing strategy, which seeks to differentiate our CDMA services from our GSM services, has resulted in a rapid increase in the CDMA subscriber base, while successfully positioning the CDMA business in the marketplace as enterprise, infotainment, health-conscious and trendy services. ARPU for our CDMA cellular business reached RMB85.3 in 2004, more than 72.7% higher than the ARPU of RMB49.4 for GSM cellular services.

The table below sets forth the revenue composition of our CDMA cellular business and each revenue item's respective share of total CDMA operating revenue for the years ended December 31, 2002, 2003 and 2004.

	2002		2003		2004	
	RMB in million	As percentage of total	RMB in million	As percentage of total	RMB in million	As percentage of total
Operating Revenue	3,648	100.0%	18,580	100.0%	26,338	100.0%
Service Revenue	3,225	88.4%	16,624	89.5%	24,220	92.0%
Usage Fee	2,231	61.2%	11,672	62.8%	16,165	61.4%
Monthly Fee	713	19.5%	3,488	18.8%	4,638	17.6%
Interconnection Revenue	184	5.0%	608	3.3%	927	3.5%
Others	97	2.7%	856	4.6%	2,490	9.5%
Sales of Telecommunications Products	423	11.6%	1,956	10.5%	2,118	8.0%

CDMA usage fees increased by 38.5% from RMB11.67 billion in 2003 to RMB16.17 billion in 2004, and represented 66.7% of total CDMA service revenue as compared with 70.2% in 2003. Monthly fees increased by 33.0%, from RMB3.49 billion in 2003 to RMB4.64 billion in 2004, and represented 19.1% of total CDMA service revenue as compared with 21.0% in 2003. Interconnection revenue increased by 52.5% from RMB0.61 billion in 2003 to RMB0.93 billion in 2004, and represented 3.8% of total service revenue as compared with 3.7% in 2003.

With the expansion of our CDMA 1X wireless data services in 2004, we have been actively developing our CDMA wireless data business, by making efforts to convert the competitive edge of the CDMA technology into a competitive edge in operations in order to enhance competitiveness in the market and our appeal to subscribers. Revenue from value-added CDMA cellular services reached RMB2.38 billion in 2004, an increase of 205.1% from RMB0.78 billion in 2003, and accounted for 9.8% of total service revenue from the CDMA cellular business in 2004. We expect revenue from value-added CDMA services will continue to grow significantly, as we will continue to focus on the development and marketing of such value-added services.





*Long Distance and Data and Internet Revenue*

Operating revenue from our long distance and data and Internet businesses reached RMB5.53 billion, a decrease of 3.6% from 2003. We intend to continue to leverage on our multi-business integrated network platform and actively promote services with distinctive features such as Ruyi Mailbox , UNI-VIDEO and U-Net .

*Long Distance Business.* Operating revenue from our traditional public switched long distance business decreased by 19.1%, from RMB2.29 billion in 2003 to RMB1.85 billion in 2004. Such decrease is primarily due to increased competition and the decrease in interconnection revenue from Unicom New World caused by our acquisition of Unicom New World.

*Data and Internet Business.* We have fully leveraged the technological advantage of our multi-businesses integrated network platform. Along with effectively expanding international and domestic call volume for IP telephony services, we have been targeting institutional subscribers and corporate subscribers in promoting services with distinctive features such as UNI-VIDEO and U-Net , and we also have been targeting the mass market in promoting data and Internet services such as Ruyi Mailbox . At the same time, we have been continuing to develop integrated data, voice and video connection services, and dedicated and dial-up connection services. As a result of these efforts, revenue from our data and Internet businesses rose by 6.8% from RMB3.44 billion in 2003 to RMB3.68 billion in 2004.

#### *Paging Revenue*

We sold our paging business to Unicom Group, effective December 31, 2003, and therefore did not have revenue from the paging business in 2004. See – Acquisitions of Unicom New Century, Unicom New World and Unicom International and Sale of Guoxin Paging above. See also A. The History and Development of the Company – Restructuring and Acquisition of Unicom New Century under Item 4 above.

#### *Operating Expenses*

Operating expenses in 2004 were RMB71.38 billion, representing an increase of 20.7% over 2003, which was greater than the 17.3% growth in operating revenue for the same period. As discussed below, a 71.2% increase in leased lines and network capacities expenses, a 25.0% increase in selling and marketing expenses, a 16.3% increase in depreciation and amortization expenses and a 27.0% increase in interconnection charges were the primary factors in the increase in operating expenses. Due to the rapid expansion of our CDMA business, selling and marketing expenses (which include the amortized portion of deferred customer acquisition costs under special promotional packages with certain CDMA contractual subscribers) and leased lines and network capacities expenses (which include the expenses from the CDMA network leases) increased faster than our operating revenue in 2004. As our various business segments continued to develop, interconnection charges also increased faster than our operating revenue in 2004 since the interconnection rates remain unchanged while our effective tariffs have been declining due to continued price competition. In addition, depreciation and amortization expenses increased primarily due to the expansion of the scale of our fixed assets. Our operating expenses as a percentage of total revenue increased to 90.0% in 2004, as compared with 87.4% in 2003. Since late 2004, we have emphasized the business strategy of effective growth, i.e., profit-driven growth, and will continue to focus on cost control and optimization of our expense structure in order to ensure continued growth in earnings.

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The table below illustrates the major expense items from 2002, 2003 and 2004 and their respective shares of total operating revenue.

	For the year ended December 31,								
	2002			2003			2004		
	RMB in million	% of Total Revenue		RMB in million	% of Total Revenue		RMB in million	% of Total Revenue	
Total Operating Expenses	33,253	82.0%		59,122	87.4%		71,376	90.0%	
Leased lines and network capacities	1,583	3.9%		4,320	6.4%		7,398	9.3%	
Interconnection charges	3,230	8.0%		5,921	8.7%		7,517	9.5%	
Depreciation and amortization	11,256	27.7%		16,385	24.2%		19,063	24.0%	
Personnel	3,335	8.2%		4,575	6.8%		4,526	5.7%	
Selling and marketing	5,981	14.8%		15,157	22.4%		18,945	23.9%	
General, administrative and other expenses	5,632	13.9%		9,112	13.5%		10,448	13.2%	
Include: Impairment loss and assets write-off of the Paging Business	116	0.3%		557	0.8%				
Cost of telecommunications products sold	2,236	5.5%		3,652	5.4%		3,479	4.4%	

*Leased Lines and Network Capacities.* With the significant increase in our CDMA subscribers, the lease expense for CDMA network capacities increased by 87.4%, from RMB3.52 billion in 2003 to RMB6.59 billion in 2004. In addition, the effect of including leased line expenses for transmission lines used by Unicom New World we acquired effective December 31, 2003 also contributed to the increase in our leased line expenses. As result, the aggregate amount of our leased line expenses and network capacity lease expenses increased to RMB7.40 billion, representing an increase of 71.2% from RMB4.32 billion in 2003. Leased lines and network capacities expenses as a percentage of total operating revenue rose from 6.4% in 2003 to 9.3% in 2004.

*Interconnection Charges.* Interconnection charges reached RMB7.52 billion in 2004, representing an increase of 27.0% from 2003, primarily due to the increase in interconnection traffic volume as a result of the development of our GSM and CDMA cellular business and long distance, data and Internet businesses, as well as the effect of including interconnection expenses of Unicom New World, which we acquired effective December 31, 2003. Interconnection charges for our CDMA cellular business increased by 65.9%. Interconnection charges increased by 17.8% for our GSM cellular business. Interconnection charges for long distance, data and Internet business increased by 23.6%. As our various business segments continued to develop, interconnection charges as a percentage of total operating revenue also increased from 8.7% in 2003 to 9.5% in 2004.

*Depreciation and Amortization.* Depreciation and amortization expenses increased by 16.3% to RMB19.06 billion in 2004, a lower growth rate than the growth in operating revenue. The increase in depreciation and amortization expenses resulted from expanded network capacity, the expansion of assets scale and the effect of including depreciation expenses attributable to Unicom New World, which we acquired on December 31, 2003. Depreciation and amortization expenses as a percentage of total operating revenue decreased slightly from 24.2% in 2003 to 24.0% in 2004.



*Personnel.* As of the end of 2004, we had 39,589 employees, an increase of 2.2% from 38,728 at the end of 2003 (including employees in the nine provinces, autonomous regions and municipalities we acquired through Unicom New World at the end of 2003). Our personnel expenses slightly decreased from RMB4.58 billion in 2003 to RMB4.53 billion in 2004. Its share as a percentage of total operating revenue dropped from 6.8% in 2003 to 5.7% in 2004. In order to align the interest of our employees with that of our shareholders, we have set up an employee share option scheme and granted options to qualified employees. During 2004, total share options involving 113,322,000 shares in our company were granted under the share option scheme.

*Selling and Marketing.* Our major selling and marketing expenses included commissions, promotion and advertising expenses and amortization of customer acquisition costs of contractual CDMA subscribers. Selling and marketing expenses totaled RMB18.95 billion in 2004, an increase of 25.0% from 2003. Amortization of CDMA subscribers acquisition costs in 2004 were RMB6.12 billion, an increase of 4.9% from 2003. The balance of unamortized deferred CDMA subscriber acquisition costs increased from RMB4.04 billion as of the end of 2003 to RMB4.75 billion as of the end of 2004 primarily due to continued offering of CDMA handset promotion packages as a result of intense competitive pressure. Due to the continued growth in the subscriber base of our various business segments (including the effect of our acquisition of Unicom New World), the commissions to distributors and sales agents rose to RMB9.91 billion, an increase of 35.9%. Promotion and advertising expenses were RMB2.37 billion, an increase of 16.2%. Selling and marketing expenses as a percentage of operating revenue increased from 22.4% in 2003 to 23.9% in 2004.

*General, Administrative and Other Expenses.* Our general, administrative and other expenses were RMB10.45 billion in 2004, representing an increase of 14.7% from RMB9.11 billion in 2003. General, administrative and other expenses as a percentage of total operating revenue decreased slightly from 13.5% in 2003 to 13.2% in 2004. In 2004, the provision for doubtful debts was RMB2.19 billion, an increase of 25.1% from 2003. Provision for doubtful debts as a percentage of service revenue increased slightly from 2.7% in 2003 to 2.9% in 2004. This has also contributed to the increase in our general, administrative and other expenses.

*Cost of Telecommunications Products Sold.* The cost of telecommunication products sold decreased by 4.7% from RMB3.65 billion in 2003 to RMB3.48 billion in 2004. The share of cost of telecommunications products sold as a percentage of operating revenue decreased from 5.4% in 2003 to 4.4% in 2004.

### *Operating Income*

In 2004, our operating revenue increased by 17.3%, while our operating expenses increased by 20.7%. As a result, our operating income reached RMB7.96 billion, an decrease of 6.6% from 2003, and our operating margin decreased from 12.5% in 2003 to 10.0% in 2004.

*GSM Cellular Business.* In our GSM cellular business, operating income was RMB8.26 billion in 2004, which is a decrease of 5.3% from 2003. The decrease in the operating income of our GSM cellular business mainly reflects the 13% decline in the ARPU for our GSM cellular business, which was partially offset by the 8.8% increase in the average monthly MOU per subscriber. The decrease in ARPU resulted from intense competition with our main competitor as well as the Little Smart services. In addition, while there was a net addition of 20.35 million subscribers to our GSM services in 2004, a sizable number of subscribers terminated their GSM services with us, contributing to significant increase in our marketing cost. Our operating margin in the GSM cellular business decreased from 21.2% in 2003 to 17.4% in 2004.

*CDMA Cellular Business.* We incurred a total operating loss of RMB0.59 billion in 2004 for our CDMA business as compared with the operating loss of RMB0.29 billion in 2003. The increase of operating loss of our CDMA cellular business was primarily due to the 33.6% decrease in ARPU as a result of intense competition, the significant increase in lease expenses for our CDMA network capacities as a result of the growth of our customer base, the continued high level of marketing expenses and the significant increase in interconnection charges. After taking into consideration of the improper accounting recordings and errors we identified in our Jiangxi and Xinjiang branches as described in Item 15 Controls and procedures, the operating losses of our CDMA business for 2004 and 2003 would have been RMB0.45 billion and RMB0.42 billion, respectively.

*Long Distance Business.* In our long distance business, operating income decreased 24.4%, from RMB0.70 billion in 2003 to RMB0.53 billion in 2004, primarily because of reduced tariff level as a result of increased competition and a reduction in the interconnection revenue after we acquired Unicom New World in December 2003. As a result, the operating margin in our long distance business decreased from 22.2% in 2003 to 17.0% in 2004.

*Data and Internet Business.* In our data and Internet businesses, we had an operating loss of RMB0.06 billion in 2004, compared with an operating income of RMB0.75 billion in 2003. This change primarily resulted from significantly higher sales cost associated with the promotion of new products such as Uni-Video than in 2003.

***Net Income***



*Financial Income and Expenses.* Our financial income decreased from RMB0.17 billion in 2003 to RMB0.10 billion in 2004, mainly due to a decline in interest income resulting from a reduction in our cash and overall reduced applicable interest rates. Our financial expenses decreased from RMB1.94 billion in 2003 to RMB1.69 billion in 2004, primarily due to overall reduced applicable interest rates. The above factors resulted in a net financial expense of RMB1.59 billion in 2004, a decrease of 10.1% from the net financial expense of RMB1.76 billion in 2003.

*Income Tax.* Our income tax increased to RMB2.08 billion in 2004, an increase of 10.1% from 2003. Our effective tax rates in 2003 and 2004 were 31.0% and 32.2%, respectively. The higher effective tax rate in 2004, as compared with 2003, was mainly due to the fact that a large percentage of our gross income in 2004 was generated in areas that have higher tax rates than the rest of our service areas.

*Net Income.* For reasons analyzed in the above discussion, our net income was RMB4.39 billion in 2004, representing an increase of 4.0% from 2003. Earnings per share increased 3.9%, from RMB0.336 in 2003 to RMB0.349 in 2004.

***Impact of Differences between HK GAAP and US GAAP***

In addition to the above management discussion and analysis of our results of the operation under HK GAAP between the years ended December 31, 2004 and 2003, in connection with the preparation and reconciliation of our consolidated financial statements in accordance with US GAAP, we believe the following significant accounting differences between HK GAAP and US GAAP would have a significant impact on our management discussion and analysis of the results of our operation between the years ended December 31, 2004 and 2003 under US GAAP. See also Note 40 to the consolidated financial statements for a more detailed summary of all significant accounting differences between HK GAAP and US GAAP that are relevant to us.

Under HK GAAP, the acquisitions of Unicom International in September 2004 and of Unicom New World on December 31, 2003 have been accounted for under the purchase method. Accordingly, the acquired results of operations have been incorporated into our operating results only from the date of the acquisition. In contrast, under US GAAP, our acquisitions of Unicom International and Unicom New World have been accounted for as a transfer of businesses under common control. Under this method, the acquired assets and liabilities have been accounted for at historical cost under US GAAP and the consolidated financial statements prepared under US GAAP for all periods presented have been retroactively restated as if Unicom International and Unicom New World had always been part of our company.

Under HK GAAP, the sale of Guoxin Paging to the Unicom Group is accounted for as a sale of discontinued operation. The difference between the sale proceeds and the carrying amount of net assets of Guoxin Paging as of December 31, 2003 was recorded as a loss on sale of discontinued operation in our consolidated income statement for the year ended December 31, 2003. The operating results of Guoxin Paging from January 1, 2003 to the effective date of the sale of Guoxin Paging were included in our consolidated income statement for the year ended December 31, 2003. Under US GAAP, the sale of Guoxin Paging is considered a transfer of business between entities under common control and accounted for at historical cost of the net assets transferred, after reduction, if appropriate, for an indicated impairment of value. In addition, under US GAAP, the results of operations of a component or segment of an entity that has been disposed of should be reported in discontinued operations as a separate component of income, separately from continuing operations, in the period in which the disposal occurred and in prior periods. Accordingly, all the operating results of Guoxin Paging have been grouped into and reported in the income statement as Discontinued operation Loss from discontinued operation under US GAAP.

In addition, under HK GAAP, we recognized upfront non-refundable revenue, such as connection fee, when received upon completion of activation services. Under US GAAP, this upfront non-refundable revenue and the related direct incremental costs incurred are deferred and recognized over the estimated customer service periods.

Other than the above, there are no major material differences between HK GAAP and US GAAP that would have a significant impact on the discussion and analysis of our results of operations between the years ended December 31, 2004 and 2003. Taking into account the operating results of the acquired business and the disposed business, our combined operating revenue under US GAAP increased from RMB71.98 billion in 2003, to RMB79.39 billion in 2004, representing an increase of 10.3%. Our net income under US GAAP decreased from RMB4.74 billion in 2003 to RMB4.71 billion in 2004, representing a decrease of 0.5%.

#### **Year Ended December 31, 2003 Compared to Year Ended December 31, 2002**

Our results of operations in 2003 were materially affected by our acquisition of Unicom New Century effective December 31, 2002. In particular, our operating revenue and operating expenses increased significantly in 2003. This was primarily due to the inclusion of the results of operations of Unicom New Century. By comparison, our results in 2002 did not include the results of operations of Unicom New Century. As result, our results of operations in 2003 are not directly comparable with those in prior years. See – Acquisitions of Unicom New Century, Unicom New World and Unicom International and the Sale of Guoxin Paging above. See also A. The History and Development of the Company – Restructuring and Acquisition of Unicom New Century under Item 4 above.

In 2003, our operating revenue continued to increase, by 66.7% from RMB40.58 billion in 2002 to RMB67.64 billion in 2003. This growth was principally due to the strong growth of our CDMA cellular business and continued growth of our GSM cellular business, as well as the inclusion of revenue attributable to Unicom New Century, which we acquired effective December 31, 2002. Our cellular businesses continued to increase in their percentage contribution to our overall business. Our long distance, data and Internet businesses also continued to grow in terms of operating revenues and in their contribution to our business.

Due to factors discussed below, in 2003 our operating expenses grew 77.8%. As a result, our operating income increased by 16.3% to RMB8.51 billion, while our operating margin decreased to 12.6%, as compared with 18.0% in 2002. Operating margin in our GSM cellular business decreased from 27.2% in 2002 to 21.2% in 2003. Our CDMA business continued to grow during the year. In our long distance business, operating income decreased 31.6% in 2003 and operating margin, at 30.6% in 2003, decreased from 36.8% in 2002. In our data and Internet businesses, operating income increased by 95.3% over 2002. Our traditional paging business continued to decline, and despite our focus on cost reduction and development of new value-added paging services, it still experienced an operating loss in 2003.

Our net income in 2003 decreased by 8.3% to RMB4.22 billion, for reasons discussed below.

#### ***Operating Revenue***



Operating revenue from our GSM cellular business grew steadily in 2003 and continued to be the major force behind our total operating revenue growth, contributing almost half of such growth in 2003, while operating revenue from our CDMA cellular business grew rapidly in 2003, significantly increasing its share of our total operating revenue for the year. Our CDMA cellular business, introduced in January 2002, reached RMB18.58 billion in operating revenue in 2003, contributing 55.2% of our total operating revenue growth in that year. Operating revenues from our GSM and CDMA cellular businesses represented 88.4% of our total operating revenue in 2003, as compared with 78.3% in 2002. The growth of the CDMA cellular business can be seen in its share of our total operating revenue, which increased from 9.0% in 2002 to 27.5% in 2003, while the share of operating revenue from the GSM cellular business in our total operating revenue decreased from 69.3% in 2002 to 60.9% in 2003. Operating revenues from our long distance and data and Internet businesses increased steadily, contributing 0.5% of our total operating revenue growth in 2003. Operating revenues from our long distance business and our data and Internet businesses represented 3.3% and 5.1%, respectively, of our total operating revenue in 2003, as compared with 6.8% and 6.9%, respectively, in 2002. The growth in our total operating revenue, however, was partially offset by the continued significant decline in operating revenue from our paging business, which also declined as a percentage of our total operating revenue from 8.0% in 2002 to 3.2% in 2003.

*Cellular Revenue*





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For the reasons discussed below, operating revenues from our GSM and CDMA cellular businesses (including revenues from sales of telecommunications products) together increased by 88.1%, from RMB31.76 billion in 2002 to RMB59.75 billion in 2003.

*GSM Cellular Business* Operating revenue from our GSM cellular business increased by 46.5%, from RMB28.11 billion in 2002 to RMB41.17 billion in 2003, primarily due to the continued increase in the total number of our total GSM cellular subscribers as a result of organic subscriber growth and the effect of our acquisition of Unicom New Century. As a result of continuing cellular penetration expansion, an increase in the proportion of low-usage subscribers among new subscribers, an increased number of pre-paid subscribers, and increasing market competition negatively affecting effective pricing, ARPU from this business declined 15.8%, from RMB67.3 in 2002 to RMB56.7 in 2003. Post-paid ARPU decreased by 19.5%, from RMB82.2 in 2002 to RMB66.2 in 2003, while pre-paid ARPU decreased by 15.0%, from RMB54.1 in 2002 to RMB46.0 in 2003. The average MOU per subscriber per month increased 5.0%, from 165.5 minutes in 2002 to 173.7 minutes in 2003. The foregoing operational statistics do not include the effects of the acquisition of Unicom New World.

Revenue from pre-paid GSM cellular service was RMB15.33 billion in 2003, a 52.1% increase from RMB10.08 billion in 2002. Revenue from pre-paid services accounted for 37.2% of the service revenue from our GSM cellular business in 2003, an increase from 35.9% of the total service revenue from the GSM cellular business in 2002. Pre-paid subscribers accounted for 73.8% of our new customers in 2003, compared to 81.1% in 2002 primarily due to the lower percentage of pre-paid subscribers of Unicom New Century, which was acquired by us on December 31, 2002, compared to the percentage of our pre-paid subscribers before the acquisition.

The table below sets forth the revenue composition of our GSM cellular business and each revenue item's respective share of total GSM operating revenue in the years ended December 31, 2001, 2002 and 2003.

	2001			2002			2003		
	RMB in million		As percentage of total	RMB in million		As percentage of total	RMB in million		As percentage of total
Operating Revenue	21,326		100.0%	28,109		100.0%	41,166		100.0%
Service Revenue	20,505		96.2%	27,388		97.4%	40,303		97.9%
Usage Fee	14,938		70.0%	20,275		72.1%	29,072		70.6%
Monthly Fee	3,660		17.2%	4,169		14.8%	7,042		17.1%
Connection fee	205		1.0%						
Interconnection Revenue	1,262		5.9%	1,710		6.1%	1,927		4.7%
Others	440		2.1%	1,234		4.4%	2,262		5.5%
Sales of Telecommunications Products	821		3.8%	721		2.6%	863		2.1%

Due to the growth in total usage of our GSM cellular services (including the effects of our acquisition of Unicom New Century) and the increasing proportion of pre-paid cellular subscribers (who do not pay monthly fees), usage fees for GSM cellular services increased by 43.3% from RMB20.28 billion in 2002 to RMB29.07 billion in 2003, and represented 72.1% of total GSM service revenue as compared with 74.0% in 2002. For the same reasons, monthly fees increased by 68.9%, from RMB4.17 billion in 2002 to RMB7.04 billion in 2003, and represented 17.5% of total GSM service revenue as compared with 15.2% in 2002. Interconnection revenue increased by 12.9% from RMB1.71 billion in 2002 to RMB1.93 billion in 2003, and represented 4.8% of total service revenue as compared with 6.2% in 2002.



While continuing to meet the diverse needs of our customers in the mass market, our GSM cellular business aims to actively pursue mid- to high-end customers through the development and promotion of value-added services. Revenue from our GSM value-added cellular services increased 146.4%, from RMB0.84 billion in 2002 to RMB2.07 billion in 2003. Its share of total GSM service revenue increased from 3.1% in 2002 to 5.0% in 2003. Of the total revenue from GSM value-added cellular services, revenue from short messaging services increased 197.8% from RMB0.46 billion in 2002 to RMB1.37 billion in 2003, and its share of total GSM service revenue grew from 1.7% in 2002 to 3.4% in 2003. Revenue from value-added services contributed significantly to the increase of our total GSM cellular revenue.

*CDMA Cellular Business.* We began to provide CDMA cellular services on a trial basis on January 8, 2002. Since then, our CDMA subscriber base has expanded rapidly as the market became more familiar with our CDMA services. In 2003, the growth in our CDMA subscriber base greatly boosted revenue from the CDMA cellular business. Operating revenue from our CDMA cellular business reached RMB18.58 billion in 2003, a 409.3% increase over RMB3.65 billion in 2002. This increase was primarily due to the rapid expansion of our CDMA cellular business as well as the effect of including revenue attributable to Unicom New Century, which we acquired effective December 31, 2002. Our CDMA marketing strategy, which seeks to differentiate our CDMA services from our GSM services, has resulted in a rapid increase in the CDMA subscriber base, while successfully positioning the CDMA business in the marketplace as enterprise, infotainment, health-conscious and trendy services. ARPU for our CDMA cellular business reached RMB128.4 in 2003, RMB62.2 higher than the ARPU of RMB66.2 for GSM post-paid cellular services.

The table below sets forth the revenue composition of our CDMA cellular business and each revenue item's respective share of total CDMA operating revenue for the years ended December 31, 2002 and 2003.

	2002		2003	
	RMB in million	As percentage of total	RMB in million	As percentage of total
Operating Revenue	3,648	100.0%	18,580	100.0%
Service Revenue	3,225	88.4%	16,624	89.5%
Usage Fee	2,231	61.2%	11,672	62.8%
Monthly Fee	713	19.5%	3,488	18.8%
Interconnection Revenue	184	5.0%	608	3.3%
Others	97	2.7%	856	4.6%
Sales of Telecommunications Products	423	11.6%	1,956	10.5%

CDMA usage fees increased by 423.3% from RMB2.23 billion in 2002 to RMB11.67 billion in 2003, and represented 70.2% of total CDMA service revenue as compared with 69.2% in 2002. Monthly fees increased by 391.5%, from RMB0.71 billion in 2002 to RMB3.49 billion in 2003, and represented 21.0% of total CDMA service revenue as compared with 22.1% in 2002. Interconnection revenue increased by 238.9% from RMB0.18 billion in 2002 to RMB0.61 billion in 2003, and represented 3.7% of total service revenue as compared with 5.7% in 2002.

With the introduction of our CDMA 1X wireless data services in March 2003, we are also actively developing our CDMA wireless data business, by making efforts to convert the competitive edge of the CDMA technology into a competitive edge in operations in order to enhance competitiveness in the market and our appeal to subscribers. Revenue from value-added CDMA cellular services reached RMB0.78 billion in 2003, an increase of 875.0% from RMB0.08 billion in 2002, and accounted for 4.7% of total service revenue from the CDMA cellular business, an increase of 2.2% from 2002.



*Long Distance and Data and Internet Revenue*



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Operating revenue from our long distance and data and Internet businesses reached RMB5.73 billion, an increase of 2.8% from 2002.

*Long Distance Business.* Operating revenue from our traditional public switched long distance business decreased by 17.7%, from 2002 to RMB2.29 billion in 2003. Such decrease was primarily due to the decrease in interconnection revenue from Unicom New Century caused by our acquisition of Unicom New Century.

*Data and Internet Business.* We fully leveraged the technological advantage of our multi-businesses integrated network platform. Along with effectively expanding international and domestic call volume for IP telephony services, we targeted business subscribers and corporate subscribers in promoting services with distinctive features such as UNI-VIDEO, and we also targeted the mass market in promoting new services, such as Ruyi Mailbox. At the same time, we continued to develop integrated data, voice and video connection services, and dedicated and dial-up connection services. As a result of those efforts, revenue from our data and Internet businesses rose by 23.1% from 2002 to RMB3.44 billion in 2003.

### *Paging Revenue*

In 2003, revenue from our paging business (including revenues from sales of telecommunications products) was RMB2.16 billion. Paging service revenue (i.e., excluding sales of paging-related telecommunications products) fell by 35.1% to RMB1.40 billion in 2003. This decline is due to the continued decline in the traditional paging business. Revenue from value-added and other services of the paging business reached RMB0.79 billion and accounted for 56.2% of the service revenue from the paging business. We disposed of our paging business, effective December 31, 2003.

### *Operating Expenses*





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Operating expenses in 2003 were RMB59.12 billion, representing an increase of 77.8%, which was greater than the 66.7% growth in operating revenue for the same period. As discussed below, a 172.9% increase in leased lines and network capacities expenses, a 153.4% increase in selling and marketing expenses and a 83.3% increase in the interconnection charges were the primary factors in the increase in operating expenses. Due to the launch of our CDMA business, selling and marketing expenses (which included the amortized portion of deferred customer acquisition costs under special promotional packages with certain CDMA contractual subscribers) and leased lines and network capacities expenses (which included the expenses from the CDMA network leases) increased faster than our operating revenue in 2003. In addition, as our various business segments continued to develop, interconnection charges also increased faster than our operating revenue in 2003 since the interconnection rates remain unchanged while our effective tariffs have been declining due to continued price competition. Our operating expenses as a percentage of total revenue increased to 87.4% in 2003, as compared with 82.0% in 2002.

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The table below illustrates the major expense items from 2001, 2002 and 2003 and their respective shares of total operating revenue.

	For the year ended December 31,									
	2001			2002			2003			
	RMB in million		% of Total Revenue	RMB in million		% of Total Revenue	RMB in million		% of Total Revenue	
Total Operating Expenses	24,129		82.1%	33,253		82.0%	59,122		87.4%	
Leased lines and network capacities	853		2.9%	1,583		3.9%	4,320		6.4%	
Interconnection charges	2,073		7.1%	3,230		8.0%	5,921		8.7%	
Depreciation and amortization	8,262		28.1%	11,256		27.7%	16,385		24.2%	
Personnel	2,487		8.5%	3,335		8.2%	4,575		6.8%	
Selling and marketing	3,613		12.2%	5,981		14.8%	15,157		22.4%	
General, administrative and other expenses	5,499		18.7%	5,632		13.9%	9,112		13.5%	
Include: Impairment loss and assets write-off of the Paging Business	665		2.3%	116		0.3%	557		0.8%	
Cost of telecommunications products sold	1,342		4.6%	2,236		5.5%	3,652		5.4%	

*Leased Lines and Network Capacities.* With the significant increase in our CDMA subscribers, the lease expense for CDMA network capacities increased 295.5%, from RMB0.89 billion in 2002 to RMB3.52 billion in 2003. In addition, the effect of including leased line expenses for transmission lines used by Unicom New Century we acquired effective December 31, 2002 also contributed to the increase in our leased line expenses. As a result, the aggregate amount of our leased line expenses and network capacity lease expenses increased to RMB4.32 billion, representing an increase of 173.4% from 2002. Leased lines and network capacities expenses as a percentage of total operating revenue rose from 3.9% to 6.4% in 2003.

*Interconnection Charges.* Interconnection charges reached RMB5.92 billion in 2003, representing an increase of 83.3% from 2002, primarily due to the increase in interconnection traffic volume as a result of the development of our GSM and CDMA cellular business and long distance business, as well as the effect of including interconnection expenses of Unicom New Century, which we acquired effective December 31, 2002. Interconnection charges for our CDMA cellular business increased by 502.9%. Interconnection charges increased by 61.8% for our GSM cellular business. Interconnection charges for long distance, data and Internet business increased by 54.0%. As our various business segments continued to develop, interconnection charges as a percentage of total operating revenue also increased from 8.0% in 2002 to 8.7% in 2003.

*Depreciation and Amortization.* Depreciation and amortization expenses increased 45.6% to RMB16.39 billion in 2003, a lower growth rate than the growth in operating revenue. The increase in depreciation and amortization expenses resulted from expanded network capacity, primarily in connection with the development of the GSM cellular business, the expansion of assets scale, and the effect of including depreciation expenses attributable to Unicom New Century, which we acquired on December 31, 2002. Depreciation and amortization expenses as a percentage of total operating revenue decreased from 27.7% in 2002 to 24.2% in 2003.



*Personnel.* As of the end of 2003, we had 38,728 employees, an increase of 32.0% from 29,332 at the end of 2002 (excluding employees in the nine provinces, autonomous regions and municipalities we acquired through Unicom New Century at the end of 2002). This increase was primarily due to the effect of including employees of Unicom New Century, which we acquired on December 31, 2002. Our personnel expenses were RMB4.57 billion in 2003, its share as a percentage of total operating revenue dropping from 8.2% in 2002 to 6.8% in 2003. In order to align the interest of our employees with that of our shareholders, we have set up an employee share option scheme and granted options to qualified employees. During 2003, total share options involving 105,956,000 shares in our company were granted under the share option scheme.

*Selling and Marketing.* Our major selling and marketing expenses included commissions, promotion and advertising expenses and amortization of customer acquisition costs of contractual CDMA subscribers. Selling and marketing expenses totaled RMB15.16 billion in 2003, an increase of 153.4% from 2002. Amortization of CDMA subscribers acquisition costs in 2003 were RMB5.84 billion, an increase of 320.1% from 2002. The balance of unamortized deferred CDMA subscriber acquisition costs fell from RMB5.99 billion as of the end of 2002 to RMB4.04 billion as of the end of 2003. Due to the continued growth in the subscriber base of our various business segments (including the effect of our acquisition of Unicom New Century), the commissions to distributors and sales agents rose to RMB7.29 billion, an increase of 99.2%. Promotion and advertising expenses were RMB2.04 billion, an increase of 108.2%. Selling and marketing expenses as a percentage of operating revenue increased from 14.8% in 2002 to 22.4% in 2003.

*General, Administrative and Other Expenses.* Our general, administrative and other expenses were RMB9.11 billion in 2003, which includes an impairment loss and assets write-off of the paging business in the amount of RMB0.56 billion. Total expenses in this category increased by 61.8% from 2002. Excluding the impairment loss and assets write-off of the paging business, total expenses for this category increased by 51.9% from 2002. General, administrative and other expenses as a percentage of total operating revenue decreased from 13.9% in 2002 to 13.5% in 2003. In 2003, the provision for doubtful debts was RMB1.75 billion, an increase of 80.4% from 2002. Provision for doubtful debts as a percentage of service revenue increased slightly from 2.5% in 2002 to 2.7% in 2003. This also gave rise to an increase in our general, administrative and other expenses.

*Cost of Telecommunications Products Sold.* The cost of telecommunication products sold increased to RMB3.65 billion in 2003, an increase of 62.9% from RMB2.24 billion in 2002. The share of cost of telecommunications products sold as a percentage of operating revenue decreased from 5.5% in 2002 to 5.4% in 2003.

### ***Operating Income***



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In 2003, our operating revenue increased by 66.7%, while our operating expenses increased by 77.8%. As a result, our operating income reached RMB8.51 billion, an increase of only 16.3% from 2002 and our operating margin only decreased from 18.0% in 2002 to 12.6% in 2003.

*GSM Cellular Business.* In our GSM cellular business, operating income reached RMB8.72 billion in 2003, which was an increase of 14.2% from 2002. The growth in the operating income of our GSM cellular business was slower than the overall increase in our operating income, mainly reflecting the 15.8% decline in the ARPU for our GSM cellular business. Our operating margin in the GSM cellular business decreased from 27.2% in 2002 to 21.2% in 2003.

*CDMA Cellular Business.* We incurred a total operating loss of RMB0.29 billion in 2003 for our CDMA business as compared with the operating loss of RMB0.99 billion in 2002 reflecting improvement in performance as a result of continued subscriber growth of our CDMA business which commenced operation since January 2002. After taking into consideration of the improper accounting recordings and errors we identified in our Jiangxi and Xinjiang branches as described in Item 15 Controls and procedures, the operating losses of our CDMA business for 2003 and 2002 would have been RMB0.42 billion and RMB1.00 billion, respectively.

*Long Distance Business.* In our long distance business, operating income decreased 31.4%, from RMB1.02 billion in 2002 to RMB0.70 billion in 2003, primarily because of a reduction in the interconnection revenue after we acquired Unicom New Century in December 2002. As a result, the operating margin in our long distance business, at 22.2% in 2003, decreased from 29.5% in 2002.

*Data and Internet Business.* In our data and Internet businesses, we had an operating income of RMB0.75 billion in 2003, a 97.4% increase from 2002. This resulted from the continued rapid growth in operating revenues in this business, together with our successful efforts to centralize operating expenses, which grew 56.9%.

*Paging Business.* As our traditional paging business continued to decline, our operating losses from our paging business grew from RMB0.62 billion in 2002 to RMB1.20 billion in 2003.

***Net Income***





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*Loss on Sale of Discontinued Operation (Guoxin Paging).* The sale of Guoxin Paging to Unicom Group in 2003 resulted in a disposal loss in the amount of RMB0.66 billion.

*Financial Income and Expenses.* Our financial income decreased from RMB0.47 billion in 2002 to RMB0.17 billion in 2003, mainly due to a decline in interest income resulting from a reduction in our cash and overall reduced applicable interest rates. Our financial expenses increased from RMB1.47 billion in 2002 to RMB1.93 billion in 2003, primarily due to the acquisition of Unicom New Century. The above factors resulted in a net financial expense of RMB1.76 billion in 2003, an increase of 76% from the net financial expense of RMB1.0 billion in 2002.

*Income Tax.* Our income tax increased from to RMB1.89 billion in 2003, an increase of 9.8% from 2002. Our effective tax rates in 2002 and 2003 were 27.3% and 31.0%, respectively. The higher effective tax rate in 2003, as compared with 2002, was mainly due to the investment tax credits we received in 2002 in connection with the acquisition of certain domestic equipments.

*Net Income.* For reasons analyzed in the above discussion, our net income fell to RMB4.22 billion in 2003. Excluding the RMB0.56 billion in impairment loss and assets write-off of the paging business and the RMB0.66 billion loss on the sale of Guoxin Paging, our net income would have been RMB5.08 billion, representing an increase of 10.5% from 2002. Earnings per share decreased 7.7%, from RMB0.366 in 2002 to RMB0.336 in 2003.

*Impact of Differences between HK GAAP and US GAAP*



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In addition to the above management discussion and analysis of our results of the operation under HK GAAP between the years ended December 31, 2003 and 2002, in connection with the preparation and reconciliation of our consolidated financial statements in accordance with US GAAP, we believe the following significant accounting differences between HK GAAP and US GAAP would have a significant impact on our management discussion and analysis of the results of our operation between the years ended December 31, 2003 and 2002 under US GAAP. See also Note 40 to the consolidated financial statements for a more detailed summary of all significant accounting differences between HK GAAP and US GAAP that are relevant to us.

Under HK GAAP, the acquisition of Unicom New World on December 31, 2003 has been accounted for under the purchase method. Accordingly, the acquired results of operations have been incorporated into our operating results only from the date of the acquisition. In contrast, under US GAAP, our acquisition of Unicom New World has been accounted for as a transfer of businesses under common control. Under this method, the acquired assets and liabilities have been accounted for at historical cost under US GAAP and the consolidated financial statements prepared under US GAAP for all periods presented have been retroactively restated as if Unicom New World had always been part of our company.

Under HK GAAP, the sale of Guoxin Paging to the Unicom Group is accounted for as a sale of discontinued operation. The difference between the sale proceeds and the carrying amount of net assets of Guoxin Paging as of December 31, 2003 was recorded as a loss on sale of discontinued operation in our consolidated income statement for the year ended December 31, 2003. The operating results of Guoxin Paging from January 1, 2003 to the effective date of the sale of Guoxin Paging were included in our consolidated income statement for the year ended December 31, 2003. Under US GAAP, the sale of Guoxin Paging is considered a transfer of business between entities under common control and accounted for at historical cost of the net assets transferred, after reduction, if appropriate, for an indicated impairment of value. In addition, under US GAAP, the results of operations of a component or segment of an entity that has been disposed of should be reported in discontinued operations as a separate component of income, separately from continuing operations, in the period in which the disposal occurred and in prior periods. Accordingly, all the operating results of Guoxin Paging have been grouped into and reported in the income statement as Discontinued operation Loss from discontinued operation under US GAAP.

In addition, under HK GAAP, we recognized upfront non-refundable revenue, such as connection fee, when received upon completion of activation services. Under US GAAP, this upfront non-refundable revenue and the related direct incremental costs incurred are deferred and recognized over the estimated customer service periods.

Other than the above, there are no major material differences between HK GAAP and US GAAP that would have a significant impact on the discussion and analysis of our results of operations between the years ended December 31, 2003 and 2002. Taking into account the operating results of the acquired business and the disposed business, our combined operating revenue under US GAAP increased from RMB50.42 billion in 2002, to RMB71.98 billion in 2003, representing an increase of 42.8%. Our net income under US GAAP decreased from RMB5.04 billion in 2002 to RMB4.74 billion in 2003, representing a decrease of 6.0%.

*Liquidity and Capital Resources*

*Working Capital and Cash Flows*



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As of the end of 2004, we had RMB4.66 billion of cash and cash equivalents and RMB0.66 billion of short-term bank deposits. As of the end of 2004, we had negative working capital (current assets minus current liabilities) of RMB28.27 billion, compared to negative working capital of RMB21.66 billion at the end of 2003. The decrease in working capital resulted primarily from (i) the increase in short-term bank loans to replace long-term bank loans; (ii) the cash payment for the acquisitions of Unicom International and Unicom New World; and (iii) increased indebtedness as a result of the indebtedness of the newly-acquired Unicom International and Unicom New World. We believe that we will have access to financing, in particular bank financing in the PRC and elsewhere, which together with net cash inflows from operations will be sufficient to fund our capital and liquidity needs.

The following table sets forth cash inflows and outflows in 2002, 2003 and 2004.

	2002	For the year ended December 31, 2003 (RMB in millions)	2004
Net cash inflows from operating activities	13,054	22,565	23,819
Net cash outflows from investing activities	(5,166)	(19,051)	(18,958)
Net cash (outflows) inflows before financing activities	7,888	3,514	4,861
Net cash inflows (outflows) from financing activities	(11,868)	(8,778)	(9,401)
Net decrease in cash and cash equivalents	(3,980)	(5,264)	(4,540)

Net cash inflows from operating activities increased by 5.6%, from RMB22.57 billion in 2003 to RMB23.82 billion, mainly reflecting the growth in our business and reduction in our capital expenditure.

Net cash outflows from investing activities were RMB18.96 billion in 2004, compared to RMB19.05 billion in 2003. This decrease in net cash outflows from investing activities in 2004 primarily resulted from our effort to control capital investment and reduce investment cost.

Net cash outflows from financing activities were RMB9.40 billion in 2004, an increase of 7.1% from the outflow of RMB8.78 billion in 2003, resulting primarily from an increase in repayment of short-term bank loans, from RMB10.28 billion in 2003 to RMB12.27 billion in 2004, partially offset by a decrease in repayment of long-term loans, from RMB18.50 billion in 2003 to RMB17.25 billion in 2004 as we attempted to further optimize our debt structure.



*Indebtedness and Capital Structure*

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The following table sets forth the amount of cash, assets, short-term and long-term debt, equity as well as debt-to-assets and debt-to-equity ratios as of the end of 2002, 2003 and 2004.

	As of December 31,		
	2002	2003	2004
	(RMB in millions, except percentages)		
Cash and cash equivalent and short-term bank deposits	19,259	10,133	5,317
Total assets	149,628	149,838	145,629
Short-term debt	15,330	18,173	20,015
Long-term debt	37,686	36,213	26,137
Minority interests	566		
Shareholders' equity	66,653	69,615	72,810
Debt-to-assets ratio <sup>(1)</sup>	44.6%	43.9%	38.8%
Debt-to-equity ratio <sup>(2)</sup>	80.4%	78.1%	63.4%

(1) Debt-to-assets ratio = (long term debt + short term interest bearing debt + minority interests)/(long term debt + short term interest bearing debt + minority interests + shareholders' equity).

(2) Debt-to-equity ratio = (long term debt + short term interest bearing debt + minority interests)/shareholders' equity.

Our debt-to-assets ratio decreased from 43.9% at the end of 2003 to 38.8% at the end of 2004. Our debt-to-equity ratio decreased from 78.1% at the end of 2003 to 63.4% at the end of 2004. The sum of our long-term and short-term interest bearing debt exceeded the amount of our cash and cash equivalents and short-term bank deposits by RMB40.83 billion as of December 31, 2004. We continue to seek to optimize our capital structure, develop multiple financing sources and reduce overall financing costs.

Outstanding short-term and long-term bank loans, denominated in RMB or the U.S. dollar, decreased from RMB54.39 billion at the end of 2003 to RMB46.15 billion at the end of 2004 reflecting our effort to optimize our debt structure by paying off bank loans that have become due. Our long-term bank loans generally bear floating interest rates that ranged from US\$ LIBOR plus 0.28% to 0.44% per annum in 2004 with maturity through 2010. The loan agreements do not include financial performance or other covenants which materially restrict our operations or those of CUCL or Unicom New World, our principal operating subsidiaries in China. As of December 31, 2004, short-term bank loans of approximately RMB3.40 billion and long-term bank loans of approximately RMB6.78 billion were guaranteed by Unicom Group.

In September 2003 we entered into a US\$700 million term loan facility with 13 financial institutions, which is consisted of three tranches: a three-year US\$200 million tranche, with an interest rate of 0.28% over the US\$ LIBOR per annum, a five-year US\$300 million tranche, with an interest rate of 0.35% over the US\$ LIBOR per annum, and a seven-year US\$200 million tranche, with an interest rate of 0.44% over the US\$ LIBOR per annum.

In February 2004, our operating entity, CUCL, entered into a US\$500 million term loan facility with 12 financial institutions, which is repayable in three years at an interest rate of 0.40% over the US\$ LIBOR per annum.



*Contractual Obligations and Commercial Commitments*



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The following tables set forth the amount of our outstanding contractual cash obligations as of December 31, 2004.

	Payments Due by Period (RMB in millions)						Due after 2008
	Total	Due in 2004	Due in 2005	Due in 2006	Due in 2007	Due in 2008	
<b>Contractual Obligations</b>							
Long-term bank Loans <sup>(1)</sup>	37,223	11,086	10,227	10,439	2,639	1,014	1,818
Finance lease obligations <sup>(2)</sup>	1,427	938	359	48	7	6	69
Capital Commitments <sup>(3)</sup>	6,537	6,537					
Operating Leases <sup>(3)(4)</sup>	9,663	6,681	622	507	390	396	1,068
Other Commitments <sup>(3)(5)</sup>	1,968	1,968					
<b>Total obligations</b>	<b>56,818</b>	<b>27,210</b>	<b>11,208</b>	<b>10,994</b>	<b>3,036</b>	<b>1,416</b>	<b>2,955</b>

(1) See consolidated financial statements, Note 27 Long-term Bank Loans .

(2) See consolidated financial statements, Note 28 Obligations Under Finance Leases .

(3) See consolidated financial statements, Note 36 Contingencies and Commitments .

(4) The operating leases commitment as disclosed above include the CDMA network capacity leasing arrangement entered into with Unicom Group and its subsidiary Unicom Horizon by our wholly-owned subsidiaries, CUCL (including Unicom New Century, which was merged into CUCL on July 20, 2004) and Unicom New World, in our cellular service areas. See Critical Accounting Policies Lease of CDMA Network Capacity under Item 5; B. Business Overview Cellular Services CDMA Cellular Services- Our Lease of CDMA Networks from Unicom Group under Item 4, B. Related Party Transactions Leasing of CDMA Network Capacity under Item 7 and Note 36(b) Contingencies and Commitments Operating Lease Commitment to the consolidated financial statements for details.

(5) Other commitments represented our commitment to purchase CDMA handsets from vendors. See Note 36(c) Contingencies and Commitments Commitment to purchase CDMA handsets to the consolidated financial statements for details.

**Off-balance Sheet Arrangements**



As of December 31, 2004, we did not have any off-balance sheet arrangements.

*Capital Expenditures*





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The following table sets forth our historical and planned capital expenditure requirements for the periods indicated. Actual future capital expenditures may differ from the amounts indicated below.

	For the years ended December 31,		
	2003	2004	2005
	(RMB in billions)		
Cellular <sup>(1)</sup>	8.91	6.40	7.59
Long distance, data and Internet	2.13	1.34	1.22
Transmission network <sup>(2)</sup>	4.55	3.06	3.05
Paging <sup>(3)</sup>	0.04	-	
Others <sup>(4)</sup>	4.13	7.59	6.37
<b>Total</b>	<b>19.76</b>	<b>18.39</b>	<b>18.23</b>

(1) The capital expenditures for 2003 reflect capital expenditures for our cellular business in 21 provinces, municipalities and autonomous regions; and capital expenditures for 2004 onwards represent 30 provinces, municipalities and autonomous regions, including the 9 provinces and autonomous regions which we acquired at the end of 2003.

(2) Expenditures on transmission network refers to investment in the inter-province and intra-province backbone transmission network, the local network and the access network.

- (3) We sold the paging business to Unicom Group on December 31, 2003.
  
- (4) Other expenditures represent investment in telecom equipment buildings, supporting systems and miscellaneous items.

Capital expenditures in 2004 totaled RMB18.39 billion. Capital expenditures attributable to the GSM cellular business, the long distance, data and Internet businesses, the transmission network and other projects were RMB6.40 billion, RMB1.34 billion, RMB3.06 billion, and RMB7.59 billion, respectively. Expenditures for other projects were mainly related to the set-up of the billing, customer service and information system, office building, construction of integrated access network and miscellaneous purchases.

Projected capital expenditures for 2005 is RMB18.23 billion, which will be used mostly for improving the GSM network and constructing network infrastructure.

We expect to primarily fund our capital expenditure needs with cash generated from operating activities. See **D. Risk Factors - Risks Relating to Our Business** Our inability to fund our capital expenditure requirements may adversely affect our growth and profitability under Item 3.

#### **US GAAP Reconciliation**



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Our consolidated financial statements are prepared in accordance with HK GAAP, which differs in certain material respects from US GAAP. Significant differences relate primarily to the effect of the acquisitions of Unicom New Century, Unicom New World and Unicom International and the sale of Guoxin Paging, treatments of the upfront non-refundable revenue and the related direct incremental costs, employees' housing benefits, revaluation of properties performed in connection with the reorganization, impairment of long-lived assets and goodwill, and additional disclosure requirements for share options scheme and measurement of costs in investment in equity securities. Reconciliation between HK GAAP and US GAAP which affect our net income and shareholders' equity arising from the aforementioned differences are included in Note 40 to the consolidated financial statements included in this annual report. In addition, additional disclosures on the condensed financial information under US GAAP, including condensed statements of income, changes in shareholders' equity and cash flows information, as well as condensed balance sheets information and other additional financial information which have been restated for relevant periods presented to reflect the impact of the effects of the acquisitions of Unicom New Century, Unicom New World and Unicom International and the sale of Guoxin Paging under common control are included in Note 40 to the consolidated financial statements presented in this annual report.

**Item 6. Directors, Senior Management and Employees**



A. **Directors and Senior Management**





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The following table sets forth certain information concerning our current directors and executive officers.

Name	Age	Position
Chang Xiaobing	48	Chairman of the Board of Directors; Executive Director; Chief Executive Officer
Shang Bing	49	Executive Director; President
Tong Jilu	47	Executive Director; Chief Financial Officer
Zhao Le	49	Executive Director; Vice President
William Lo Wing Yan	44	Executive Director; Vice President
Ye Fengping	41	Executive Director; Vice President
Liu Yunjie	62	Non-Executive Director
Wu Jinglian	75	Independent Non-Executive Director
Shan Weijian	51	Independent Non-Executive Director
Linus Cheung Wing Lam	56	Independent Non-Executive Director

Chang Xiaobing was appointed in December 2004 as an Executive Director, Chairman of the Board of Directors and Chief Executive Officer of our company. Mr. Chang, a professor level senior engineer, graduated in 1982 from the Nanjing Institute of Posts and Telecommunications with a B.S. degree in telecommunications engineering and received an MBA degree from Tsinghua University in 2001. From 1992 to 2000, Mr. Chang served as a Deputy Director of the Nanjing Municipal Posts and Telecommunications Bureau of Jiangsu PT, a Deputy Director General of the Directorate General of Telecommunications, or DGT, of the MPT and a Deputy Director General and Director General of the Department of Telecommunications Administration of the MII. From 2000 to October 2004, Mr. Chang served as Vice President of China Telecom Group and, since 2002, an executive director and President of China Telecom Corporation Limited. Mr. Chang was appointed the Chairman of Unicom Group in November 2004. Mr. Chang also serves as the Chairman of the A Share Company and CUCL, respectively. Mr. Chang has 22 years of operational and managerial experience in the telecommunications industry in China.

Shang Bing was appointed in November 2004 as an Executive Director and President of our company responsible for our day-to-day management and operations. Mr. Shang, a senior economist, graduated in 1982 from Shenyang Chemical Industry Institution with degree in Chemical Industry and received an MBA degree from New York State University of USA. From 1986 to 1998, Mr. Shang served as a Director of Industrial Technology Development Centre in Liaoning Province, Deputy General Manager and General Manager of Economic Technology Development Company in Liaoning Province. Mr. Shang joined Unicom Group in August 1998. From 1998 to 2001, Mr. Shang served as Deputy General Manager and General Manager of Unicom Group Liaoning Branch. Mr. Shang was appointed as Vice President of Unicom Group in March 2001 and subsequently became a Director and Vice President of Unicom Group in September 2003. Mr. Shang was appointed the President of Unicom Group in November 2004. At present, Mr. Shang is also a Director of Unicom Group, a Director and President of the A Share Company and a Director and President of CUCL. Mr. Shang has extensive management experience and knowledge in telecommunications operations.

Tong Jilu was appointed in February 2004 as an Executive Director and Chief Financial Officer of our company. He assists the President in handling issues relating to finance. Mr. Tong graduated in 1987 from the Department of Economic Management at the Beijing University of Posts and Telecommunications. He holds a Master Degree in International Management from National University of Australia; and is an Executive Director of the Association of Chief Accountants in China. From August 1989 to October 1998, he served as Chief Economist, Deputy Director and later Director of the Finance Bureau of the Posts and Telecommunications Administration of Liaoning Province. From November 1998 to June 2000, Mr. Tong served as Deputy Director General of the Posts and Telecommunications Administration and the Posts Office of Liaoning Province. Mr. Tong joined Unicom Group in July 2000 and served as Chief Accountant of Unicom Group from July 2000 to February 2001. Since March 2001, Mr. Tong has served as Vice President of Unicom Group. He is now a Director and Chief Accountant of Unicom Group, a Director of A Share company, and a Director and Vice President of CUCL. Mr. Tong has extensive experience in telecommunications management and finance management of listed companies.

Zhao Le was appointed in February 2004 as an Executive Director and Vice President of our company. He assists the President in managing day-to-day operations. Mr. Zhao is a senior engineer, graduated in 1989 from the Schools of Economics & Management at Tsinghua University with Master Degree in Industrial Management. From 1990 to 1992, Mr. Zhao served as the Station-In-Charge of the Earth Station of Satellite Communication of Long Distance Telecommunication Bureau of Shanghai. From 1992 to 1994, Mr. Zhao served as Deputy Chief Economist of Long Distance Telecommunication Bureau of Shanghai. From 1995 to 1998, Mr. Zhao served as Director of the Planning Department of the Posts and Telecommunications Administration of Shanghai. Mr. Zhao joined Unicom Group since 1999. From 1999 to 2003, he served as General Manager of China Unicom Shanghai Branch. Mr. Zhao is now the Chairman of China United Telecommunications (Hong Kong) Ltd., Executive Director and Vice President of China Unicom (Hong Kong) Group Limited and a Director of Unicom International. Mr. Zhao has been in the management role of telecommunications operations for a long period and has extensive telecommunications management experience.

William Lo Wing Yan was appointed in July 2002 as an Executive Director and Vice President of our company. Mr. Lo assists the President in handling investor relations and issues relating to international co-operation. Mr. Lo graduated from Cambridge University in 1987, with a PhD degree in Genetic Engineering. From 1988 to 1990, Mr. Lo was a management consultant with McKinsey & Company. From 1994 to 1998, Mr. Lo was the Founding Managing Director of Hongkong Telecom IMS Limited. From 1998 to 1999, Mr. Lo served as Chief Executive Officer of Citibank's Global Consumer Banking Business for Hong Kong and Macau. Mr. Lo serves as a non-executive director on the board of a number of publicly listed companies in Hong Kong and New York, including Softbank Investment International Ltd, Vartronix International Ltd, Ocean Grand Chemicals Holdings Ltd, Superdata Software Holdings Ltd, I.T Ltd, Capital Publications Ltd, Panorama International Holdings Ltd and Nam Tai Electronics, Inc. In 1999, Mr. Lo was appointed as a Justice of the Peace (JP) of Hong Kong. In 2003, Mr. Lo was appointed as Committee Member of Shantou People's Political Consultative Conference. Mr. Lo has extensive work experience and management expertise in the areas of information technology, telecommunications and banking industry.

Ye Fengping was appointed in January 2003 as an Executive Director and Vice President of our company. Mr. Ye assists the President in handling general administration and media relations. Mr. Ye, a senior engineer, graduated from Nanjing Posts and Telecommunications Institution in 1984, with a major in Telecommunications Engineering and obtained a Master of Business Administration degree from the University of Minnesota's Carlson School in 2004. From 1984 to 1998, Mr. Ye worked for the Shenzhen Posts and Telecommunications Bureau and once served as Deputy Department Head in the Materials Management Department and General Manager of the Materials Supply Company of the Bureau. From 1998 to 2000, Mr. Ye worked for the Shenzhen Telecommunications Bureau as Chief of the Corporate Development Department. Mr. Ye joined China Unicom in April 2000 as Deputy General Manager and later General Manager of China Unicom Corporation Limited's Shenzhen Branch. He also served as Deputy General Manager of China Unicom Corporation Limited's Guangdong Branch and General Manager of the Sales and Marketing Department of Unicom Group. Currently, Mr. Ye is also a Director and President of Unicom International. Mr. Ye has over twenty years of experience in the telecommunications industry and extensive experience in marketing planning and management.

Liu Yunjie was appointed in February 2004 as a Non-Executive Director of our company. Mr. Liu is a professor level senior engineer and graduated from the Department of Applied Physics at Beijing University in 1968. From 1983 to 1995, Mr. Liu served as Deputy Director General and later Director General of the Institute of Data Communication Research of the MPT. From 1995 to 1998, Mr. Liu served as Deputy Director General of the Directorate General of Telecommunications and as Director General of the Bureau of Data Communications of the MPT. Mr. Liu was also President of the Institute of Postal Science Research and Planning of the MPT from 1998 to 1999. Since April 1999, Mr. Liu has served as the Chief Engineer and later Vice President of Unicom Group. Mr. Liu was Vice President of our company from May 2000 to January 2004. He is now a director of the A Share Company. Mr. Liu has extensive experience in telecommunications technology and management, particularly in the area of data communications.

Wu Jinglian was appointed in April 2000 as an Independent Non-Executive Director of our company. Mr. Wu is a senior researcher at the Development Research Center of the State Council (DRC) and a professor at the Graduate School of the Chinese Academy of Social Sciences and China Europe International Business School (CEIBS). Mr. Wu graduated from Fudan University, and was previously an Executive Director of the DRC and Deputy Director of the Programming Office for Economic Reform of the State Council. Mr. Wu has also been a visiting scholar at Yale University, a visiting professor at the Asia-Pacific Research Center of Stanford University and a visiting researcher at the Massachusetts Institute of Technology.

Shan Weijian was appointed in May 2003 as an Independent Non-Executive Director of our company. Mr. Shan is the Co-Managing Partner of Newbridge Capital. Mr. Shan serves on the boards of Bank of China (Hong Kong), Korea First Bank, Taiwan Cement Corporation International, Baoshan Iron and Steel, among others. Before joining Newbridge, Mr. Shan was a Managing Director at J.P. Morgan. Prior to J.P. Morgan, he was a professor at the Wharton School of University of Pennsylvania. His earlier employers include the World Bank, Grahamman and James, a law firm based in San Francisco, and Beijing University of International Business and Economics. Mr. Shan holds a Ph.D. from the University of California-Berkeley.

Linus Cheung Wing Lam was appointed in May 2004 as an Independent Non-Executive Director of our company. Prior to his appointment, Mr. Cheung was Deputy Chairman of PCCW Limited. Prior to the merger of Pacific Century Cyberworks Limited and Cable & Wireless HKT Limited (Hongkong Telecom), Mr. Cheung was the Chief Executive of Hongkong Telecom and an Executive Director of Cable & Wireless plc in the United Kingdom. Mr. Cheung also worked at Cathay Pacific Airways for 23 years before departing as Deputy Managing Director. In 1990 he was appointed an Official Justice of the Peace and in 1992 he was appointed a Non-official Justice of the Peace. Mr. Cheung is currently a member of the Chinese People's Political Consultative Conference for the Tianjin Municipal Government. He received a bachelor's of social science degree with honors and a diploma in Management Studies from the University of Hong Kong. Mr. Cheung is also an Honorary Fellow of the University of Hong Kong and of The Chartered Institute of Marketing in the United Kingdom.

**B. Compensation**



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The aggregate compensation paid by us to our directors and executive officers as a group in 2004 was approximately RMB16.64 million, including retirement and other benefits. Each of our executive directors and executive officers enters into a bonus agreement with us that ties the amount of bonus the director or officer will receive at the end of a year to our operating results of the year and the job performance of the director or officer. Some of our directors and executive directors also hold options to purchase shares in our company. See E. Share Ownership below for detailed descriptions of our share option schemes and options granted to our directors and executive officers as well as compensation for the year 2004.

**C. Board Practices**





**General**



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Pursuant to our Articles of Association, at each annual general meeting, one-third of our directors retire from office by rotation except for any director holding office as Chairman or Chief Executive Officer. The retiring Directors are eligible for re-election. The Board may at any time appoint a new director to fill a vacancy or as an additional director. The Board may also appoint and remove our executive officers. No benefits are payable to our directors or executive officers upon termination of their service with us in accordance with the provisions of their service agreements. The following table sets forth certain information concerning our current directors and former directors who served as directors in 2004.

Name	Appointment Date	Re-appointment Date	Resignation Date
<b>Current Directors</b>			
Chang Xiaobing	December 21, 2004		
Shang Bing	November 5, 2004	May 12, 2005	
Tong Jilu	February 1, 2004	May 12, 2004	
Zhao Le	February 1, 2004	May 12, 2004 and May 12, 2005	
Lo Wing Yan, William	July 8, 2002	May 12, 2003 and May 12, 2004	
Ye Fengping	January 2, 2003	May 12, 2003 and May 12, 2004	
Liu Yunjie	February 1, 2000	May 12, 2004	
Cheung Wing Lam, Linus	May 12, 2004		
Wu Jinglian	April 20, 2000	May 13, 2002, May 12, 2004 and May 12, 2005	
Shan Weijian	May 12, 2003	May 12, 2005	
<b>Former Directors</b>			
Wang Jianzhou			November 5, 2004
Shi Cuiming			February 1, 2004
Ge Lei			February 1, 2004
Lee Hon Chiu			May 12, 2004
Craig O. McCaw			May 12, 2005
C. James Judson (Alternate Director to Craig O. McCaw)			May 12, 2005

**Audit Committee**



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The audit committee reviews and supervises our financial reporting process and internal financial controls. The duties of the audit committee include the following:

considering and approving the appointment, resignation and removal of our external auditor and the auditor's fees;

reviewing our interim and annual financial statements and disclosure before submission to the board of directors;

discussing with the auditor any problems and reservations arising from the audit of the interim and final results;

reviewing any correspondence from the auditor to the management and the responses of the management; and

reviewing the relevant reports concerning our internal controls and procedures.

The Board of Directors recently approved certain amendments to the duties of the audit committee, including strengthening of responsibilities in the following areas:

supervising the external auditor, who will directly report to the committee;

pre-approving the audit and non-audit services to be provided by the external auditor, and determining whether any non-audit services would affect the independence of the auditor; and

discussing with the management the timing and procedures for the rotation of the partner of the auditing firm responsible for the audit of our company and the partner responsible for the review of audit-related documents.

As of May 31, 2005, the members of the audit committee are Shan Weijian, Wu Jinglian and Linus Cheung Wing Lam.

### **Remuneration Committee**





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The remuneration committee meets regularly to consider human resources issues, issuance of share options and other matters relating to compensation. In particular, the remuneration committee makes recommendations to the Board on executive compensation. The primary duties of the remuneration committee are to make recommendations to the Board regarding the remuneration structure of the executive directors and to determine specific remuneration packages for the executive directors on behalf of the board. The remuneration committee is also responsible for operating our employee share option scheme and any other incentive scheme as they apply to the executive directors, including determining the granting of options to executive directors. As of May 31, 2005, the members of the remuneration committee are Wu Jianlian, Chairman of the committee, Liu Yunjie and Linus Cheung Wing Lam.

*D.*            **Employees**



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As of December 31, 2004, we had 39,589 employees, which was similar to the 38,728 employees of our company at the end of 2003 (including employees in the nine provinces, autonomous regions and municipalities we acquired through Unicom New World at the end of 2003). These employees are classified by function as follows:

By Function	Number of Employees			
Management and administration	6,267			
Other general administration	7,035			
Marketing and sales	11,749			
Technical, engineering and network maintenance	10,828			
Retail and customer service	1,362			
General support	2,348			
<b>Total</b>	<b>39,589</b>			

By Business Segment	Number of Employees
Cellular	33,141
GSM	22,297
CDMA	10,844
Long distance	2,181
Data and Internet	4,267
<b>Total</b>	<b>39,589</b>

As of December 31, 2004, we also employed approximately 62,600 temporary employees.

### *E.* Share Ownership



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As of May 31, 2005, our directors and executive officers as a group do not own any shares in our company.

As of May 31, 2005, our directors and executive officers as a group hold options for 7,519,400 shares, or less than 0.1% of our issued and outstanding share capital, including the following options granted under our pre-global offering share option scheme and share option scheme:

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Options granted under the share option scheme

Name	Number of Shares Covered	Expiration Date	Exercise Price	Consideration Paid	Compensation for 2004 (RMB)
Chang Xiaobing <sup>(1)</sup>	526,000*	December 20, 2010	HK\$6.20	HK\$1.00	77,000
Shang Bing <sup>(2)</sup>	292,000	July 9, 2008	HK\$6.18	HK\$1.00	553,000
	292,000	May 20, 2009	HK\$4.30	HK\$1.00	
	292,000*	July 19, 2010	HK\$5.92	HK\$1.00	
	128,000*	December 20, 2010	HK\$6.20	HK\$1.00	
Tong Jilu	292,000	July 9, 2008	HK\$6.18	HK\$1.00	2,562,000
	292,000	May 20, 2009	HK\$4.30	HK\$1.00	
	292,000	June 21, 2010	HK\$15.42	HK\$1.00	
	292,000*	July 19, 2010	HK\$5.92	HK\$1.00	
Zhao Le	136,000	July 9, 2008	HK\$6.18	HK\$1.00	1,996,000
	204,000	May 20, 2009	HK\$4.30	HK\$1.00	
	272,000*	July 19, 2010	HK\$5.92	HK\$1.00	
Lo Wing Yan, William	176,000	May 20, 2009	HK\$4.30	HK\$1.00	2,392,000
	262,000*	July 19, 2010	HK\$5.92	HK\$1.00	
Ye Fengping	132,000	July 9, 2008	HK\$6.18	HK\$1.00	2,177,000
	204,000	May 20, 2009	HK\$4.30	HK\$1.00	
	136,000	June 21, 2010	HK\$15.42	HK\$1.00	
	262,000	July 19, 2010	HK\$5.92	HK\$1.00	
Liu Yunjie	292,000	May 20, 2009	HK\$4.30	HK\$1.00	292,000
	292,000*	July 19, 2010	HK\$5.92	HK\$1.00	
Wu Jinglian	292,000	July 9, 2008	HK\$6.18	HK\$1.00	319,000
	292,000	May 20, 2009	HK\$4.30	HK\$1.00	
	292,000*	July 19, 2010	HK\$5.92	HK\$1.00	
Shan Weijian	292,000	May 20, 2009	HK\$4.30	HK\$1.00	319,000
	292,000*	July 19, 2010	HK\$5.92	HK\$1.00	
Cheung Wing Lam, Linus	292,000*	July 19, 2010	HK\$5.92	HK\$1.00	203,000
Wang Jianzhou <sup>(3)(8)</sup>	420,000	July 9, 2008	HK\$6.18	HK\$1.00	2,214,000
	420,000	May 20, 2009	HK\$4.30	HK\$1.00	
	526,000*	July 19, 2010	HK\$5.92	HK\$1.00	
Craig O. McCaw <sup>(4)(8)</sup>	292,000	July 9, 2008	HK\$6.18	HK\$1.00	319,000
	292,000	May 20, 2009	HK\$4.30	HK\$1.00	
	292,000*	July 19, 2010	HK\$5.92	HK\$1.00	

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Shi Cuiming <sup>(5)(8)</sup>	396,000 396,000	July 9, 2008 May 20, 2009	HK\$6.18 HK\$4.30	HK\$1.00 HK\$1.00		3,073,000
Ge Lei <sup>(6)(8)</sup>	292,000 292,000	July 9, 2008 May 20, 2009	HK\$6.18 HK\$4.30	HK\$1.00 HK\$1.00		27,000
Lee Hon Chiu <sup>(7)(8)</sup>	292,000 292,000	July 9, 2008 May 20, 2009	HK\$6.18 HK\$4.30	HK\$1.00 HK\$1.00		116,000



- 
- (1) Mr. Chang was appointed as Chairman and Chief Executive Officer of our company in December 2004.
- (2) Mr. Shang was appointed as Executive Director and President of our company in November 2004.
- (3) Mr. Wang resigned as Chairman, Chief Executive Officer and President of our company on November 5, 2004.
- (4) Mr. McCaw resigned as director of our Company on May 12, 2005.
- (5) Mr. Shi Cuiming resigned as Executive Director and Executive Vice President on February 1, 2004.
- (6) Mr. Ge Lei resigned as Non-Executive Director on February 1, 2004.
- (7) Mr. Lee Hon Chiu resigned as Independent Non-Executive Director on May 12, 2004.
- (8) For the directors who resigned during the year 2004, the numbers of options indicated represent the numbers of options held by the respective directors as of their dates of resignation.

\* Granted in 2004.

*Options granted under the pre-global offering share option scheme*

Name	Number of Shares Covered	Expiration Date	Subscription Price	Consideration Paid
Shang Bing	204,400	June 21, 2010	HK\$15.42	HK\$1.00
Liu Yunjie	292,600	June 21, 2010	HK\$15.42	HK\$1.00
Zhao Le	204,400	June 21, 2010	HK\$15.42	HK\$1.00
Wang Jianzhou <sup>(1)</sup>	396,200	June 21, 2010	HK\$15.42	HK\$1.00
Shi Cuiming <sup>(2)</sup>	396,200	June 21, 2010	HK\$15.42	HK\$1.00
Ge Lei <sup>(3)</sup>	292,600	June 21, 2010	HK\$15.42	HK\$1.00

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- (1) Mr. Wang resigned as Chairman, Chief Executive Officer and President of our company on November 5, 2004.
- (2) Mr. Shi Cuiming resigned as Executive Director and Executive Vice President on February 1, 2004.
- (3) Mr. Ge Lei resigned as Non-Executive Director on February 1, 2004.

### **Stock Incentive Schemes**



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We retained a compensation consulting firm to help us design stock incentive schemes that align the interests of our management and employees with those of our shareholders and link their compensation with our operating results and share performance.

*Share Option Scheme.* We adopted a share option scheme on June 1, 2000 and amended the scheme on May 13, 2002. The amended scheme provides for the grant of options to our employees, including executive directors and non-executive directors. Any grant of share options to a connected person (as defined in the Listing Rules of the Hong Kong Stock Exchange) of Unicom requires approval by our independent non-executive directors, excluding any independent non-executive director who is the grantee of the option. We plan to grant options that cover a total number of ordinary shares not exceeding 10% of the total number of our issued and outstanding shares as of May 13, 2002. The option period commences on any date after the date on which an option is offered, but may not exceed 10 years from the offer date. The subscription price of a share in respect of any particular option granted under this share option scheme will be determined by our board of directors in its discretion at the grant date, which shall be no less than the higher of: (i) the nominal value of the shares; (ii) the closing price of the shares on the Hong Kong Stock Exchange on the grant date in respect of such option; and (iii) the average closing price of the shares on the Hong Kong Stock Exchange for the five trading days immediately preceding the grant date. As of May 31, 2005, 6,818,000 options granted by us were outstanding and held by 10 directors and approximately 2,500 of our employees. As of May 31, 2005, 9,226,000 options with an exercise price of HK\$6.18, 164,000 options with an exercise price of HK\$5.92, 88,000 options with an exercise price of HK\$4.65 and 6,891,200 options with an exercise price of HK\$4.30 had been exercised.

*Pre-Global Offering Share Option Scheme.* We also adopted a pre-global offering share option scheme on June 1, 2000. As of May 31, 2005, 701,400 options granted by us were outstanding and held by 3 directors and approximately 250 of our employees. We do not expect to grant further options under this scheme. On May 13, 2002, this scheme was amended along with the amendment of the share option scheme described above. The amended terms of the pre-global offering share option scheme are substantially the same as the share option scheme, except for the following:

The subscription price of a share in respect of any particular option granted under the pre-global offering share option scheme is HK\$15.42, the offer price in the Hong Kong public offering portion of our initial public offering, excluding brokerage fees and transaction levy.

The period during which an option may be exercised commences two years from the date of grant and ends 10 years from June 22, 2000.

As of December 31, 2004, no options granted under this scheme had been exercised.

## **Item 7. Major Shareholders and Related Party Transactions**



**A. Major Shareholders**





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As of May 31, 2005, our controlling shareholder, Unicom Group, through its 17.91% direct interest in Unicom BVI, and its majority-owned subsidiary, China United Telecommunications Corporation Limited, which in turn holds 82.09% of Unicom BVI, beneficially owned 9,725,000,020 shares of Unicom, or 77.37% of our total outstanding shares. See A. History and Development of the Company under Item 4 above. Unicom Group is controlled by the Ministry of Finance and a group of approximately fifteen companies, most of which are state-owned enterprises in China. Shares owned by Unicom Group do not carry voting rights different from our other issued shares.

As of May 31, 2005, most of our record shareholders were located outside of the United States. In addition, as of May 31, 2005, there were approximately 24 million ADSs outstanding, each representing 10 shares and together representing 1.90% of our total outstanding shares or 8.44% of our total outstanding shares not held by our controlling shareholder.

**B. Related Party Transactions**



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Principal transactions between us and our controlling shareholder, Unicom Group, include the following categories:

agreements relating to the restructuring in connection with our initial public offering;

agreements relating to the restructuring in connection with the acquisition of Unicom New Century from Unicom Group;

agreements relating to the acquisition of Unicom New World from Unicom Group and the sale of Guoxin Paging to Unicom Group;

agreements relating to the acquisition of Unicom International from Unicom Group;

provision of ongoing telecommunications and ancillary services and premises;

leasing of CDMA network capacity by us from Unicom Group and related interconnection and roaming arrangements; and

guarantee of our bank loans by Unicom Group and short-term loans from Unicom Group.

### **Agreements Relating to the Restructuring in Connection with Our Initial Public Offering**



*The Reorganization Agreement*



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In relation to the restructuring in connection with our initial public offering, our wholly-owned subsidiary, CUCL, entered into a reorganization agreement with Unicom Group dated April 21, 2000. This agreement includes the following terms:

(a) Unicom Group's agreement to transfer to CUCL the assets and liabilities attributable to the businesses as described in A. History and Development of the Company The Restructuring of Unicom Group and Our Initial Public Offering in 2000 under Item 4,

(b) mutual warranties and indemnities given by Unicom Group and CUCL in relation to the assets and liabilities transferred to CUCL and in relation to the restructuring,

(c) undertakings by Unicom Group in favor of CUCL, including undertakings:

to hold and maintain all licenses received from the MII in connection with any of our businesses for our benefit, and to allocate spectrum and to provide other resources to us;

subject to applicable Chinese laws and regulations in effect at the relevant time, to take all actions necessary to obtain, maintain, renew and otherwise extend to or for our benefit such governmental or regulatory licenses, consents, permits or other approvals as we shall require to continue to operate our businesses;

to arrange for us to participate in its international roaming arrangements;

not to engage in any business which competes with our businesses except for the existing competing businesses of Unicom Group;

to grant us a right of first refusal in relation to any government authorization, license or permit, or other business opportunity to develop any new telecommunications technology, product or service;



in order to minimize the risk of competition with our Internet business, to take steps to dispose of its interest in Beijing Shi Hua within twenty-four months following receipt of a notification from us that we intend to provide Internet services which we consider similar to those provided by Beijing Shi Hua;

to ensure that we can continue to use premises for which title documentation cannot be obtained at this time for a period of three years following the restructuring;

not to dispose of any of our shares it beneficially owns or to take or permit any other actions, including primary issuances of securities by us or CUCL, which would result in us or CUCL no longer constituting majority owned subsidiaries of Unicom Group; and

not to seek an overseas listing for any of its businesses or the businesses of its subsidiaries in which we are engaged or may engage in the future except through us,

(d) an option granted by Unicom Group to us to acquire Unicom Group's interest in any telecommunications interest such as Unicom Paging, Unicom Xingye and Unicom Group's CDMA telephony license and business, and

(e) a commitment by Unicom Group that it will provide continuous financial support to us when necessary.

***Equity Transfer Agreement***



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In relation to the restructuring in connection with our initial public offering, we, Unicom Group, China Unicom (Hong Kong) Group Limited and China Unicom (BVI) Limited entered into an equity transfer agreement, dated April 21, 2000. This agreement includes the following terms:

- (a) Unicom Group's agreement to transfer all of its equity interest in CUCL to us;
- (b) our agreement to issue shares to China Unicom (BVI) Limited, China Unicom (BVI) Limited's agreement to issue shares to China Unicom (Hong Kong) Group Limited and China Unicom (Hong Kong) Group Limited's agreement to issue shares to Unicom Group;
- (c) Unicom Group's and our agreement that:
- we shall be entitled to apply in Hong Kong, Macau, Taiwan and in all places outside of China for all trademarks incorporating the word Unicom in English and Chinese and the Unicom logo; and
- once these trademarks have been registered, we will sublicense these trademarks to Unicom Group, CUCL, Guoxin Paging and Guoxin Paging's subsidiaries on a royalty-free basis; and
- (d) warranties and indemnities given by Unicom Group to us in relation to CUCL.

*Trademark Agreement*

Unicom Group is the registered owner of the Unicom trademark in English and the trademark bearing the Unicom logo, which are registered at the People's Republic of China State Trademark Bureau. Under a PRC trademark license agreement entered into on May 25, 2000 between Unicom Group and CUCL, CUCL and our affiliates were granted the right to use these trademarks on a royalty-free basis for an initial period of five years, renewable at the option of CUCL. Under the terms of this agreement, we and our affiliates are the exclusive licensees of these trademarks provided that Unicom Group may also license these trademarks to any of its existing or future subsidiaries. Unicom Group also agreed to license to CUCL any trademark that it registers in China in the future which incorporates the word Unicom.

CUCL entered into a service agreement with Unicom Paging on August 1, 2001. Under the terms of the agreement, both parties agreed to license their respective trademarks and logos to each other on equitable terms and free of charge.

**Agreements relating to the Restructuring in connection with Acquisition of Unicom New Century from Unicom Group**



*The Reorganization Agreement*

In relation to the restructuring in connection with the acquisition by us of Unicom New Century from Unicom Group, Unicom Group entered into a reorganization agreement with Unicom New Century, dated November 18, 2002. This agreement includes the following terms:

(a) Unicom Group's agreement to transfer to Unicom New Century the assets and liabilities attributable to the businesses as described in A. History and Development of the Company- Restructuring and Acquisition of Unicom New Century under Item 4;

(b) mutual warranties and indemnities given by Unicom Group and Unicom New Century in relation to the assets and liabilities transferred to Unicom New Century and in relation to the restructuring; and

(c) undertakings by Unicom Group in favor of Unicom New Century, including undertakings:

to hold and maintain all licenses received from the MII in connection with any of the transferred businesses for the benefit of Unicom New Century, and to allocate spectrum and to provide other resources to Unicom New Century;

subject to applicable Chinese laws and regulations in effect at the relevant time, to take all actions necessary to obtain, maintain, renew and otherwise extend to or for the benefit of Unicom New Century such governmental or regulatory licenses, consents, permits or other approvals as Unicom New Century may require to continue to operate its businesses; and

not to engage in any business which competes with our businesses except for the existing competing businesses of Unicom Group.

*Conditional Sale and Purchase Agreement*





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In relation to the acquisition by us of Unicom New Century from Unicom Group, we and Unicom BVI entered into a conditional sale and purchase agreement, dated November 20, 2002. This agreement includes the following terms:

- (a) Unicom BVI's agreement to transfer all of its equity interest in Unicom New Century (BVI) Limited, which holds 100% of the equity interest in Unicom New Century, to us;
- (b) our agreement to pay Unicom BVI a cash consideration in the amount of HK\$4,523,181,304 (approximately RMB4.8 billion); and
- (c) warranties given by Unicom BVI to us in relation to Unicom New Century.

### *Trademark Agreement*



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Under a trademark license agreement entered into on November 20, 2002 between the A Share Company and Unicom New Century, Unicom New Century and our affiliates were granted the right to use the Unicom trademarks and logo on a royalty-free basis for an initial period of ten years, renewable for a further ten-year term at the option of Unicom New Century. The parties will negotiate the royalty payments during the renewed term; however, in no event will such payment exceed the royalty payments, if any, paid by Unicom Group's other wholly- or majority-owned subsidiaries. The A Share Company has also agreed to license to Unicom New Century any trademark that Unicom Group registers in China in the future which incorporates the word Unicom.

**Agreements relating to the Acquisition of Unicom New World from Unicom Group and the Sale of Guoxin Paging to Unicom Group**



*The Reorganization Agreement*

In relation to the restructuring in connection with the acquisition by us of Unicom New World from Unicom Group, Unicom Group entered into a reorganization agreement with Unicom New World, dated November 4, 2003. This agreement includes the following terms:

(a) Unicom Group's agreement to transfer to Unicom New World the assets and liabilities attributable to the businesses as described under A. History and Development of the Company—Acquisition of Unicom New World and Sale of Guoxin Paging under Item 4;

(b) mutual warranties and indemnities given by Unicom Group and Unicom New World in relation to the assets and liabilities transferred to Unicom New World and in relation to the restructuring; and

(c) undertakings by Unicom Group in favor of Unicom New World, including undertakings:

to hold and maintain all licenses received from the MII in connection with any of the transferred businesses for the benefit of Unicom New World, and to allocate spectrum and to provide other resources to Unicom New World;

subject to applicable Chinese laws and regulations in effect at the relevant time, to take all actions necessary to obtain, maintain, renew and otherwise extend to or for the benefit of Unicom New World such governmental or regulatory licenses, consents, permits or other approvals as Unicom New World may require to continue to operate its businesses; and

not to engage in any business which competes with our businesses except for the existing competing businesses of Unicom Group.

*Conditional Sale and Purchase Agreement with respect to Unicom New World*





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In relation to the acquisition by us of Unicom New World from Unicom Group, we and Unicom BVI entered into a conditional sale and purchase agreement, dated November 20, 2003. This agreement includes the following terms:

- (a) Unicom BVI's agreement to transfer all of its equity interest in Unicom New World (BVI) Limited, which holds 100% of the equity interest in Unicom New World, to us;
- (b) our agreement to pay Unicom BVI a cash consideration in the amount of HK\$3,014,886,000 (approximately RMB3.2 billion); and
- (c) warranties given by Unicom BVI to us in relation to Unicom New World.

### *Conditional Sale and Purchase Agreement with respect to Guoxin Paging*

In relation to the sale by us of Guoxin Paging to Unicom Group, CUCL and the A Share Company entered into a conditional sale and purchase agreement, dated November 20, 2003. This agreement includes the following terms:

- (a) CUCL's agreement to sell to the A Share Company, and the A Share Company's agreement to acquire from CUCL, all of CUCL's equity interest in Guoxin Paging;
- (b) the A Share Company's agreement to pay CUCL a cash consideration in the amount of HK\$2,590,917,656 (approximately RMB2.75 billion); and
- (c) warranties given by CUCL to the A Share Company in relation to Guoxin Paging.

### *Trademark Agreement*



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Under a trademark license agreement entered into on November 20, 2003 between the A Share Company and Unicom New World, Unicom New World and our affiliates were granted the right to use the Unicom trademarks and logo on a royalty-free basis for an initial period of ten years, renewable for a further ten-year term at the option of Unicom New World. The parties will negotiate the royalty payments during the renewed term; however, in no event will such payment exceed the royalty payments, if any, paid by Unicom Group's other wholly- or majority-owned subsidiaries. The A Share Company has also agreed to license to Unicom New World any trademark that Unicom Group registers in China in the future which incorporates the word Unicom.

**Agreements relating to the Acquisition of Unicom International from Unicom Group**



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In relation to the acquisition by us of Unicom International from Unicom Group, we and China Unicom (Hong Kong) Group Limited, which is an indirectly wholly-owned beneficiary of Unicom Group, entered into a conditional sale and purchase agreement, dated July 28, 2004. This agreement includes the following terms:

- (a) China Unicom (Hong Kong) Group Limited's agreement to transfer all of its equity interest in Unicom International to us;
- (b) our agreement to pay China Unicom (Hong Kong) Group Limited a cash consideration in the amount of HK\$37,159,995.77; and
- (c) warranties given by China Unicom (Hong Kong) Group Limited to us in relation to Unicom International.

### **Provision of Ongoing Telecommunications and Ancillary Services and Premises**



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We had entered into a number of service arrangements with Unicom Group and/or its subsidiaries with respect to provision of ongoing telecommunications and ancillary services between Unicom Group and us, including leasing of satellite transmission capacity, supply of international telecommunication network gateway services, supply of various telephone cards, supply of equipment procurement services, supply of cellular subscriber services, supply of customer services, supply of agency services, leasing of transmission line capacity and interconnection and roaming arrangements, as well as provision of premises.

On March 24, 2005, we and Unicom Group entered into a comprehensive services agreement, or the New Comprehensive Services Agreement, a comprehensive operator services agreement, or the New Comprehensive Operator Services Agreement, and a premises leasing agreement, or the New Guoxin Premises Leasing Agreement, to replace the previous service arrangements between Unicom Group and us.

Each of the New Comprehensive Services Agreement, the New Comprehensive Operator Services Agreement and the New Guoxin Premises Leasing Agreement has an initial term of two years commencing on January 1, 2005 and is renewable for further two-year terms at our option.

### *Leasing of Satellite Transmission Capacity*





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We lease satellite transmission capacity from a 95.00% owned subsidiary of Unicom Group. We use this capacity to supplement our long distance network.

That subsidiary of Unicom Group and CUCL previously entered into a satellite transmission channel leasing agreement, dated May 25, 2000. Under that agreement, payments for leasing of satellite transmission capacity were calculated on the basis of tariffs set by the MII. We paid the minimum applicable tariff for the relevant volume and duration less a discount of up to 10%. The discount would not be less than that offered to any third party leasing similar transmission capacity. The total leasing charges for satellite transmission capacity for 2004 were approximately RMB14.15 million.

The New Comprehensive Services Agreement, which replaced the satellite transmission channel agreement, contains similar terms with respect to the lease of satellite transmission capacity.

*Supply of International Telecommunication Network Gateway Services*

Unicom Group provides us with access to international connections for our international long distance service through its international telecommunication network gateways. CUCL and Unicom Group previously entered into a services agreement, dated May 25, 2000, under which Unicom Group agreed to supply international telecommunication network gateway services to us. Unicom Group has undertaken not to supply international telecommunication network gateway services to third parties. The charges for these services were based on Unicom Group's cost of operation and maintenance of the international telecommunication network gateway facilities, including depreciation, plus a margin of 10% over cost. We retained all revenues generated by our international long distance service. Total charges for the supply of international telecommunication network gateway services in 2004 were approximately RMB17.06 million.

The New Comprehensive Services Agreement contains similar terms with respect to the supply of international telecommunication network gateway services.

***Supply of Telephone Cards***



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Each of CUCL, Unicom New Century and Unicom New World previously entered into a services agreement with Unicom Group, dated May 25, 2000, November 20, 2002 and November 20, 2003 respectively, to provide for a telephone cards supply arrangement under which, Unicom Group agreed through its subsidiary, Unicom Xingye, to supply various kinds of telephone cards, including SIM cards, UIM cards, IP telephony cards and rechargeable calling cards, to us. Charges for the supply of these cards were based on the actual cost incurred by Unicom Xingye in supplying the cards plus a margin over cost to be agreed upon from time to time, but in any case not to exceed 20%, subject to specified volume discounts. Under these three services agreements, prices and volumes would be reviewed by the parties on an annual basis. Total charges for the supply of telephone cards for 2004 were approximately RMB1.09 billion.

The New Comprehensive Services Agreement contain similar terms with respect to the supply of telephone cards.

### *Supply of Equipment Procurement Services*



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Prior to the restructuring in connection with our initial public offering, Unicom Import and Export Co. Ltd., a 95.0% direct subsidiary of Unicom Group, handled most procurement of foreign and domestic telecommunications equipment and other materials required for construction of Unicom Group's networks. Each of CUCL, Unicom New Century and Unicom New World previously entered into a services agreement with Unicom Group, dated May 25, 2000, November 20, 2002 and November 20, 2003 respectively, to provide for this procurement service arrangement under which we were allowed to continue to use Unicom Group's procuring service at the rate of:

0.7% of the contract value in the case of imported equipment, or

0.5% of the contract value in the case of domestic equipment.

These three agreements were amended on November 22, 2004 so that with effect from July 1, 2004, the above rates were lowered as follows:

0.55% of the contract value of those contracts under US\$30 million (including US\$30 million) and 0.35% of the contract value of those procurement contracts over US\$30 million, in the case of imported equipment, or



0.25% of the contract value of those contracts under RMB200 million (including RMB 200 million) and 0.15% of the contract value of those contracts over RMB 200 million, in the case of domestic equipment.

In addition, pursuant to this amendment on November 22, 2004, Unicom Group agreed to indemnify us for any loss caused by any negligence, default, act or omission of Unicom Group or Unicom Import and Export Co. Ltd. up to an amount equal to the total amount of agency services fees paid to Unicom Group under the three agreements. Our total payment to Unicom Group for equipment procurement services for 2004 was approximately RMB17.76 million.

Under the New Comprehensive Services Agreement, Unicom Group agreed to provide us comprehensive procurement services at the same rates as those applied with effect from July 1, 2004 pursuant to the November 22, 2004 amendment mentioned above.

In addition, under the New Comprehensive Services Agreement, Unicom Group has continued to agree to indemnify us for any loss caused by any negligence, default, act or omission of Unicom Group or Unicom Import and Export Co. Ltd. up to an amount equal to the total amount of agency services fees paid to Unicom Group under the New Comprehensive Services Agreement.

*Interconnection Arrangements*



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Our various telecommunication networks interconnect with various telecommunication networks of Unicom Group. CUCL previously entered into two services agreements with Unicom Group, dated May 25, 2000 and November 22, 2001, respectively, and each of Unicom New Century and Unicom New World previously entered into a services agreement with Unicom Group, dated November 20, 2002 and November 20, 2003 respectively. These four services agreements provided for our interconnection arrangements with Unicom Group, under which interconnection settlement between Unicom Group's networks and our networks was based on relevant standards established from time to time by the MII.

However, in the case of calls between cellular subscribers of different networks in different provinces, settlement was based on either the relevant standards established by the MII or a cost-based internal settlement arrangement applied by Unicom Group prior to the restructuring in connection with our initial public offering, whichever is more favorable to us.

In 2004, interconnection revenue and interconnection expenses derived from the previous arrangements with Unicom Group were approximately RMB193.5 million and RMB40.1 million, respectively.

Under the New Comprehensive Services Agreement, interconnection settlements between Unicom Group's networks and our networks are as follows:

- (a) Settlement between the cellular network of both parties

With respect to cellular calls between different provinces, settlement will be made by one of the following two methods that is more favourable to us:

- (i) the cellular network from which the outgoing calls originate and the cellular network which receives the incoming calls will each retain 4% of the long distance call fee incurred and the remaining 92% of the long distance call fee will be credited to us;

(ii) pursuant to the settlement standard stipulated in the Notice Concerning the Issue of the Measures on Settlement of Interconnection between Public Telecommunications Networks and Sharing of Relaying Fees (Xin Bu Dian [2003] No. 454) promulgated by the MII on October 28, 2003, the cellular network from which the outgoing calls originate and the cellular network which receives the incoming calls will each retain RMB0.06 from the long distance call fee. The remaining long distance call fee will be credited to us.

(b) Other interconnection settlement between the networks of both parties

Both parties agree to conduct settlement in accordance with the relevant provisions in the Notice Concerning the Issue of the Measures on Settlement of Interconnection between Public Telecommunications Networks and Sharing of Relaying Fees (Xin Bu Dian [2003] No. 454) promulgated by the MII on October 28, 2003 (and its amendments from time to time).

***Roaming Arrangements***



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We and Unicom Group provide roaming services to each other. In addition, we make our long distance network available to Unicom Group in its implementation of its roaming arrangements with other operators. CUCL previously entered into two services agreements with Unicom Group, dated May 25, 2000 and November 22, 2001, respectively, and each of Unicom New Century and Unicom New World previously entered into a services agreement with Unicom Group, dated November 20, 2002 and November 20, 2003 respectively. These four services agreements provided for our roaming arrangements with Unicom Group, under which charges for these roaming services between us and Unicom Group were based on our respective internal costs of providing these services, and would be on no less favorable terms than those available to any third party. We received 50% of Unicom Group's roaming revenue from third party operators for calls using our long distance network.

In 2004, roaming revenue and roaming expenses derived from the previous arrangements with Unicom Group were approximately RMB26.7 million and approximately RMB23.8 million, respectively.

Under the New Comprehensive Services Agreement, the roaming fee arrangements between Unicom Group and us are as follows:

(a) The cellular subscribers using roaming services will pay roaming fees at the agreed rate of RMB0.60 per minute of roaming usage for both incoming and outgoing calls based on MII guidelines.

(i) If our cellular subscribers roam in the service areas of Unicom Group, we will be entitled to receive the roaming fees, which will be apportioned in the following way: (A) RMB0.40 (the rate for local call charges under MII guidelines) will be paid to Unicom Group; and (B) the remaining RMB0.20 will be withheld by us;

(ii) If the cellular subscribers of Unicom Group roam in our service areas, Unicom Group will be entitled to receive the roaming fees, which will be apportioned in the following way: (A) RMB0.56 will be paid to us; and (B) RMB0.04 will be withheld by Unicom Group.

(b) If the network of a third party cellular network operator is made available to the cellular subscribers of Unicom Group pursuant to the international roaming arrangements of Unicom Group, or if the network of Unicom Group is made available to the subscribers of any third party cellular network operator pursuant to such arrangements, we will receive 50% of all roaming revenue to be received under such international roaming arrangements.

*Leasing of Transmission Line Capacity*





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Unicom Group leases fixed-line transmission capacity from CUCL. CUCL previously entered into a services agreement with Unicom Group, dated May 25, 2000, to provide for this transmission line capacity leasing arrangement under which lease charges were based on tariffs stipulated by the MII from time to time less a discount of up to 10%. The discount given by CUCL to Unicom Group must not be more than what CUCL offered to other third party lessees for a similar lease. When new tariffs were adopted by the MII, the discount rate would be reviewed. In 2004, we received from Unicom Group total leasing fees of approximately RMB39 million.

The New Comprehensive Services Agreement contains similar terms with respect to the leasing of transmission line capacity by us to Unicom Group.

### *Supply of Cellular Subscriber Value-added Services*

Prior to the sale of Guoxin Paging to Unicom Group, it provided operator-based value-added services to our cellular subscribers through its paging network, equipment and operators. Such services include the Unicom Assistant services. Following the sale of Guoxin Paging to Unicom Group at the end of 2003, Unicom Group has agreed to provide (through Guoxin Paging) to us cellular subscriber value-added services pursuant to a previous comprehensive operator services agreement dated November 20, 2003. The various local branches of Guoxin Paging and us would agree on the proportion for sharing the revenue derived and actually received by us from such value-added services, provided that the agreed-upon proportion for Guoxin Paging may not be higher than the average agreed-upon proportion for independent value-added telecommunications content providers who provided value-added communications content to us in the same region. The revenue sharing proportions would be adjusted annually.

We made total payment of approximately RMB859 million to Unicom Group in 2004 for its supply of cellular subscriber value-added services.

Under the New Comprehensive Operator Services Agreement, we will retain 40% of the revenue derived and actually received by us from value-added services provided to our subscribers by Unicom Group (through Guoxin Paging) and allocate 60% of such revenue to Guoxin Paging, on the condition that such proportion for Guoxin Paging may not be higher than the average agreed-upon proportion for independent value-added telecommunications content providers who provide value-added communications content to us in the same region.

*Supply of Customer Services*

Pursuant to a previous comprehensive operator services agreement dated November 20, 2003, Unicom Group has agreed to provide (acting on its own or through Guoxin Paging) to us customer services. These customer services included business inquiries, tariff inquiries, account maintenance, complaints handling, customer interviews and subscriber retention. Service fees payable by us to Unicom Group or Guoxin Paging were calculated on the basis of the costs of the customer service plus a profit margin of no more than 10%. The costs of the customer service were the costs per operator seat multiplied by the number of effectively operating operator seats. The cost per operator seat in economically developed areas, such as Beijing and Shanghai, was the actual cost, i.e., actual wages, administration expenses, operation and maintenance expenses, depreciation of equipment and leasing fees for premises attributable to the customer service in such area for the previous year. The cost per operator seat in other area was agreed upon between the local branches of Guoxin Paging and us, subject to our final confirmation, provided that such cost could not exceed the nationwide (other than Beijing and Shanghai) weighted average of such costs plus 10%. Unicom Group would notify us the number of effectively operating operator seats of each month within 10 days after the end of that month, and then we would confirm that number within five business days based on criteria set forth in the relevant MII regulations. Our total payment to Unicom Group for its supply of customer services in 2004 was RMB525 million.

Under the New Comprehensive Operator Services Agreement, the cost per operator seat in economically developed areas such as Beijing and Shanghai remains to be the actual cost per operator seat, while the cost per operator seat in an area other than economically developed areas will be the lower of the actual cost per operator seat in that area and the nationwide (excluding Beijing and Shanghai) average of actual cost per operator plus 10%. Other than this, the New Comprehensive Services Agreement contains similar terms with respect to the supply of customer services.

*Supply of Agency Services*



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Pursuant to a previous comprehensive operator services agreement dated November 20, 2003, Unicom Group agreed to provide (through Guoxin Paging) to us subscriber development services, including by telephone or through other channels utilizing Guoxin Paging's paging network, equipment and operators. Agency fees payable by us to Unicom Group or Guoxin Paging could not exceed the average of agency fees payable to any third party agent providing subscriber development services to us in the same region. We paid agency fees of approximately RMB9.05 million to Unicom Group in 2004 for its supply of agency services described above.

The New Comprehensive Operator Services Agreement contains similar terms with respect to the supply of agency services.

*Mutual Provision of Premises*



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Unicom Group and CUCL provide to each other premises from time to time pursuant to the services agreement between Unicom Group and CUCL dated May 25, 2000. Unicom Group also provided premises to Unicom New Century and Unicom New World pursuant to services agreements with each of Unicom New Century and Unicom New World dated November 20, 2002 and November 20, 2003, respectively. Other than premises leased from third parties, the rental rates in each case were based on the lower of depreciation costs and market prices for similar premises in that locality, but CUCL could charge Unicom Group market rates for premises leased to Unicom Group. In cases where the premises were leased from a third party, the rental was the amount payable in the head lease. In the case of shared premises, the price was split in proportion to the respective areas occupied by the parties. In connection with our provision of premises to Guoxin Paging, which was effective from January 1, 2004, the rental was based on the higher of depreciation costs and market prices for similar premises in each locality. The net charges for premises leased to us by Unicom Group as offset by our charges for premises leased to Unicom Group for 2004 were RMB25.53 million.

The terms in the New Comprehensive Services Agreement with respect to mutual provision of premises and the terms in the New Guoxin Premises Leasing Agreement with respect to our provision of premises to Guoxin Paging are similar to those in the previous agreements.

### **Leasing of CDMA Network Capacity**





*Old CDMA Lease*

Our wholly-owned subsidiary, CUCL, entered into a lease agreement on November 22, 2001 with Unicom Group and its subsidiary Unicom Horizon, pursuant to which Unicom Horizon agreed to lease to CUCL capacity on its CDMA network in CUCL's cellular service areas, giving CUCL the exclusive right to operate the CDMA network in CUCL's service areas. The initial term of the lease was one year, renewable each year at CUCL's option. In addition, as part of the acquisition arrangements of Unicom New Century and Unicom New World, Unicom New Century and Unicom New World each also entered into CDMA capacity lease agreements with Unicom Group and Unicom Horizon, on November 20, 2002 and November 20, 2003, respectively. The terms of these leasing arrangements were in all material respects the same as those contained in the CDMA lease agreement entered into by CUCL as described above, except for the amount of leased capacity and the areas in which the capacity is eased. We refer to these three lease agreements as the Old CDMA Leases. Under the Old CDMA Leases, Unicom Horizon agreed to lease capacity on its CDMA network to each of CUCL, Unicom New Century and Unicom New World in their respective cellular service areas. In 2004, our total lease payment under the Old CDMA Leases was RMB6.59 billion.

Under the Old CDMA Leases, Unicom Horizon agreed to plan, finance and construct the CDMA network, including the procurement of all equipment, and to ensure that the CDMA network was constructed in accordance with the detailed specifications and timetable agreed between Unicom Horizon and us. All payments, costs, expenses and amounts paid or incurred by Unicom Horizon that were directly attributable to the construction of the CDMA network form the total network construction cost, which was used in calculating the lease fee payable by us, including:

construction, installation and equipment procurement costs and expenses,

survey and design costs,

investment in technology, software and other intangible assets,

insurance premiums and capitalized interest on loans,

any taxes levied or paid in respect of the procurement of equipment and the construction of the CDMA network, including import taxes and custom duties, and

all costs incurred in relation to any upgrade of technology.

The Old CDMA Leases required that the network construction cost be verified and appropriate documentation provided to us or our auditors for verification. The lease fee was calculated so as to enable Unicom Horizon to recover its total network construction cost within seven years, together with an internal rate of return of 8%.

We were responsible for the operation, management and maintenance of the CDMA network in accordance with the relevant requirements of the Old CDMA Leases and had the exclusive right to provide CDMA services in our cellular service areas. All operating revenue, including airtime charges, monthly subscription fees, interconnection charges, income from sales of UIM cards and handsets and other income generated from or in connection with the operation of the CDMA network belonged to us. All costs of operating and managing the CDMA network and all maintenance costs of a non-capital nature should be borne by us except that constructed capacity related costs (i.e. those costs of operating and managing the CDMA network which related directly to the constructed capacity on the CDMA network, including the rental fees for stations and base stations and related expenses including water and electricity charges, heating charges and fuel charges for the relevant equipment etc., as well as maintenance costs of a non-capital nature) should be borne by us only to the extent of such part of the costs that corresponded to the proportion of capacity actually leased under the Old CDMA Leases. Such part of the Constructed Capacity Related Costs that corresponded to the proportion of capacity not actually leased under the Old CDMA Leases should be borne by Unicom New Horizon.

In addition to the capacity that we agreed to lease in the first term, subject to giving not less than 180 days prior notice to Unicom Horizon, we could request to lease additional capacity. Unicom Horizon was required to ensure that all capacity which we had so requested was supplied by the due date of delivery of the capacity, provided that, unless otherwise agreed, Unicom Horizon would not be obliged to expand the CDMA network beyond a certain limit. We could not reduce the amount of capacity leased during the initial one-year lease term. However, subject to providing not less than 180 days prior written notice to or with the prior written consent of Unicom Horizon, we could reduce the amount of capacity leased for any additional lease term, provided that we must lease all capacity which we had requested or otherwise committed to lease for at least one year following the date of delivery or renewal of the lease of such capacity.

Subject to certain exceptions, including delay caused by a force majeure event, a material breach of the Old CDMA Leases by us or compliance with applicable laws and regulations, if any capacity was not ready for operational service by the relevant delivery date, then Unicom Horizon should be liable to provide a delay discount to us, equal to the daily lease fee in respect of the relevant capacity multiplied by the number of days of delay, which should be credited against future lease fee payments.

We had the option to purchase the CDMA network, which could be exercised at any time during the initial lease term or any additional lease term of the lease and within one year thereafter. The acquisition price would be negotiated between Unicom Horizon and us, based on the appraised value of the CDMA network determined by an independent assets appraiser in accordance with applicable PRC laws and regulations and taking account of prevailing market conditions and other factors, provided that it would not exceed such price as would, taking into account all lease fee payments made by us to Unicom Horizon and all delay discounts of lease fee, enable Unicom Horizon to recover its total network construction cost, together with an internal rate of return on its investment of 8%. The exercise of the purchase option would be subject to the relevant laws, regulations and listing rules in Hong Kong and the PRC, particularly those governing connected transactions. Title to the CDMA network assets would remain vested in Unicom Horizon until the CDMA network assets were transferred to us following exercise of the purchase option.

In consideration of our entering into the Old CDMA Leases, Unicom Group unconditionally and irrevocably guaranteed the due and punctual performance by Unicom Horizon of its obligations under the Old CDMA Leases. Unicom Group also agreed to indemnify us for any loss suffered as a result of any defect in any of the equipment or any loss caused by any negligence, default, act or omission of Unicom Horizon or Unicom Group under the Old CDMA Leases or in connection with the CDMA network. The aggregate liability of Unicom Group for any claim should not exceed the total amount of lease fee payments made to Unicom Horizon and, where the purchase option had been exercised, the total purchase price paid for the CDMA network. The guarantee and indemnity provided by Unicom Group under the Old CDMA Leases would continue in force until the expiration of the relevant Old CDMA Lease.

We could terminate the Old CDMA Leases by not less than 180 days prior written notice, with effect from the end of any additional term. In addition, Unicom Group or we could terminate an Old CDMA Lease if the other committed any continuing or material breach of the relevant Old CDMA Leases. Unicom Group or Unicom Horizon was not otherwise permitted to terminate the lease.

#### *New CDMA Lease*

On March 24, 2005, we entered into a new CDMA lease agreement, or New CDMA Lease, with Unicom Group and its subsidiary Unicom Horizon to replace the Old CDMA Lease. The New CDMA Lease has an initial term of two years commencing January 1, 2005 and may be renewed at our option. The length of each renewed term shall be agreed by all parties to the New CDMA Lease.

Under the New CDMA Lease, Unicom Horizon has agreed to lease all constructed capacity of its CDMA network to us and the lease fee for the CDMA network will be as follows:

in 2005, 29% of the audited annual service revenue generated by our CDMA cellular business, or CDMA Business Income; and

in 2006, 30% of the CDMA Business Income,

provided that the annual lease fee may not be less than a certain minimum level. The minimum lease fee for 2005 will be 90% of the total amount of lease fee paid by us to Unicom Horizon pursuant to the Old CDMA Leases for 2004. The minimum lease fee for 2006 will be 90% of

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the total amount of lease fee paid by us to Unicom Horizon pursuant to the New CDMA Lease for 2005. The lease fee arrangements for any renewed term of the New CDMA Lease will be subject to negotiations among the parties to the New CDMA Lease.

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Subject to certain exceptions, including delay caused by a force majeure event (including natural disasters, national emergencies, civil disturbances, riots, acts of terrorism, industrial disputes and other similar events beyond the control of the parties), a material breach of the New CDMA Lease by us or compliance with applicable laws and regulations, if Unicom Horizon fails to provide any capacity of its CDMA network which affects the provision of services by us, Unicom Horizon shall be liable to provide a discount for delay to us, calculated as follows:

$$\text{Discount for delay} = \text{Number of our CDMA subscribers affected by the delay} \times \text{delay period (number of days)} \times \text{ARPU of CDMA subscribers the number of days in the relevant month}$$

In the above formula, number of our CDMA subscribers affected by the delay shall be confirmed by us on the basis of substantive evidence; ARPU of CDMA subscribers shall be the average monthly ARPU figure of the CDMA subscribers in the relevant areas for the three months immediately prior to the delay, as calculated and confirmed by us.

The proportion of the constructed capacity related costs to be borne by us shall be calculated by reference to the actual number of our cumulative CDMA subscribers at the end of the month prior to the occurrence of the costs divided by 90%, as a percentage of the total amount of capacity (expressed in terms of the number of subscribers) constructed on the CDMA network.

The other key terms of the New CDMA Lease, including exclusive operating rights, purchase option, guarantee and indemnity, are substantially similar to those of the Old CDMA Leases.

### **Guarantee of Our Bank Loans by Unicom Group**

As of December 31, 2004, short-term bank loans of approximately RMB3,397 million and long-term bank loans of approximately RMB6,779 million of our operating subsidiaries were guaranteed by Unicom Group. Such guarantees were provided for our benefit without any cost to us.

As of December 31, 2004, there is no outstanding loans from Unicom Group to us.

*c.*                    **Interests of Experts and Counsel**

Not applicable.

**Item 8. Financial Information**

See Item 18, Financial Statements .

**Legal Proceedings**

We are not involved in any material litigation, arbitration or administrative proceedings. So far as we are aware, no such litigation, arbitration or administrative proceedings are pending or threatened.



**Policy on Dividend Distribution**

The objective of our dividend policy is to maximize our shareholders' value. The declaration and payment of future dividends will depend upon, among other things, business prospects, future earnings, cash flow, liquidity level and cost of capital. We believe such policy will provide our shareholders with a stable return in the long term along with the growth of our company. We may only pay dividends out of our distributable profits.

**Item 9. The Offer and Listing**

**Market Price Information**

Our American depositary shares, each representing ten ordinary shares, are listed and traded on the New York Stock Exchange. Our ordinary shares are listed and traded on the Hong Kong Stock Exchange. The New York Stock Exchange and the Hong Kong Stock Exchange are the principal trading markets for our ADSs and ordinary shares, which are not listed on any other exchanges in or outside the United States.

The high and low closing prices of our ordinary shares on the Hong Kong Stock Exchange and of our ADSs on the New York Stock Exchange since listing are as follows:

	Price per Ordinary Share (HK\$)		Price per ADS (US\$)	
	High	Low	High	Low
<b>Annual:</b>				
2001	14.00	7.10	18.00	9.00
2002	8.90	4.15	11.54	5.35
2003	8.00	3.92	10.55	5.02
2004	10.20	5.20	13.18	6.78
<b>Quarterly:</b>				
First Quarter, 2003	6.00	4.25	7.72	5.40
Second Quarter, 2003	5.75	3.92	7.46	5.02
Third Quarter, 2003	6.35	5.05	8.29	6.54
Fourth Quarter, 2003	8.00	6.65	10.55	8.42
First Quarter, 2004	10.20	7.00	13.18	8.93
Second Quarter, 2004	7.60	5.20	9.55	6.78
Third Quarter, 2004	6.65	5.55	8.53	7.10
Fourth Quarter, 2004	6.45	5.50	8.28	7.15
<b>Monthly:</b>				
January 2005	6.35	5.60	8.11	7.30
February 2005	7.00	6.10	9.05	7.80
March 2005	7.25	6.00	9.19	7.57
April 2005	6.45	5.90	8.26	7.61
May 2005	6.40	6.00	8.23	7.73
June 2005 (through June 24)	6.65	6.05	8.42	7.79

**Item 10. Additional Information**

A. **Share Capital**

Not applicable.

*B.* **Memorandum and Articles of Association**

**General**

Under our Memorandum of Association, we have the capacity, rights, powers, liabilities and privileges of a natural person. The following is a summary of selected provisions of our Articles of Association:

**Directors**

*Material Interests and Voting*



A director shall not vote (or be counted in the quorum) on any resolution of our board of directors in respect of any contract or arrangement or proposal in which he or any of his associates (as defined in the Hong Kong Stock Exchange Listing Rules) is, to his knowledge, materially interested, and if he shall do so, his vote shall not be counted (nor shall he be counted in the quorum for that resolution), but this prohibition does not apply to any contract, arrangement or other proposal for or concerning:

the giving of any security or indemnity either (a) to the director or any of his associates (as defined in the Hong Kong Stock Exchange Listing Rules) in respect of money lent or obligations incurred by him or any of them at the request of or for the benefit of Unicom or any of its subsidiaries or (b) to a third party in respect of a debt or obligation of Unicom or any of its subsidiaries for which the director or any of his associates has himself assumed responsibility or guaranteed or secured in whole or in part;

an offer of shares or debentures or other securities of or by Unicom (or any other company which Unicom may promote or be interested in) where the director or any of his associates is a participant in the underwriting or sub-underwriting of the offer;

any other company in which the director or any of his associates is interested only, whether directly or indirectly, as an officer or shareholder or in which the director is beneficially interested in shares of that company, provided that he, together with any of his associates is not beneficially interested in 5% or more of (a) the issued shares of any class of such company (or of any third company through which such interest is derived) or (b) the voting rights attached to such issued shares or securities (excluding for the purpose of calculating such 5% interest any indirect interest of such director or any of his associates by virtue of an interest of Unicom in such company);

the benefit of employees of Unicom or any of its subsidiaries including (a) the adoption, modification or operation of any employees share scheme under which the director or any of his associates may benefit or (b) the adoption, modification or operation of a pension fund or retirement, death or disability benefits scheme which relates both to directors, their associates and employees of Unicom or any of its subsidiaries and does not provide in respect of the director or any of his associates any privilege or advantage not generally accorded to the class of persons to which such scheme or fund relates; or

any contract or arrangement in which the director or any of his associates is interested in the same manner as other holders of shares or debentures or other securities of Unicom by virtue only of his interest in shares or debentures or other securities of Unicom.

*Remuneration and Pensions*

The directors of Unicom are entitled to receive by way of remuneration for their services such sum as is from time to time determined by Unicom in general meeting. The directors are also entitled to be repaid all traveling, hotel and other expenses reasonably incurred by them in or about the performance of their duties as directors. The board of directors may grant special remuneration to any director who performs services which in the opinion of the board are outside the scope of the ordinary duties of a director.

The board may establish and maintain any contributory or non-contributory pension or superannuation funds for the benefit of, or give donations, gratuities, pensions, allowances or emoluments to, any persons (a) who are or were at any time in the employment or service of Unicom, or of any company which is a subsidiary of Unicom, or is allied or associated with Unicom or with any such subsidiary company, or (b) who are or were at any time directors or officers of Unicom or of any such other company above, and holding or who have held any salaried employment or office in Unicom or such other company, and the wives, widows, families and dependants of any such persons and may make payments for or towards the insurance of any such persons. Any director holding any such employment or office is entitled to participate in, and retain for his own benefit, any such donation, gratuity, pension, allowance or emolument.

***Borrowing Powers***

The directors may exercise all the powers of Unicom to borrow money and to mortgage or charge all or any part of the undertaking, property and assets (present and future) and uncalled capital of Unicom and to issue debentures, debenture stocks, bonds and other securities, whether outright or as collateral security for any debt, liability or obligation of Unicom or of any third party.

*Qualification of Directors*

A director of Unicom is not required to hold any qualification shares. No person is required to vacate office or be ineligible for re-election or reappointment as a director.

*Rotation of Directors*

At every annual general meeting, one-third of the directors for the time being, or, if the number is not three or a multiple of three, then the number nearest one-third, shall retire from office by rotation except for any director holding office as Chairman or Chief Executive Officer. The directors to retire in every year shall be those who have been longest in office since their last election. In addition, a director appointed by the board to fill in a casual vacancy or as an addition to the board shall retire at the next following general meeting and shall not be taken into account in determining the number of directors who are to retire by rotation at each annual general meeting. The retiring directors shall be eligible for re-election.

**Rights Attached to Ordinary Shares**

*Voting Rights*



Under the Companies Ordinance, any action to be taken by the shareholders in a general meeting requires the affirmative vote of either an ordinary or a special resolution passed at the meeting. An ordinary resolution is one passed by the majority of such shareholders as are entitled to, and do, vote in person or by proxy at a general meeting. A special resolution is one passed by not less than three-quarters of such shareholders as are entitled to, and do, vote in person or by proxy at a general meeting. Most shareholders decisions are passed by ordinary resolutions. However, the Companies Ordinance and our articles of association stipulate that certain matters may only be passed by special resolutions.

Subject to any special rights, privileges or restrictions as to voting that may from time to time be attached to any class or classes of shares, at any general meeting a resolution put to the vote of the meeting shall be decided on a show of hands unless a poll is required by the Listing Rules of the Hong Kong Stock Exchange or is demanded by:

the chairman of the meeting,

at least three shareholders present in person or by proxy and entitled to vote at the meeting,

any shareholder or shareholders present in person or by proxy and representing in the aggregate not less than one-tenth of the total voting rights of all shareholders having the right to attend and vote at the meeting, or

any shareholder or shareholders present in person or by proxy and holding shares conferring a right to attend and vote at the meeting on which there have been paid up sums in the aggregate equal to not less than one-tenth of the total sum paid up on all shares conferring that right.

On a show of hands, every individual shareholder who is present in person and every corporate shareholder who is present by a representative duly authorized under section 115 of the Companies Ordinance has one vote.

On a poll, every shareholder present in person or, if the shareholder is a corporation, by duly authorized representative, or by proxy has one vote for every share of which he or she is the shareholder which is fully paid up or credited as fully paid up. However, no amount paid up or credited as paid up on a share in advance of calls or installments is treated for the foregoing purposes as paid up on the share.

Any action to be taken by the shareholders requires the affirmative vote of a majority of the shares at a meeting of shareholders. There are no cumulative voting rights. Accordingly, the holders of a majority of the shares voting for the election of directors can elect all the directors if they choose to do so.

*Issue of Shares*

Under the Companies Ordinance, our board of directors may, without prior approval of our shareholders, offer to issue new shares to existing shareholders proportionately according to their shareholdings. Our board of directors may not offer to issue new shares in any other manner without the prior approval of our shareholders in a general meeting. Any such approval given in a general meeting will continue in force until the conclusion of the following annual general meeting or the expiration of the period within which the next annual general meeting is required by law to be held or when revoked or varied by an ordinary resolution of our shareholders in a general meeting, whichever comes first. If such approval is given, the unissued shares shall be at the disposal of our board of directors, which may offer, allot, grant options over or otherwise dispose of them to such persons, at such times and for such consideration and upon such terms and conditions as our board of directors may determine.

In accordance with the Listing Rules of the Hong Kong Stock Exchange, any such approval given by the shareholders must be limited to shares with an aggregate nominal value not exceeding 20 per cent of the aggregate nominal value of our share capital in issue plus the aggregate nominal amount of share capital repurchased by us since the granting of such approval.

*Dividends*

Subject to the Companies Ordinance and as set out in our articles of association, our shareholders in a general meeting may from time to time by ordinary resolution declare dividends to be paid to our shareholders according to their rights and interests in the profits available for distribution, but no dividend shall be declared in excess of the amount recommended by our board of directors.

In addition to any dividends declared in a general meeting upon the recommendation of the board of directors, our board of directors may from time to time declare and pay to our shareholders such interim dividends as appear to our board of directors to be justified by our financial position. Our board of directors may also pay any fixed dividend which is payable on any of our shares on any other dates, whenever our financial position, in the opinion of our board of directors, justifies such payments.

All dividends or bonuses unclaimed for one year after having become payable may be invested or otherwise made use of by the board for the benefit of Unicom until claimed. All dividends or bonuses unclaimed for six years after having been declared may be forfeited by the board and will revert to Unicom.

***Winding Up***

If we are wound up, the surplus assets remaining after payment to all creditors shall be divided among the shareholders in proportion to the capital paid up on the shares held by them, subject to the rights of the holders of any shares which may be issued on special terms or conditions.

If we are wound up, the liquidator may, with the sanction of a special resolution, divide among our shareholders in specie or in kind the whole or any part of our assets or vest any part of our assets in trustees upon such trusts for the benefit of our shareholders or any of them as the resolution shall provide.

*Miscellaneous*

Shareholders are not entitled to any redemption rights, conversion rights or preemptive rights on the transfer of ordinary shares.

The transfer agent and registrar for the shares is Hong Kong Registrars Limited, 46th Floor, Hopewell Centre, 183 Queen's Road East, Hong Kong.

*Modification of Rights*

Subject to the Companies Ordinance, any of the rights from time to time attaching to any class of shares may, subject to the provisions of the Companies Ordinance, be varied or abrogated with the consent in writing of the holders of not less than three-fourths of the issued shares of that class or with the sanction of a special resolution passed at a separate general meeting of the holders of shares of that class. The provisions of our Articles of Association relating to general meetings apply to such separate general meetings, except that the necessary quorum is not less than two persons holding or representing by proxy one-third in nominal value of the issued shares of that class, and that any holder of the shares of the class present in person or by proxy may demand a poll.

**Annual General and Extraordinary General Meetings**



We must hold in each year a general meeting as our annual general meeting in addition to any other meetings in that year. The annual general meeting is held at such time (within a period of not more than fifteen months, or such longer period as the Registrar of Companies of Hong Kong may authorize in writing, after the holding of the last preceding annual general meeting) and place as may be determined by the Directors. All other general meetings are called extraordinary general meetings. The Directors may call an extraordinary general meeting at any time or upon request in accordance with the Hong Kong Companies Ordinance.

Subject to the Companies Ordinance, an annual general meeting and a meeting called for the passing of a special resolution can be called by not less than twenty-one days' notice in writing, and any other general meeting can be called by not less than fourteen days' notice in writing. The notice must specify the place, date and time of meeting, and, in the case of special business, the general nature of that business.

**Limitations on Rights to Own Securities**

There are no limitations on the rights to own securities, including the rights of non-resident or foreign shareholders to hold or exercise voting rights on the securities, imposed by Hong Kong law or by our Memorandum of Association or our Articles of Association.

**Changes in Capital**

We may exercise any powers conferred or permitted by the Companies Ordinance to purchase or otherwise acquire our own shares and warrants at any price or to give, directly or indirectly, by means of a loan, guarantee, the provision of security or otherwise, financial assistance for the purpose of or in connection with a purchase made by any person of any shares or warrants in Unicom. Repurchases of our own shares may be made either by way of a general offer to all shareholders in proportion to their shareholdings, by purchasing our shares on a stock exchange or by an off-market contract with individual shareholders. Any such purchase or other acquisition or financial assistance must be made or given in accordance with any relevant rules or regulations issued by the Hong Kong Stock Exchange or the Securities and Futures Commission of Hong Kong.

We in general meeting may, from time to time, by ordinary resolution increase our authorized share capital by the creation of new shares, and prescribe the amount of new capital and number of new shares. We may from time to time by ordinary resolution:

consolidate and divide all or any of our share capital into shares of a larger amount than our existing shares;

divide our shares into several classes and attach to them any preferential, deferred, qualified or special rights, privileges or conditions;

cancel any shares which at the date of the passing of the resolution have not been taken or agreed to be taken by any person, and diminish the amount of our share capital by the amount of the shares so canceled;

sub-divide our shares or any to them into shares of a smaller amount than is fixed by our Memorandum of Association, subject nevertheless to the provisions of the Companies Ordinance; and

make provision for the issue and allotment of shares which do not carry any voting rights.

*c.*            **Material Contracts**

In addition to contracts we have entered into with our controlling shareholder, Unicom Group, or its subsidiaries, as described in Related Party Transactions under Item 7, Unicom Group, we or our subsidiaries have entered into the following contracts that are not in the ordinary course of business within the two years preceding the date of this annual report that are or may be material:

Our share option schemes, as described in A. Directors and Senior Management and E. Share Ownership Stock Incentive Schemes under Item 6.

Conditional Sale and Purchase Agreement between Unicom BVI and our Company, dated November 20, 2003, relating to our acquisition of Unicom New World. See A. History and Development of the Company Acquisition of Unicom New World and the Sale of Guoxin Paging under Item 4.

Conditional Sale and Purchase Agreement between CUCL and A Share Company, dated November 20, 2003, relating to the sale of Guoxin Paging by us to Unicom Group. See A. History and Development of the Company Acquisition of Unicom New World and the Sale of Guoxin Paging under Item 4.

Conditional Sale and Purchase Agreement between China Unicom (Hong Kong) Group Limited and our Company, dated July 28, 2004, relating to our acquisition of Unicom International. See A. History and Development of the Company Acquisition of China Unicom International Limited under Item 4.

*D.*

## **Exchange Controls**

The ability of our operating subsidiaries, CUCL and Unicom New World, to satisfy their respective foreign exchange obligations and to pay dividends to us depends on existing and future exchange control regulations in China. The Renminbi is currently convertible under the current account, which includes trade and service related foreign exchange transactions. Renminbi currently cannot be converted under the capital account, which includes foreign direct investment. CUCL and Unicom New World, our wholly-owned subsidiaries that hold substantially all of our assets, are both foreign investment enterprises. The foreign investment enterprise status will allow these subsidiaries to purchase foreign exchange at designated foreign exchange banks for settlement of current account transactions without the approval of the State Administration for Foreign Exchange. These current account transactions include payment of dividends. However, the relevant Chinese government authorities may in the future limit or eliminate the authorizations for a foreign investment enterprise to retain its foreign exchange to satisfy its foreign exchange obligations or to pay dividends in the future. Furthermore, certain foreign exchange transactions of these subsidiaries under the capital account still require approvals from the State Administration for Foreign Exchange. This requirement affects our subsidiaries' ability to obtain foreign exchange through equity financing, including by means of capital contributions from us.

Under existing Hong Kong law, (i) there are no foreign exchange controls or other laws which restrict the import or export of capital and which would affect the availability of cash and cash equivalents for our use, (ii) there are no foreign exchange controls or other laws, decrees or regulations that affect the remittance of interest, dividends or other payments on our outstanding debt and equity securities to U.S. residents and (iii) there are no limitations on the rights of non-resident or foreign owners to hold our debt or equity securities.

*E.*                    **Taxation**

The taxation of income and capital gains of holders of ordinary shares or ADSs is subject to the laws and practices of Hong Kong and of jurisdictions in which holders of ordinary shares or ADSs are resident or otherwise subject to tax. The following summary of certain relevant taxation provisions is based on current law and practice, is subject to change and does not constitute legal or tax advice. The discussion does not deal with all possible tax consequences relating to an investment in the ordinary shares or ADSs. In particular, the discussion does not address the tax consequences under state, local and other laws, such as non-Hong Kong and non-U.S. federal laws. The discussion is based upon laws and relevant interpretations in effect as of the date of this annual report.

**Hong Kong**



*Tax on Dividends*

Under the current practices of the Hong Kong Inland Revenue Department, no tax is payable in Hong Kong in connection with dividends paid by us.

*Profits*

No tax is imposed in Hong Kong in respect of capital gains from the sale of property, such as the shares and ADSs. Trading gains from the sale of property by persons carrying on a trade, profession or business in Hong Kong where such gains are derived from or arise in Hong Kong from such trade, profession or business will be chargeable to Hong Kong profits tax which is currently imposed at the rate of 17.5% on corporations and individuals at a maximum rate of 15.5% with effect from April 1, 2003 and 16.0% with effect from April 1, 2004. Gains from sales of the shares effected on the Hong Kong Stock Exchange will be considered to be derived from or arise in Hong Kong. Liability for Hong Kong profits tax would thus arise in respect of trading gains from sales of shares or ADSs realized by persons carrying on a business of trading or dealing in securities in Hong Kong.

*Stamp Duty*

Hong Kong stamp duty, currently charged at the rate of 0.1% of the higher of the consideration for or the value of the shares, will be payable by the purchaser on every purchase and by the seller on every sale of shares. In addition, a fixed duty of HK\$5 is currently payable on any instrument of transfer of shares.

The withdrawal of shares upon the surrender of ADRs, and the issuance of ADRs upon the deposit of shares, will also attract stamp duty at the rate described above for sale and purchase transactions unless such withdrawal or deposit does not result in a change in the beneficial ownership of the shares under Hong Kong law. The issuance of the ADRs upon the deposit of shares issued directly to The Bank of New York, as depository of the ADSs, or for the account of The Bank of New York does not attract stamp duty. No Hong Kong stamp duty is payable upon the transfer of ADSs outside Hong Kong.

*Estate Duty*

The shares are Hong Kong property under Hong Kong law, and accordingly such shares may be subject to estate duty on the death of the beneficial owner of such shares, regardless of the place of the owner's residence, citizenship or domicile. We cannot assure you that the Hong Kong Inland Revenue Department will not treat the ADSs as Hong Kong property that may be subject to estate duty on the death of the beneficial owner of the ADS even if the ADRs evidencing such ADSs are located outside Hong Kong at the date of such death. Hong Kong estate duty is imposed on a progressive scale from 5% to 15%. The rate of and the threshold for estate duty has, in the past, been adjusted on a fairly regular basis. No estate duty is payable when the aggregate value of the dutiable estate does not exceed HK\$7.5 million, and the maximum rate of duty of 15% applies when the aggregate value of the dutiable estate exceeds HK\$10.5 million. The rates and thresholds stated here apply to the estate of persons who died after April 1, 1998.

**United States**

*United States Federal Income Taxation*

This section describes the material United States federal income tax consequences to a U.S. holder (as defined below) of owning shares or ADSs. It applies to you only if you hold your shares or ADSs as capital assets for tax purposes. This section does not apply to you if you are a member of a special class of holders subject to special rules, including:

a dealer in securities,

holdings, a trader in securities that elects to use a mark-to-market method of accounting for your securities

a tax-exempt organization,



an insurance company,

a person liable for alternative minimum tax,

a person that actually or constructively owns 10% or more of our voting stock,

a person that holds shares or ADSs that are a hedge or that are hedged against currency risks or as part of a straddle or a conversion transaction, or

a person whose functional currency is not the U.S. dollar.

This section is based on the Internal Revenue Code of 1986, as amended, its legislative history, existing and proposed regulations, published rulings and court decisions, all as currently in effect. These laws are subject to change, possibly on a retroactive basis. In addition, this section is based in part upon the representations of the Depositary and the assumption that each obligation in the deposit agreement and any related agreement will be performed in accordance with its terms.

You are a U.S. holder if you are a beneficial owner of shares or ADSs and you are:

a citizen or resident of the United States,

a corporation organized under the laws of the United States or any States,

an estate whose income is subject to United States federal income tax regardless of its source, or

a trust if a United States court can exercise primary supervision over the trust's administration and one or more United States persons are authorized to control all substantial decisions of the trust.

You should consult your own tax advisor regarding the United States federal, state and local tax consequences of owning and disposing of shares and ADSs in your particular circumstances.

This discussion addresses only United States federal income taxation.

In general, and taking into account the earlier assumptions, for United States federal income tax purposes, if you hold ADRs evidencing ADSs, you will be treated as the owner of the shares represented by those ADSs. Exchanges of shares for ADSs, and ADSs for shares, generally will not be subject to United States federal income tax.

#### *Taxation of Dividends*

Under the United States federal income tax laws, and subject to the passive foreign investment company, or PFIC, rules discussed below, if you are a U.S. holder, the gross amount of any dividend we pay out of our current or accumulated earnings and profits (as determined for United States federal income tax purposes) is subject to United States federal taxation. If you are a noncorporate U.S. holder, dividends paid to you after December 31, 2002 and before January 1, 2009 that constitute qualified dividend income will be taxable to you at a maximum tax rate of 15% provided that you hold the shares or ADSs for more than 60 days during the 121-day period beginning 60 days before the ex-dividend date and meet other holding period requirements. Dividends we pay with respect to the shares or ADSs will be qualified dividend income provided that, in the year that you receive the dividend, the shares or ADSs are readily tradable on an established securities market in the United States.

The dividend is taxable to you when you, in the case of shares, or the Depositary, in the case of ADSs, receive the dividend, actually or constructively. The dividend will not be eligible for the dividends-received deduction generally allowed to United States corporations in respect of dividends received from other United States corporations. The amount of the dividend distribution that you must include in your income as a U.S. holder will be the U.S. dollar value of the Hong Kong Dollar payments made, determined at the spot Hong Kong/U.S. dollar rate on the date the dividend distribution is includible in your income, regardless of whether the payment is in fact converted into U.S. dollars. Generally, any gain or loss resulting from currency exchange fluctuations during the period from the date you include the dividend payment in income to the date you convert the payment into U.S. dollars will be treated as ordinary income or loss and will not be eligible for the special tax rate applicable to qualified dividend income. The gain or loss generally will be income or loss from sources within the United States for foreign tax credit limitation purposes. Distributions in excess of current and accumulated earnings and profits, as determined for United States federal income tax purposes, will be treated as a non-taxable return of capital to the extent of your basis in the shares or ADSs and thereafter as capital gain.

Special rules apply in determining the foreign tax credit limitation with respect to dividends that are subject to the maximum 15% tax rate. Dividends will be income from sources outside the United States, but dividends paid in taxable years beginning before January 1, 2007 generally will be passive income or financial services income and dividends paid in taxable years beginning after December 31, 2006 will, depending on your circumstances, be passive income or general income which, in either case, is treated separately from other types of income for purposes of computing the foreign tax credit allowable to you.

#### *Taxation of Capital Gains*

Subject to the passive foreign investment company rules discussed below, if you are a U.S. holder and you sell or otherwise dispose of your shares or ADSs, you will recognize capital gain or loss for United States federal income tax purposes equal to the difference between the U.S. dollar value of the amount that you realize and your tax basis, determined in U.S. dollars, in your shares or ADSs. Capital gain of a non-corporate U.S. holder that is recognized on or after May 6, 2003 and before January 1, 2009 is generally taxed at a maximum rate of 15% where the property is held more than one year. The gain or loss will generally be income or loss from sources within the United States for foreign tax credit limitation purposes. Your ability to deduct capital losses is subject to limitations. Any Hong Kong stamp duty that you pay will not be a creditable tax for United States federal income tax purposes, but you may be able to deduct such stamp duty subject to limitations under the Code.

*Passive Foreign Investment Company Rules.* We believe that we should not be treated as a passive foreign investment company for United States federal income tax purposes, but this conclusion is a factual determination that is made annually and thus may be subject to change.

In general, if you are a U.S. holder, we will be a passive foreign investment company with respect to you if for any taxable year in which you held our ADSs or shares:

at least 75% of our gross income for the taxable year is passive income, or

at least 50% of the value, determined on the basis of a quarterly average, of our assets is attributable to assets that produce or are held for the production of passive income.

Passive income generally includes dividends, interest, royalties, and rents, but not including certain rents and royalties derived in the active conduct of a trade or business, annuities, gains from assets that produce passive income. If a foreign corporation owns directly or indirectly at least 25% by value of the stock of another corporation, the foreign corporation is treated for purposes of the passive foreign investment company tests as owning its proportionate share of the assets of the other corporation, and as receiving directly its proportionate share of the other corporation's income.

If we are treated as a passive foreign investment company, and you are a U.S. holder that does not make a mark-to-market election, as described below, you will be subject to special rules with respect to:

any gain you realize on the sale or other disposition of your shares or ADSs, and

any excess distribution that we make to you. Generally, any distributions to you during a single taxable year that are greater than 125% of the average annual distributions received by you in respect of the shares or ADSs during the three preceding taxable years or, if shorter, your holding period for the shares or ADSs.

Under these rules:

the gain or excess distribution will be allocated ratably over your holding period for the shares or ADSs,

the amount allocated to the taxable year in which you realized the gain or excess distribution will be taxed as ordinary income,

the amount allocated to each prior year, with certain exceptions, will be taxed at the highest tax rate in effect for that year, and

the interest charge generally applicable to underpayments of tax will be imposed in respect of the tax attributable to each such year.

Special rules apply for calculating the amount of the foreign tax credit with respect to excess distributions by a passive foreign investment company.

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If you own shares or ADSs in a passive foreign investment company that are treated as marketable stock, you may make a mark-to-market election. If you make this election, you will not be subject to the passive foreign investment company rules described above. Instead, in general, you will include as ordinary income each year the excess, if any, of the fair market value of your shares or ADSs at the end of the taxable year over your adjusted basis in your shares or ADSs. You will also be allowed to take an ordinary loss in respect of the excess, if any, of the adjusted basis of your shares or ADSs over their fair market value at the end of the taxable year (but only to the extent of the net amount of previously included income as a result of the mark-to-market election). Your basis in the shares or ADSs will be adjusted to reflect any such income or loss amounts. Your gain, if any, recognized upon the sale of your shares or ADSs will be taxed as ordinary income.

In addition, notwithstanding any election you make with regard to the shares or ADSs, dividends that you receive from us will not constitute qualified dividend income to you if we are a PFIC either in the taxable year of the distribution or the preceding taxable year. Dividends that you receive that do not constitute qualified dividend income are not eligible for taxation at the 15% maximum rate applicable to qualified dividend income. Instead, you must include the gross amount of any such dividend paid by us out of our accumulated earnings and profits (as determined for United States federal income tax purposes) in your gross income, and it will be subject to tax at rates applicable to ordinary income.

If you own shares or ADSs during any year that we are a passive foreign investment company, you must file Internal Revenue Service Form 8621.

*F.*                    **Dividends and Paying Agents**

Not applicable.

*G.*                    **Statement by Experts**



Not applicable.

*H.* **Documents on Display**

You can read and copy documents referred to in this annual report that have been filed with the U.S. Securities and Exchange Commission, or the SEC, at the SEC's public reference room located at 100 F Street, N.E., Room 1580, Washington, D.C. 20549. Please call the SEC at 1-800-SEC-0330 for further information on the public reference rooms and their copy charges.

*I.*                    **Subsidiary Information**

Not applicable.

**Item 11. Quantitative and Qualitative Disclosures About Market Risks**

Our exposure to financial market risks relates primarily to changes in interest rates and currency exchange rates.

**Interest Rate Risk**

We are subject to market risks due to fluctuations in interest rates, principally as a result of our long-term loans, all of which bear variable interest rates. The original maturities of our long-term loans range from one to seven years.

The People's Bank of China has the sole authority in China to establish official interest rates for Renminbi-denominated loans. Financial institutions in China set their effective interest rates within the range established by the People's Bank of China. The fair value of our borrowings is the same as the carrying value since all our bank loan interest are variable. Most of our bank loans are denominated in Renminbi and borrowed from domestic banks at interest rates that vary in accordance with the standard guidance interest rates announced by relevant Chinese government authorities.

Interest rates and payment methods on loans denominated in foreign currencies are set by financial institutions based on interest rate changes in the international financial market, cost of funds, risk levels and other factors. In September 2003, we entered into a US\$700 million term loan facility with 13 financial institutions, which is consisted of three tranches: a three-year US\$200 million tranche, with an interest rate of 0.28% over the US\$ LIBOR, a five-year US\$300 million tranche, with an interest rate of 0.35% over the US\$ LIBOR, and a seven-year US\$200 million tranche, with an interest rate of 0.44% per annum over the US\$ LIBOR.

In February 2004, we entered into a US\$500 million long-term syndicated loan agreement with 12 financial institutions to finance working capital and network construction expenditure. This facility is repayable in three years and carries an interest rate of 0.40% over US\$ LIBOR per annum.

As a result, we are exposed to interest rate risk resulting from fluctuations in interest rates on our debts. Increases in interest rates will increase the cost of new borrowing and the interest expense with respect to our outstanding floating rate debt, and therefore could have a material adverse effect on our financial position. From time to time, we may enter into interest rate swap agreements designed to mitigate our exposure to interest rate risks in connection with our borrowings denominated in foreign currencies, although we did not consider it necessary to do so in 2004. We are also considering hedging our borrowings denominated in Renminbi once interest rate swaps become available for Renminbi-denominated borrowings in China.

The following table provides information, by maturity date, regarding our interest rate-sensitive financial instruments, which consist of variable rate debt obligation, as of December 31, 2004. We do not have fixed rate debt obligation as of December 31, 2004.

	2005	2006	Expected Maturity Date				Thereafter	As of December 31, 2004	
			2007	2008	2009	Total		Fair Value	
	(RMB equivalent in million, except interest rate)								
Variable rate bank and other loans	20,015	11,882	7,957	7,605	1,014	1,818	50,290	50,290	
Average interest rate <sup>(1)</sup>	4.16%	4.09%	4.03%	3.73%	3.61%	3.10%			

(1) The interest rates for variable rate bank and other loans are calculated based on the weighted average interest rates at the end of 2004.

For the year ended December 31, 2004, if the average interest rates for our variable rate bank and other loans had increased by 10%, we estimate that we would have incurred additional interest expenses of RMB230 million in 2004.

**Exchange Rate Risk**

The majority of our indebtedness and capital expenditures are in Renminbi. Currency exchange rate risk exists with respect to our repayment of indebtedness to our foreign lenders, payables to equipment suppliers and contractors and our dividend payments to holders of ordinary shares and ADSs in foreign currencies. As of December 31, 2004, approximately RMB10.06 billion of capital commitments was authorized and contracted for in currencies other than Renminbi and foreign currency-denominated debt outstanding, representing our three-tranches US\$700 million term loan entered into with 13 financial institutions in September 2003 and \$500 million long-term syndicated loan entered into with 12 financial institutions in February 2004 as described above. In addition, we had approximately US\$85 million in bank balances and cash, and short-term bank deposits as of December 31, 2004. Although the Renminbi to US\$ exchange rate has been relatively stable since 1994, we cannot predict nor give any assurance of its future stability. Fluctuations in exchange rates may lead to significant fluctuations in the exposure of our foreign-currency-denominated liabilities and assets. We may, from time to time, enter into currency swap agreements and foreign exchange forward contracts designed to mitigate our exposure to foreign currency risks, although we did not consider this to be necessary in 2004.

The following table provides information regarding our foreign currency-sensitive financial instruments and transactions, which consist of short-term bank deposits, bank balances and cash, long-term debt obligations and capital commitments as of December 31, 2004.

	2005	2006	Expected Maturity Date				As of December 31, 2004	
			2007	2008	2009	Thereafter	Total	Fair Value
(RMB equivalent in million, except interest rate)								
<b>On-balance sheet financial instruments:</b>								
Short-term deposits with banks:								
in U.S. dollars	662						662	662
in Hong Kong dollars								
Bank balances and cash								
in U.S. dollars	40						40	40
in Hong Kong dollars	80						80	80
<b>Debts:</b>								
Variable rate bank and other loans (U.S. dollar)		1,655	4,139	2,483		1,655	9,932	9,932
Average interest rate <sup>(1)</sup>		2.85%	2.82%	2.78%		2.89%		
<b>Off-balance sheet commitments:</b>								
Capital commitments authorized and contracted for in U.S. dollar								
	126						126	126

(1) The interest rates for variable rate bank and other loans are calculated based on the weighted average interest rates at the end of 2004.

**Item 12. Description of Securities Other than Equity Securities**

Not Applicable.

**PART II**





**Item 13. Defaults, Dividend Arrearages and Delinquencies**



None.

**Item 14. Material Modifications to the Rights of Security Holders and Use of Proceeds**



None.

**Item 15. Controls and Procedures**



In the course of our regular internal audit during 2004, we identified certain improper accounting recordings and errors at our Jiangxi and Xinjiang branches. These two branches were acquired by us in connection with our acquisition of the cellular telecommunications businesses in nine provinces and autonomous regions in the PRC on December 31, 2002. We have identified and communicated these issues to our audit committee. We have concluded that no restatement of our consolidated financial statements as of and for the years ended December 31, 2002 and 2003 is necessary as these issues did not result in a material misstatement of such consolidated financial statements and did not have a material impact on our financial condition and results of operations.

However, our management is of the view that these issues at our Jiangxi and Xinjiang branches reflect a material weakness in internal control over financial reporting. In particular, these issues with respect to these two branches relate to, among others, provision for bad debt, recordings of mobile handset costs and agency commission as well as revenue recognition. These issues resulted in an overstatement of our net income of approximately RMB34 million and RMB115 million for the years 2002 and 2003, respectively. Our management has made the appropriate corrections to these issues in our consolidated financial statements as of and for the year ended December 31, 2004.

Upon the identification of these issues at our Jiangxi and Xinjiang branches, our management promptly imposed disciplinary action against the responsible employees at these two branches. We have not identified similar issues at our other branches in the course of our regular internal audit.

Our chief executive officer and chief financial officer have evaluated the effectiveness of our disclosure controls and procedures (as defined in Rule 13a-15(e) of the U.S. Securities Exchange Act of 1934, as amended (the Exchange Act)) as of December 31, 2004, the end of the period covered by this annual report. In making this evaluation, our chief executive officer and chief financial officer have considered matters relating to the issues referenced above, including the process described below that was undertaken to ensure that such issues would not be repeated.

In response to the issues identified by us at our Jiangxi and Xinjiang branches, our management, under the direction of our audit committee and upon the recommendations of our company's independent registered public accounting firm, has directed that we dedicate resources and take a series of measures to strengthen control processes and procedures in order to prevent a recurrence of such issues and to improve our internal control over financial reporting. These measures include, among others:

strengthening the internal audit and monitoring controls over our branches;



improving information management system to enhance internal control and reinforcing existing control over the financial reporting process;

financial data;  
implementing more stringent responsibility systems to ensure the accuracy in the reporting of

establishing an enterprise risk management system and risk evaluation procedures;

strengthening the period-end financial reporting process, including enhancing the trainings of our finance and accounting personnel with respect to U.S. and Hong Kong accounting practices; and

further formalizing anti-fraud and whistleblower policies and procedures.

Our management is fully aware of the importance of maintaining and improving our controls and procedures. In preparation for the compliance with Section 404 of the Sarbanes-Oxley Act of 2002 and under the supervision and with the participation of our senior management, including our chief executive officer and chief financial officer, we are in the process of conducting further evaluation of our internal control over financial reporting and plan to design and implement enhanced processes and controls to improve our internal control over financial reporting. As we are still in the evaluation process, we may identify areas of internal control deficiencies that may require appropriate actions for correction or improvement. We are committed to further improving our controls and procedures.

Based on their evaluation of the effectiveness of our disclosure controls and procedures as described above, and subject to the full implementation of the measures discussed above, our chief executive officer and chief financial officer have concluded that, as of the end of the period covered by this annual report, our disclosure controls and procedures were adequate to ensure that material information relating to us and our consolidated subsidiaries was made known to them by others within our company and our consolidated subsidiaries.

Other than as described above, there were no significant changes in our internal control over financial reporting that occurred during the period covered by this annual report that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

**Item 16A. Audit Committee Financial Expert**



Our board of directors has determined that Mr. Shan Weijian, a member of our audit committee, is an audit committee financial expert.

**Item 16B. Code of Ethics**



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We have adopted a code of ethics that applies to our chief executive officer, chief financial officer, president, vice-president, controller and other senior officers. We have posted the text of such code of ethics on our Internet website at [www.chinaunicom.com.hk](http://www.chinaunicom.com.hk).

**Item 16C. Principal Accountant Fees and Services**



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The following table sets forth the aggregate audit fees, audit-related fees, tax fees and other fees for our principal accountant billed for products and services provided by our principal accountant for audit services, audit-related services, tax services and other services for each of the fiscal years 2003 and 2004:

	For the years ended December 31,	
	2003	2004
	(in US dollars)	
Audit fees	6,528,000	6,950,000
Audit-related fees	1,900,000	10,000
Tax fees	2,000	14,000
All other fees		190,000
<b>Total</b>	<b>8,430,000</b>	<b>7,164,000</b>

Audit services are defined as the standard audit work that needs to be performed each year in order to issue an opinion on the consolidated financial statements of our Company and of Unicom Group. It also includes audit services that only the external auditor reasonably can provide, such as pre-issuance reviews of quarterly and interim financial results.

Audit-related services include those other assurances and related services provided by auditors, but not restricted to those that can only reasonably be provided by the external auditor signing the audit report, that are reasonably related to the performance of the audit or review of our Company's financial statements such as acquisition due diligence, consultations concerning financial accounting and reporting standards.

Tax services include the assistance with compliance and reporting of enterprise taxes, assistance with our assessment of new or changing tax regimes, and assistance with assessing relevant rules, regulations and facts going into our correspondence with tax authorities.

Other services include review of revenue assurance process provided by our principal accountant to our provincial branch in 2004.

### **Audit Committee's Pre-approval Policies and Procedures**

The Audit Committee of our Board of Directors is responsible, among other things, for the oversight of the external auditor subject to the requirements of the Hong Kong Company Ordinance and our Articles of Association. The Audit Committee has adopted a policy regarding pre-approval of audit and permissible non-audit services to be provided by our independent accountants. Under the policy, proposed services either (i) may be pre-approved by the Audit Committee without consideration of specific case-by-case services; or (ii) require the specific pre-approval of the Audit Committee. General approval applies to services of a recurring and predictable nature. These types of services, once approved by the Audit Committee, will not require further approval in the future, except when actual fees and expenses exceed pre-approved budget levels. In such a case, the Audit Committee may authorize one of its members to approve budget increases subject to the requirement that such member provide a report on his decision to approve or deny an application for budget increases to the Audit Committee at an Audit Committee meeting held immediately after such member grants or denies the approval.

Specific pre-approval applies to all other services. These services must be approved by the Audit Committee on a case-by-case basis after an application including proposed budget and scope of services to be provided by our independent auditors is submitted to the Audit Committee.





**Item 16D. Exemptions from the Listing Standards for Audit Committees**



Not applicable.

**Item 16E. Purchases of Equity Securities by the Issuer and Affiliated Purchasers**



Not applicable.

**PART III**



**Item 17. Financial Statements**





We have elected to provide financial statements and related information specified in Item 18 in lieu of Item 17.

**Item 18. Financial Statements**



See Index to Consolidated Financial Statements for a list of all financial statements filed as part of this annual report.

**Item 19. Exhibits**

## Edgar Filing: CHINA UNICOM LTD - Form 20-F

<b>Exhibit Number</b>	<b>Description of Exhibit</b>
1.1	Memorandum of Association of Unicom, dated January 27, 2000 <sup>(1)</sup> .
1.2	Amended Articles of Association of Unicom (as amended) <sup>(1)</sup> .
1.3	Amended Articles of Association of Unicom (as amended on May 12, 2004) <sup>(6)</sup> .
2.1	Deposit Agreement, among Unicom, the Bank of New York, as Depositary, and Owners and Beneficial Owners of American Depositary Receipts issued thereunder, including the form of American Depositary Receipt <sup>(2)</sup> .
2.2	Form of specimen certificate for the shares <sup>(1)</sup> .
4.1	CDMA Network Capacity Lease Agreement among CUCL, Unicom Group and Unicom Horizon, dated November 22, 2001 <sup>(4)</sup> .
4.2	Reorganization Agreement between Unicom Group and CUCL (together with English translation) <sup>(1)</sup> .
4.3	Services Agreement between Unicom Group and CUCL (together with English translation) <sup>(1)</sup> .
4.4	Lease Agreement between CUCL and Unicom Xingye Science and Technology Trade Co. Ltd. (together with English translation) <sup>(1)</sup> .
4.5	Transmission Line Lease and Services Agreement between Unicom Group, CUCL and Guoxin Paging (together with English translation) <sup>(1)</sup> .
4.6	Pre-Global Offering Share Option Scheme, adopted by ordinary resolution of the Company on June 1, 2000 and amended by ordinary resolution of the Company on May 13, 2002 <sup>(4)</sup> .
4.7	Share Option Scheme, adopted by ordinary resolution of the Company on June 1, 2000 and amended by ordinary resolution of the Company on May 13, 2002 <sup>(4)</sup> .
4.8	Service Agreements between executive directors of Unicom and Unicom <sup>(3)</sup> .

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<b>Exhibit Number</b>	<b>Description of Exhibit</b>
4.9	Reorganization Agreement between Unicom Group and Unicom New Century, dated November 18, 2002. (English translation) <sup>(5)</sup> .
4.10	Form of Conditional Sale and Purchase Agreement between Unicom BVI and our company, dated November 20, 2002 <sup>(5)</sup> .
4.11	Comprehensive Services Agreement between Unicom Group and A Share Company, dated November 20, 2002. (English translation) <sup>(5)</sup> .
4.12	Transfer Agreement with respect to the Comprehensive Services Agreement between A Share Company and Unicom New Century, dated November 20, 2002. (English translation) <sup>(5)</sup> .
4.13	Form of CDMA Network Capacity Lease Agreement among Unicom Horizon, A Share Company and Unicom Group, dated November 20, 2002 <sup>(5)</sup> .
4.14	Transfer Agreement with respect to the CDMA Network Capacity Lease Agreement between A Share Company and Unicom New Century, dated November 20, 2002. (English translation) <sup>(5)</sup> .
4.15	Reorganization Agreement between Unicom Group and Unicom New World, dated November 4, 2003. (English translation) <sup>(6)</sup> .
4.16	Conditional Sale and Purchase Agreement between Unicom BVI and our Company, dated November 20, 2003 <sup>(6)</sup> .
4.17	Conditional Sale and Purchase Agreement between CUCL and A Share Company, dated November 20, 2003. (English translation) <sup>(6)</sup> .
4.18	Comprehensive Services Agreement between Unicom Group and A Share Company, dated November 20, 2003. (English translation) <sup>(6)</sup> .
4.19	Transfer Agreement with respect to the Comprehensive Services Agreement between A Share Company and Unicom New World, dated November 20, 2003. (English translation) <sup>(6)</sup> .
4.20	CDMA Network Capacity Lease Agreement among Unicom Horizon, A Share Company and Unicom Group, dated November 20, 2003 <sup>(6)</sup> .
4.21	Transfer Agreement with respect to the CDMA Network Capacity Lease Agreement between A Share Company and Unicom New World, dated November 20, 2003. (English translation) <sup>(6)</sup> .
4.22	Comprehensive Operator Services Agreement between Unicom Group and A Share Company, dated November 20, 2003. (English translation) <sup>(6)</sup> .
4.23	Transfer Agreement with respect to the Comprehensive Operator Services Agreement between A Share Company, CUCL, Unicom New Century and Unicom New World, dated November 20, 2003. (English translation) <sup>(6)</sup> .
4.24	Service Agreement between Mr. William Lo Wing Yan, executive director of Unicom, and Unicom. (English translation) <sup>(6)</sup> .
4.25	Letter Agreement between Mr. Wang Jianzhou, executive director of Unicom, and Unicom with respect to the Extension of the Service Agreement between Mr. Wang and Unicom. (English translation) <sup>(6)</sup> .
4.26	Conditional Sales and Purchase Agreement between China Unicom (Hong Kong) Group Limited and our Company with respect to the acquisition of Unicom International, dated July 28, 2004.
4.27	CDMA Network Capacity Lease Agreement between Unicom Horizon, A Share Company and Unicom Group, dated March 24, 2005.



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<b>Exhibit Number</b>	<b>Description of Exhibit</b>
4.28	Transfer Agreement of The CDMA Network Capacity Lease Agreement between A Share Company, CUCL and Unicom New World, dated March 24, 2005. (English translation).
4.29	Comprehensive Services Agreement between A Share Company and Unicom Group, dated March 24, 2005. (English translation).
4.30	Transfer Agreement of the Comprehensive Services Agreement between A Share Company, CUCL and Unicom New World, dated March 24, 2005. (English translation).
4.31	Operator-based Comprehensive Services Agreement between Unicom New Guoxin and A Share Company, dated March 24, 2005. (English translation).
4.32	Transfer Agreement of the Operator-based Comprehensive Services Agreement between A Share Company and CUCL and Unicom New World, dated March 24, 2005. (English translation).
4.33	Premise Leasing Agreement between CUCL, Unicom New World and A Share Company, dated March 24, 2005. (English translation).
4.34	Transfer Agreement of the Premise Leasing Agreement between A Share Company and Unicom New Guoxin, dated March 24, 2005. (English translation).
8.1	List of our significant subsidiaries.
11.1	Code of Ethics <sup>(6)</sup>
12.1	CEO Certification
12.2	CFO Certification
13.1	CEO Certification
13.2	CFO Certification

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(1) Incorporated by reference to our Registration Statement on Form F-1 (File No. 333-11938) filed with the SEC in connection with our initial public offering in June 2000.

(2) Incorporated by reference to the Registration Statement on Form F-6 (Filed No. 333-11952) filed with the SEC with respect to American Depositary Shares representing our shares.

(3) Incorporated by reference to our Annual Report on Form 20-F (File No. 1-15028) for the year ended December 31, 2000.

(4) Incorporated by reference to our Annual Report on Form 20-F (File No. 1-15028) for the year ended December 31, 2001.

(5) Incorporated by reference to our Annual Report on Form 20-F (File No. 1-15028) for the year ended December 31, 2002.



- (6) Incorporated by reference to our Annual Report on Form 20-F (File No. 1-15028) for the year ended December 31, 2003.

SIGNATURE

The registrant hereby certifies that it meets all of the requirements for filing on Form 20-F and that it has duly caused and authorized the undersigned to sign this annual report on its behalf.

Date: June 28, 2005

CHINA UNICOM LIMITED

By: /s/ Chang Xiaobing  
Name: Chang Xiaobing  
Title: Chairman and Chief Executive Officer

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**CHINA UNICOM LIMITED AND ITS SUBSIDIARIES**

**AUDITED CONSOLIDATED FINANCIAL STATEMENTS**

**FOR THE YEARS ENDED**

**DECEMBER 31, 2002, 2003 AND 2004**

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**INDEX TO CONSOLIDATED FINANCIAL STATEMENTS**

**CHINA UNICOM LIMITED AND ITS SUBSIDIARIES**

Report of Independent Registered Public Accounting Firm

Consolidated statements of income for the years ended December 31, 2002, 2003 and 2004

Consolidated balance sheets as of December 31, 2003 and 2004

Consolidated statements of changes in shareholders' equity for the years ended December 31, 2002, 2003 and 2004

Consolidated statements of cash flows for the years ended December 31, 2002, 2003 and 2004

Notes to the consolidated financial statements

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**Report of Independent Registered Public Accounting Firm**

**TO THE BOARD OF DIRECTORS AND SHAREHOLDERS OF CHINA UNICOM LIMITED**

*(Incorporated in the Hong Kong Special Administrative Region of the People's Republic of China ( Hong Kong ) with limited liability)*

In our opinion, the accompanying consolidated balance sheets and the related consolidated statements of income, of cash flows and of changes in shareholders' equity present fairly, in all material respects, the financial position of China Unicom Limited (the Company) and its subsidiaries (the Group) at December 31, 2003 and 2004, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2004, in conformity with accounting principles generally accepted in Hong Kong. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

Accounting principles generally accepted in Hong Kong vary in certain significant respects from accounting principles generally accepted in the United States of America. Information relating to the nature and effect of such differences is presented in Note 40 to the consolidated financial statements.

**PricewaterhouseCoopers**

*Certified Public Accountants*

Hong Kong, June 16, 2005

## CHINA UNICOM LIMITED AND ITS SUBSIDIARIES

## CONSOLIDATED STATEMENTS OF INCOME

FOR THE YEARS ENDED DECEMBER 31, 2002, 2003 AND 2004

(Expressed in thousands, except per share data)

	Note	2002 RMB As restated	2003 RMB	2004 RMB	2004 US\$
Operating revenue (Turnover):					
GSM Business	6, 31, 34	27,387,925	40,303,611	46,579,235	5,627,890
CDMA Business	3(f), 6, 20(a), 23, 31, 34	3,225,347	16,623,518	24,219,602	2,926,310
Data and Internet Business	6, 31, 34	2,793,039	3,437,083	3,662,734	442,546
Long Distance Business	6, 31, 34	2,765,723	2,273,148	1,848,009	223,284
Paging Business	6, 31, 34	2,161,188	1,403,053		
Total service revenue		38,333,222	64,040,413	76,309,580	9,220,030
Sales of telecommunications products	6, 31, 34	2,243,303	3,595,912	3,022,031	365,134
Total operating revenue	6, 34	40,576,525	67,636,325	79,331,611	9,585,164
Operating expenses:					
Leased lines and network capacities	7, 8, 31	(1,583,255)	(4,320,382)	(7,398,128)	(893,872)
Interconnection charges	8, 31	(3,229,640)	(5,920,793)	(7,516,586)	(908,184)
Depreciation and amortization	7	(11,255,724)	(16,385,293)	(19,063,074)	(2,303,277)
Personnel	7, 8, 12, 13	(3,335,218)	(4,574,546)	(4,526,100)	(546,862)
Selling and marketing	7, 20(a), 23, 31	(5,980,948)	(15,156,835)	(18,944,348)	(2,288,932)
General, administrative and other expenses	7, 8, 31	(5,631,850)	(9,112,385)	(10,448,241)	(1,262,399)
Cost of telecommunications products sold	31	(2,236,206)	(3,652,045)	(3,478,989)	(420,345)
Total operating expenses		(33,252,841)	(59,122,279)	(71,375,466)	(8,623,871)
Operating income		7,323,684	8,514,046	7,956,145	961,293
Loss on sale of discontinued operation (Guoxin Paging)	5		(663,279)		
		7,323,684	7,850,767	7,956,145	961,293
Interest income	7	470,282	173,033	102,907	12,434
Finance costs	9	(1,474,441)	(1,936,022)	(1,688,418)	(204,001)
Other (expense) income, net	10	(16,359)	8,071	95,990	11,598
Income before taxation	7	6,303,166	6,095,849	6,466,624	781,324
Taxation	3(a), 14	(1,720,205)	(1,888,381)	(2,079,625)	(251,269)
Income after taxation		4,582,961	4,207,468	4,386,999	530,055
Minority interests		15,252	9,629		
Net income	15	4,598,213	4,217,097	4,386,999	530,055
Proposed final dividend	15	1,255,300	1,255,317	1,256,349	151,797

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Dividend paid	15	1,255,300	1,256,160	151,774
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The accompanying notes are an integral part of the consolidated financial statements.



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	Note	2002 As restated		2003		2004		2004	
Basic earnings per share	16	RMB	0.366	RMB	0.336	RMB	0.349	USD	0.042
Diluted earnings per share	16	RMB	0.366	RMB	0.336	RMB	0.348	USD	0.042
Number of shares outstanding for basic earnings (in thousands)	16		12,552,996		12,553,010		12,561,242		12,561,242
Number of shares outstanding for diluted earnings (in thousands)	16		12,552,996		12,568,683		12,607,241		12,607,241
Basic earnings per ADS	16	RMB	3.663	RMB	3.359	RMB	3.492	USD	0.422
Diluted earnings per ADS	16	RMB	3.663	RMB	3.355	RMB	3.480	USD	0.420
Number of ADS outstanding for basic earnings (in thousands)	16		1,255,300		1,255,301		1,256,124		1,256,124
Number of ADS outstanding for diluted earnings (in thousands)	16		1,255,300		1,256,869		1,260,724		1,260,724

The accompanying notes are an integral part of the consolidated financial statements.

## CHINA UNICOM LIMITED AND ITS SUBSIDIARIES

## CONSOLIDATED BALANCE SHEETS

AS OF DECEMBER 31, 2003 and 2004

(Expressed in thousands)

	Note	2003 RMB	2004 RMB	2004 US\$
<b>Non-current assets:</b>				
Property, plant and equipment, net	21	118,104,848	118,904,060	14,366,467
Goodwill	3(a), 22	3,315,468	3,136,557	378,971
Other assets	23	5,849,430	5,736,384	693,093
Deferred tax assets	14	324,900		
Total non-current assets		127,594,646	127,777,001	15,438,531
<b>Current assets:</b>				
Current portion of deferred tax assets	3(a), 14	873,849	606,009	73,220
Amounts due from Unicom Group	31(c)		61,401	7,419
Amounts due from related parties	31(b)	263,414	193,048	23,325
Amounts due from domestic carriers	33(b)	184,613	269,919	32,613
Prepayments and other current assets	20	3,147,777	3,059,714	369,687
Inventories	19	2,169,354	3,114,632	376,322
Accounts receivable, net	18	5,471,547	5,229,980	631,907
Short-term bank deposits		912,794	662,025	79,989
Bank balances and cash	4(b)(i), 27(a)(iii)	9,219,936	4,655,464	562,492
Total current assets		22,243,284	17,852,192	2,156,974
<b>Current liabilities:</b>				
Payables and accrued liabilities	25	17,098,420	16,785,749	2,028,122
Amounts due to Unicom Group	31(c)	432,047		
Amounts due to related parties	31(b)	108,891	5,760	696
Amounts due to domestic carriers	33(b)	778,841	948,574	114,611
Current portion of obligations under finance leases	28, 33(b)	25,435	938,189	113,356
Current portion of long-term bank loans	27	7,197,877	11,086,305	1,339,492
Taxes payable		623,857	395,688	47,809
Advances from customers		6,666,086	7,034,995	849,996
Short-term bank loans	26	10,975,199	8,928,417	1,078,767
Total current liabilities		43,906,653	46,123,677	5,572,849
<b>Net current liabilities</b>		(21,663,369)	(28,271,485)	(3,415,875)
<b>Total assets less current liabilities</b>		105,931,277	99,505,516	12,022,656

The accompanying notes are an integral part of the consolidated financial statements.



	Note	2003 RMB	2004 RMB	2004 US\$
<b>Financed by:</b>				
<b>Shareholders equity:</b>				
Share capital	29	1,331,390	1,332,487	160,996
Share premium		52,483,266	52,546,294	6,348,854
Reserves	15(a)	1,719,331	2,148,631	259,606
Retained earnings:				
Proposed final dividend	15(b)	1,255,317	1,256,349	151,797
Others	3(a)	12,826,186	15,526,693	1,875,998
Shareholders equity		69,615,490	72,810,454	8,797,251
<b>Non-current liabilities:</b>				
Long-term bank loans	27	36,212,791	26,137,188	3,158,000
Obligations under finance leases	28, 33(b)	99,719	488,956	59,078
Deferred tax liabilities	14		66,340	8,015
Other long-term liabilities		3,277	2,578	312
Total non-current liabilities		36,315,787	26,695,062	3,225,405
		105,931,277	99,505,516	12,022,656

The accompanying notes are an integral part of the consolidated financial statements.

**CHINA UNICOM LIMITED AND SUBSIDIARIES****CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY****FOR THE YEARS ENDED DECEMBER 31, 2002, 2003 AND 2004****(Expressed in thousands of RMB)**

	Share capital	Share premium	Revaluation reserve	Statutory reserve	Retained profits	Total
Balance at January 1, 2002, as previously reported	1,331,371	52,482,127	176,853	649,433	7,041,379	61,681,163
Change in accounting policy:						
- Additional provision for deferred tax assets (see Note 3(a))					373,159	373,159
- To adjust for statutory reserve due to the change in accounting policy (see Note 15(a))				37,316	(37,316)	
Balance at January 1, 2002, as restated	1,331,371	52,482,127	176,853	686,749	7,377,222	62,054,322
Net income for the year, as restated (see Note 3(a))					4,598,213	4,598,213
Appropriation to statutory reserve, as restated (see Note 15(a))				436,463	(436,463)	
Balance at December 31, 2002, as restated	1,331,371	52,482,127	176,853	1,123,212	11,538,972	66,652,535
Dividends (see Note 15(b))					(1,255,300)	(1,255,300)
Exercise of share options	19	1,139				1,158
Net income for the year					4,217,097	4,217,097
Appropriation to statutory reserve (see Note 15(a))				419,266	(419,266)	
Balance at December 31, 2003	1,331,390	52,483,266	176,853	1,542,478	14,081,503	69,615,490
Dividends (see Note 15(b))					(1,256,160)	(1,256,160)
Exercise of share options (see Note 30(g))	1,097	63,028				64,125
Net income for the year					4,386,999	4,386,999
Appropriation to statutory reserve (see Note 15(a))				429,300	(429,300)	
Balance at December 31, 2004	1,332,487	52,546,294	176,853	1,971,778	16,783,042	72,810,454
Representing:						
Proposed final dividend (see Note 15(b))					1,256,349	
Others					15,526,693	
Balance at December 31, 2004					16,783,042	

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The accompanying notes are an integral part of the consolidated financial statements.

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## CHINA UNICOM LIMITED AND ITS SUBSIDIARIES

## CONSOLIDATED STATEMENTS OF CASH FLOWS

FOR THE YEARS ENDED DECEMBER 31, 2002, 2003 AND 2004

(Expressed in thousands)

	Note	2002 RMB	2003 RMB	2004 RMB	2004 US\$
<b>Net cash inflow from operations</b>	(a)	15,675,105	26,449,770	27,703,311	3,347,225
Interest received		599,506	204,025	106,365	12,851
Interest paid		(1,868,208)	(2,540,513)	(2,310,270)	(279,136)
Dividends received		24,978	2,573		
Dividends paid to minority owners of subsidiaries		(31,902)	(4,689)		
PRC income tax paid		(1,345,201)	(1,545,907)	(1,680,111)	(202,998)
Net cash inflow from operating activities		13,054,278	22,565,259	23,819,295	2,877,942
<b>Investing activities</b>					
Purchase of property, plant and equipment		(21,152,102)	(21,184,245)	(19,161,078)	(2,315,119)
Sale of property, plant and equipment		24,552	94,804	53,970	6,521
Purchase of minority interests		(257,337)			
Decrease in short-term bank deposits		20,096,738	3,832,411	250,769	30,299
Purchase of Unicom New Century, net of cash acquired	4(a)	(3,692,687)			
Payment of direct acquisition cost of Unicom New Century			(59,767)	(4,566)	(552)
Purchase of Unicom New World, net of cash acquired	4(b)		(2,326,449)		
Payment of direct acquisition cost of Unicom New World				(14,039)	(1,696)
Purchase of Unicom International, net of cash acquired	4(c)			44,267	5,349
Purchase of trading securities		(14,557)	(87,956)		
Sale of trading securities		18,865	118,575		
Purchase of investment in associated companies		(2,105)	(10,062)		
Sale of investment in associated companies		4,241	853		
Sale of investment securities		35,300	19,753		
Sale of Guoxin Paging, net of cash disposed	5		1,259,159	450,000	54,371
Purchase of other assets		(226,947)	(708,379)	(577,926)	(69,827)
Net cash outflow from investing activities		(5,166,039)	(19,051,303)	(18,958,603)	(2,290,654)
<b>Financing activities</b>					
Proceeds from exercise of share options			1,158	64,125	7,748
Decrease of payables to Unicom Group		(1,393,434)	(724,127)		
Proceeds from short-term bank loans		9,623,438	10,901,425	10,224,971	1,235,422
Proceeds from long-term bank loans		7,757,005	11,075,836	11,083,383	1,339,139
Repayment of short-term bank loans		(7,928,938)	(10,278,727)	(12,271,753)	(1,482,723)
Repayment of long-term bank loans		(19,925,822)	(18,497,783)	(17,245,641)	(2,083,688)
Dividends paid (see Note 15(b))			(1,255,300)	(1,256,160)	(151,774)

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Net cash outflow from financing activities	(11,867,751)	(8,777,518)	(9,401,075)	(1,135,876)
Net decrease in cash and cash equivalents	(3,979,512)	(5,263,562)	(4,540,383)	(548,588)
Cash and cash equivalents, beginning of year	18,413,010	14,433,498	9,169,936	1,107,949
Cash and cash equivalents, end of year	14,433,498	9,169,936	4,629,553	559,361

**Analysis of the balances of cash and cash equivalents:**

Cash balances	5,942	4,610	4,756	575
Bank balances	14,427,556	9,215,326	4,650,708	561,917
Less: Restricted bank deposits (i)		(50,000)	(25,911)	(3,131)
	14,433,498	9,169,936	4,629,553	559,361

Note (i): As of December 31, 2004, approximately RMB26 million bank balances (2002: Nil; 2003: RMB50 million) was restricted by the bank to secure for long-term bank loans.



(a) The reconciliation of income before taxation to net cash inflow from operations was as follows:

	2002 RMB	2003 RMB	2004 RMB	2004 US\$
Income before taxation	6,303,166	6,095,849	6,466,624	781,324
Adjustments for:				
Depreciation and amortization	11,255,724	16,385,293	19,063,074	2,303,277
Amortization of deferred customer acquisition costs of contractual CDMA subscribers	1,385,424	5,836,587	6,120,737	739,532
Interest income	(470,282)	(173,033)	(102,907)	(12,434)
Interest expense	1,456,736	1,919,375	1,668,467	201,591
Loss on sale of Guoxin Paging		663,279		
Loss on disposal of property, plant and equipment	82,467	49,940	10,537	1,273
Provision for impairment loss of property, plant and equipment and goodwill	38,797	528,048		
Provision for doubtful debts	971,989	1,749,887	2,191,820	264,825
Share of (incomes)/losses from associated companies	(553)	2,275		
Dividends from investment securities	(24,978)	(2,573)		
Realized gains on trading securities	(1,876)	(12,045)		
Unrealized losses/(gains) on trading securities	27,461	(10,129)		
Realized gains on investment securities	(18,098)	(13,268)		
Realized gains in associated companies	(1,251)			
Provision of impairment loss of investment securities	650			
Operating income before working capital changes	21,005,376	33,019,485	35,418,352	4,279,388
Increase in accounts receivable	(2,085,863)	(2,650,625)	(1,915,496)	(231,438)
(Increase)/ decrease in inventories	(1,276,602)	1,263,299	(939,899)	(113,562)
Increase in other assets	(5,478,259)	(3,169,766)	(5,251,569)	(634,516)
Increase in prepayments and other current assets	(1,142,810)	(1,342,086)	(792,416)	(95,743)
Decrease/ (increase) in amounts due from domestic carriers	8,599	(22,227)	(85,306)	(10,307)
Decrease in amounts due from related parties	280,216	553,354	70,516	8,520
Increase/ (decrease) in payables and accrued liabilities	1,488,449	(35,732)	1,835,813	221,810
Increase/ (decrease) in advances from customers	1,978,456	(55,497)	367,431	44,394
Increase/ (decrease) in amounts due to domestic carriers	221,196	(161,937)	169,733	20,508
Decrease in amounts due to Unicom Group		(562,633)	(943,448)	(113,991)
Increase/ (decrease) in amounts due to related parties	676,347	(385,865)	(230,400)	(27,838)
Net cash inflow from operations	15,675,105	26,449,770	27,703,311	3,347,225

(b) Supplemental information:

Payables to equipment suppliers for construction-in-progress during 2004 decreased by approximately RMB775 million (2002: RMB2, 201 million; 2003: RMB3, 234 million).



**CHINA UNICOM LIMITED**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

(Amounts expressed in RMB unless otherwise stated)

**1. ORGANISATION AND PRINCIPAL ACTIVITIES**

China Unicom Limited (the Company) was incorporated in the Hong Kong Special Administrative Region ( Hong Kong ), the People's Republic of China (the PRC) on February 8, 2000. The principal activities of the Company are investment holding and the Company's subsidiaries are engaged in the provision of GSM and CDMA cellular, data, Internet, long distance and paging (discontinued in 2004) services in the PRC. The GSM and CDMA business hereinafter collectively refer to as the Cellular Business. The Company and its subsidiaries are hereinafter referred to as the Group.

The Group completed the following acquisitions and sale activities in 2002, 2003 and 2004 respectively:

*Acquisition of Unicom New Century Telecommunications Corporation Limited ( Unicom New Century )*

In 2002, the Company acquired the entire equity interests in Unicom New Century from its ultimate parent company, China United Telecommunications Corporation (a state-owned enterprise established in the PRC, hereinafter referred to as Unicom Group). For details of this acquisition, please refer to Note 4(a).

*Acquisition of Unicom New World Telecommunications Corporation Limited ( Unicom New World )*

In 2003, the Company acquired the entire equity interests in Unicom New World from Unicom Group. For details of this acquisition, please refer to Note 4(b).

*Sale of Guoxin Paging Corporation Limited ( Guoxin Paging )*

In 2003, the Company sold the entire equity interests in Guoxin Paging to Unicom Group. For details of the sale, please refer to Note 5.

*Acquisition of China Unicom International Limited ( Unicom International )*

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In 2004, the Company acquired the entire equity interests in Unicom International from China Unicom (Hong Kong) Group Limited (a wholly-owned subsidiary of Unicom Group, hereafter referred to as Unicom Group (HK)). For details of this acquisition, please refer to Note 4(c).

After the above acquisitions and sales, the Company expands its cellular business's geographical coverage to 30 provinces, municipalities and autonomous regions (which covers the whole mainland China apart from Guizhou province) in the PRC, and discontinued its nationwide paging operating in the PRC.

On July 30, 2004, China Unicom Corporation Limited (hereinafter referred to as CUCL), a direct wholly-owned subsidiary of the Company) combined with Unicom New Century and obtained the revised business license. After the combination, Unicom New Century was legally dissolved and CUCL extended its Cellular Business in 21 provinces.

On October 15, 2004, the Company together with Unicom International set up and incorporated China Unicom (Macau) Company Limited (Unicom Macau) in Macau Special Administrative Region of the PRC (Macau). The Company effectively held 100% in the entire issued capital of Unicom Macau.

The immediate holding company of the Company is China Unicom (BVI) Limited (Unicom BVI). The majority of the equity interests in Unicom BVI is owned by China United Telecommunications Corporation Limited (a joint stock company incorporated in the PRC on December 31, 2001, with its A shares listed on the Shanghai Stock Exchange on October 9, 2002).

The directors of the Company consider Unicom Group to be the ultimate parent company.

## 2. BASIS OF PRESENTATION

The financial statements have been prepared under the historical cost convention except that, certain land and building and investments in securities are stated at fair value. They have been prepared in accordance with accounting principles generally accepted in Hong Kong ( HK GAAP ) issued by the Hong Kong Institute of Certified Public Accountants( HKICPA ). This basis of accounting differs from that used in the preparation of statutory financial statements for PRC statutory reporting purposes, which were based on the accounting principles and financial regulations applicable to enterprises established in the PRC ( PRC GAAP ).

The principal adjustments made to conform to HK GAAP include the following:

Reversal of revaluation surplus and related depreciation and amortization charges arising from the revaluation of assets performed by independent valuers registered in the PRC;

Additional accrual for retirement benefits;

Additional provision for housing benefits;

Additional capitalization of borrowing costs;

Provision for deferred taxation on HK GAAP adjustments; and

Capitalization of the direct costs associated with the acquisition of subsidiaries.

The Company has adopted the purchase method to account for the acquisitions of Unicom New Century, Unicom New World and Unicom International. The difference between the purchase consideration and the fair values of the net assets acquired has been recorded as goodwill/negative goodwill, which is amortized using the straight-line method over relevant beneficial periods. The effective dates of the acquisitions of Unicom New Century, Unicom New World and Unicom International were December 31, 2002, December 31, 2003 and September 16, 2004 respectively. The operating results of these acquired subsidiaries have been included in the consolidated statements of income of the Group after the acquisitions were effective.

The sale of Guoxin Paging has been accounted for as a disposal of discontinued operation by the Group. The difference between the sale proceeds and the carrying amount of net assets of Guoxin Paging as of the effective date of disposal

(December 31, 2003) was recorded as the loss on sale of discontinued operation in the consolidated statements of income of the Group. The operating results of Guoxin Paging for 2003 were included in the consolidated statements of income of the Group up to the effective date of the sale.

### 3. PRINCIPAL ACCOUNTING POLICIES

The principal accounting policies adopted in the preparation of the financial statements are set out as follows:

#### *(a) Basis of preparation*

As of December 31, 2004, the current liabilities of the Group had exceeded the current assets by approximately RMB28.3 billion (2003: RMB21.7 billion). The decrease in working capital was mainly attributable to the use of short-term bank deposits to repay long-term bank loans. Taking into account of available financing and continuous net cash inflow from operating results, the Group has sufficient working capital for present requirements. As a result, the financial statements of the Group for the year ended December 31, 2002, 2003 and 2004 have been prepared under the going concern basis.

#### **Recently issued accounting standards**

In year 2003, the Group adopted the following Statements of Standard Accounting Practice ( SSAP ) issued by the HKICPA which are effective for accounting periods commencing on or after January 1, 2003:

SSAP 12 (revised)	Income Tax
SSAP 35	Government Grants and Disclosure of Government Assistance

Upon the adoption of SSAP 12 Income Taxes (revised) ( SSAP 12 ) in 2003, deferred taxation is provided in full, using the liability method, on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the financial statements. Taxation rates enacted or substantively enacted at the balance sheet date are used to determine deferred taxation. Deferred tax assets are recognized to the extent that it is probable that future taxable income will be available against which the temporary differences can be utilized.

Prior to 2003, deferred taxation was accounted for at the current taxation rate in respect of timing differences between income as computed for taxation purpose and income as stated in the statement of income. A deferred tax asset was not recognized unless the related benefits are expected to crystallize in the foreseeable future. The adoption of SSAP 12 in 2003 represents a change in accounting policy which has been applied retrospectively so that the comparatives presented have been restated to conform to the changed policy.

As detailed in the consolidated statement of changes in equity, the above change in the accounting policy has resulted in an increase of opening retained earnings as of January 1, 2002 and 2003 by approximately RMB373,159,000 and RMB405,300,000, respectively, representing the deferred tax assets relating to the provision for doubtful debts previously not recognized. This change has resulted in an increase in deferred tax assets at January 1, 2003 by approximately RMB405,300,000. The net income for the year ended December 31, 2002 has also been increased by approximately RMB32,141,000.



The adoption of SSAP 12 has also resulted in an increase of the deferred tax assets of Unicom New Century as of December 31, 2002 by approximately RMB80,448,000. This adjustment increased the net assets value of Unicom New Century on December 31, 2002 and accordingly reduced the goodwill recorded by the Group arising from the acquisition of Unicom New Century on December 31, 2002.

Since the impact of the adoption of SSAP 35 Government Grants and Disclosure of Government Assistance on the Group's financial statements is not significant, no prior period adjustment has been required.

The HKICPA has issued a number of new and revised Hong Kong Financial Reporting Standards ( HKFRSs ) and Hong Kong Accounting Standards ( HKASs ), herein collectively referred to as new HKFRSs, which are effective for accounting periods beginning on or after January 1, 2005. The Group has not early adopted these new HKFRSs in the financial statements for the year ended December 31, 2004. The Group is in the process of making an assessment of the impact of these new HKFRSs and has so far concluded that the more significant differences between new HKFRSs and current accounting policies that are expected to affect the Group are as follows:

**(i) Share-based payment**

Under HKFRS 2 *Share-based payment*, the Group is required to determine the fair value of all share-based payments to employees as remuneration and recognize an expense in the statement of income. Under the specific transitional provisions of HKFRS 2, this treatment applies to equity-settled share-based payment transactions where shares, share options or other equity instruments were granted after November 7, 2002 and had not yet vested on January 1, 2005 and to liabilities arising from share-based payment transactions existing on January 1, 2005. This treatment would result in an increase in personnel expenses as such items have not been recognized as expenses previously by the Group. The Group recognizes stock-based employee compensation costs based on the estimated fair value of share options at the grant date by using the Black-Scholes Option pricing model, after taking into consideration of risk-free rate, expected life of option, expected dividend yield and volatility etc, which are expensed over the relevant vesting periods. Upon the adoption of HKFRS 2 in 2005 on a retrospective basis, it would result in a decrease in net income by approximately RMB89 million for the year ended December 31, 2004 (2002: Nil, 2003: RMB22 million). This treatment would also result in an employee share-based compensation reserve as of December 31, 2004 of approximately RMB111 million (2003: RMB22 million) with a corresponding decrease in the retained earnings as of December 31, 2003 and 2004 of the same amount respectively.

**(ii) Goodwill /Negative goodwill**

Under HKFRS 3 *Business Combinations*, goodwill is no longer amortized but instead is subject to impairment test on annual basis or when there are indications of impairment. This policy is applied prospectively from January 1, 2005. This results in a change to the Group's accounting policy applied previously under which goodwill is amortized over the beneficial period of 20 years and assessed for an indication of impairment at each balance sheet date (see Note 3(e)). In accordance with the provision of HKFRS 3, the Group will cease amortization of goodwill from January 1, 2005, and accumulated amortization as at December 31, 2004 will be eliminated against the cost of goodwill. As of December 31, 2004, the carrying amount of goodwill, net of accumulated amortization, amounted to approximately RMB3,144 million (2003: approximately RMB3,315 million) and the amortization for the year ended December 31, 2004 amounted to RMB171 million (2002: RMB23 million, 2003: RMB115 million) (see Note 22).

Upon the adoption of HKFRS 3 in 2005, negative goodwill previously recognized with carrying amount of approximately RMB7 million as of December 31, 2004, which represented the excess of fair values of the net identifiable assets and liabilities acquired over the purchase consideration at the



date of acquisition, will be derecognized at January 1, 2005 (see Note 4(c), 22), with a corresponding adjustment to the retained earnings of the Group.

As required under HKFRS 3, upon the adoption of HKFRS 3 from January 1, 2005, the Group will also apply HKAS 36 Impairment of assets and HKAS 38 Intangible assets prospectively from the same date. The adoption of these accounting policies would have no significant impact on the Group's operating results.

### **(iii) Land use right in PRC**

Under HKAS 17 Leases, land use right in the PRC will no longer be accounted for as property, plant and equipment. Instead, it will be reclassified as other assets - long-term prepayment of lease, which will be stated at cost and recognized as an expense on a straight-line basis over the lease term. This policy will be applied prospectively from January 1, 2005 by the Group. As of December 31, 2004, the carrying amount of land use right in the PRC amounted to approximately RMB412 million (2003: RMB242 million) (see Note 21). This change would have no material impact on the operating results of the Group.

### **(iv) Revenue**

Upon adoption of the new HKFRS, the Group will change its accounting policy for upfront non-refundable revenue, such as connection fee, which has previously been recognized upon completion of activation services. Effective from January 1, 2005, upfront non-refundable revenue and the related direct incremental cost incurred are deferred and recognized over the expected customer service periods. The expected customer service period for the Cellular Business is estimated based on the expected stabilized churn rates of subscribers. Management judges that this change of accounting policy provides reliable and more relevant information because it better reflects the economic effects of the transactions and is consistent with the accounting policy adopted for the Group's financial information presented under generally accepted accounting principles in the United States of America (see Note 40(D) (i)).

This change of accounting policy will be accounted for retrospectively and the relevant comparatives will need to be restated. Upon the adoption of the change in this accounting policy in 2005, it would result in an increase of net income by approximately RMB196 million for the year ended December 31, 2004 (2002: RMB66 million, 2003: RMB82 million), and a decrease of retained earnings as of December 31, 2004 by approximately RMB368 million (2002: RMB646 million, 2003: RMB564 million).

The Group will continue to assess the above impact and other potential impact of the other new HKFRSs. Other significant changes may be identified as a result.

***(b) Group accounting***

**(i) Consolidation**

The consolidated financial statements include the financial statements of the Company and its subsidiaries made up to December 31.

Subsidiaries are those entities in which the Company, directly or indirectly, controls the composition of the board of directors; controls more than half of the voting power; or holds more than half of the issued share capital.

The results of subsidiaries acquired or disposed of during the year are included in the consolidated statement of income from the effective dates of acquisitions or up to the effective date of disposal, as appropriate.

All significant inter company transactions and balances within the Group are eliminated on consolidation.

Minority interests represent the interests of outside shareholders in the operating results and net assets of subsidiaries.

**(ii) Associated companies**

An associated company is a company, not being a subsidiary, in which an equity interest is held for the long-term and significant influence is exercised in its management.

The consolidated statements of income include the Group's share of the results of associated companies for the year, and the consolidated balance sheet include the Group's share of the net assets of the associated companies and goodwill/negative goodwill (net of accumulated amortization) on acquisitions.

Equity accounting is discontinued where the carrying amount of the investment in an associated company reaches zero, unless the Group has incurred obligations or guaranteed obligations in respect of the associated companies.

Where, in the opinion of the directors, there is an impairment loss of an associated company, permanently reduced below its carrying value, or the market value has fallen below the carrying value over a sustained period, a provision is made for such impairment loss.

**(c) Use of estimates**

The preparation of financial statements in conformity with HK GAAP requires management to make estimates and assumptions that affect the reported amounts and disclosures. Accordingly, actual results may differ from those estimates and assumptions.

**(d) Property, plant and equipment**

**(i) Land use rights and building**

Land use rights and buildings are stated at valuation. Independent valuations are performed periodically with the last valuation performed on March 31, 2000. In the intervening years, the directors review the carrying value of land use rights and buildings and adjustment is made where in the directors' opinion there has been a material change in value. Any increase in land use rights and buildings valuation is credited to the revaluation reserve; any decrease is first offset against an increase on earlier valuation in respect of the same property and is thereafter charged to the statement of income. Upon the disposal of revalued land use rights and buildings, the realized portion of the revaluation reserve is transferred from the valuation reserve to retained earnings.

**(ii) Other fixed assets**

Other fixed assets, comprising leasehold improvement, plant, telecommunications equipment, office furniture and fixtures are stated at cost less accumulated depreciation and accumulated impairment losses. The cost of an asset comprises its purchase price and any directly attributable costs of bringing the asset to its working condition and location for its intended use. Expenditures incurred after the property, plant and equipment have been put into operation, such as repairs and maintenance and overhaul costs, are normally charged to expense in the year in which they are incurred. In situations where it can be clearly demonstrated that the expenditure has resulted in an increase in the future economic benefits expected to be obtained from the use of the asset beyond its originally assessed standard of performance, the expenditure is capitalized as an additional cost of the assets.

**(iii) Depreciation**

Land use rights are amortized over the period of the lease while other fixed assets are depreciated at rates sufficient to write off their costs less accumulated losses over their estimated useful lives on a straight-line basis. The estimated useful lives of property, plant and equipment are as follows:

	Depreciable life	Residual value
Land use rights	Over the period of lease	
Buildings	8 - 40 years	3%
Leasehold improvements	Over the lease term	
Telecommunications equipment	3 - 15 years	3%
Office furniture, fixtures and other	4 - 14 years	3%

**(iv) Construction-in-progress**

Construction-in-progress represents buildings under construction and plant and equipment pending installation, and is stated at cost less accumulated impairment losses. Costs include construction and acquisition costs, and interest charges arising from borrowings used to finance the assets during the construction period.

No provision for depreciation is made on construction-in-progress until such time as the assets are completed and ready for use.

**(v) Impairment and gains or loss on disposal**

At each balance sheet date, both internal and external sources of information are considered to assess whether there is any indication that assets including property, plant and equipment are impaired. If any such indication exists, the recoverable amount of the asset is estimated and where relevant, an impairment loss is recognized to reduce the assets to its recoverable amount. Such impairment losses are recognized in the statement of income except where the asset is carried at valuation and the impairment loss does not exceed the revaluation surplus for that same asset, in which cases it is treated as a revaluation decrease. In determining the recoverable amount, expected future cash flows generated by the property, plant and equipment are discounted to their present values.

Provision for impairment loss is charged to the statement of income and classified under general, administrative and other expenses as a component of operating expenses. Reversal of impairment losses recognized in prior years is recorded when impairment losses recognized for the asset no longer exist or have decreased. The reversal is recorded in the statement of income.

The gain or loss on disposal of a property, plant and equipment is the differences between the net sales proceeds and the carrying amount of the relevant assets, and is recognized in the statement of income. Any revaluation reserve balance remaining attributable to the relevant asset is



transferred to retained earnings and is shown as a movement in reserves.

***(e) Goodwill/Negative goodwill***

Goodwill represents the excess of purchase consideration over the fair values of the Group's share of the net identifiable assets and liabilities of the acquired subsidiary/associated company at the date of acquisition. Goodwill is carried at cost less accumulated amortization and accumulated impairment losses. Goodwill is amortized using the straight-line method over the estimated economic lives of the acquired businesses. Goodwill arising on major strategic acquisitions of the Group to expand its geographical market coverage is amortized over 20 years.

Negative goodwill represents the excess of the fair values of the Group's share of the net identifiable assets and liabilities of the acquired subsidiary over the purchase consideration at the date of acquisition. Negative goodwill is recognized using the straight-line method over the remaining weighted average useful life of acquired identifiable non-monetary assets.

When later events and circumstances occur which indicate the carrying balance of goodwill may not be recoverable, the unamortized balance is written down to its estimated recoverable amount. Estimated recoverable amount is determined based on estimated discounted future net cash flows of the related business over its remaining life.

***(f) Other assets***

Other assets mainly represent (i) expenditures on facilities for interconnection with other operators, for which the Group has a permanent use right, (ii) long-term prepaid leased lines and rentals and (iii) deferred customer acquisition costs of CDMA contractual subscribers.

Expenditures on interconnection facilities are amortized using the straight-line method over the beneficial period of 5 years. Long-term prepaid leased lines and rentals are amortized using a straight-line method over the lease period.

Deferred customer acquisition costs of CDMA contractual subscriber represent the cost of CDMA handsets given to contractual subscribers under special promotional packages. Deferred customer acquisition costs, to the extent recoverable, are amortized over the contractual period (not exceeding 2 years) to match with the minimum contract revenue. Deferred customer acquisition costs of contractual CDMA subscribers are included in prepayment and other current assets when the customer contract is within 1 year, whereas they are recorded as other assets when the contract period is over 1 year.

**(g) Investments in securities**

**(i) Investment securities**

Equity securities intended to be held on a continuing basis are classified as investment securities and recorded at cost less any provision for impairment loss.

The carrying amounts of investment securities are reviewed at the end of each year to assess whether the fair values have declined below the carrying amounts. When a decline other than temporary decline has occurred, the carrying amount of such securities will be reduced to its fair value. The impairment loss is recognized as an expense in the statements of income. This impairment loss is written back to statements of income when the circumstances and events that led to the write-downs or write-offs cease to exist and there is persuasive evidence that the new circumstances and events will persist for the foreseeable future. Upon disposal of investment securities, income or loss thereon is accounted for in the statements of income.

**(ii) Trading securities**

Trading securities are carried at fair value. At each balance sheet date, the net unrealized gains or losses arising from the changes in fair value of trading securities are recognized in the statements of income. Gains or losses on disposal of trading securities, representing the differences between the net sales proceeds and the carrying amounts, are recognized in the statements of income as they arise.

**(h) Cash and cash equivalents**

Cash and cash equivalents are carried at cost in the balance sheet. For the purposes of the cash flow statement, cash and cash equivalents comprise cash on hand, deposits held at call with banks, cash investments with maturity of 3 months or less from the date of investment.

**(i) Short-term bank deposits**

Short-term bank deposits are cash invested in fixed-term deposits with original maturities ranging from more than 3 months to 1 year.



***(j) Accounts receivables and other receivables***

Provision is made against accounts receivable and other receivables to the extent they are considered to be doubtful. They are stated in the balance sheet net of such provision.

***(k) Inventories***

Inventories, which principally comprise handsets, SIM cards, UIM cards and accessories, are stated at the lower of cost and net realizable value. Cost is based on the weighted average method and comprises all costs of purchase and other costs incurred in bringing the inventories to their present location and condition. Net realizable value is determined on the basis of anticipated sales proceeds less estimated selling expenses. The amount of any reversal of any write-down of inventories, arising from an increase in net realizable value, is recognized as a reduction in the amount of inventories recognized as expense in the period in which the reversal occurs.

***(l) Advances from customers***

Advances from customers are amounts paid by customers for GSM and CDMA prepaid cards, GSM and CDMA prepaid service fees, Internet protocol ( IP ) telephone cards and other calling cards which cover future telecommunications services (over a period of 3 to 12 months). Customer advances are stated at the amount of proceeds received less the amount already recognized as revenues upon the rendering of services.

***(m) Assets under lease***

**(i) Finance leases**

Leases that substantially transfer to the Group all the risks and rewards of ownership of assets are accounted for as finance leases. Finance leases are capitalized at the inception of the lease at the lower of the fair value of the leased assets or the present value of the minimum lease payments. Each lease payment is allocated between the capital and finance charges so as to achieve a constant rate on the capital balances outstanding. The corresponding rental obligations, net of finance charges, are included in long-term liabilities. The finance charges are charged to the statement of income over the lease periods.

Assets held under finance leases are depreciated over the shorter of their estimated useful lives and the lease periods.

**(ii) Operating leases**

Leases where substantially all the risks and rewards of ownership of assets remain with the lessor are accounted for as operating leases. Minimum lease payments under operating leases net of any incentives received from the lessor are recognized as leasing expenses in the statement of income on a straight-line basis over the lease periods. Leased rental received under operating leases are recognized as lease rental income on a straight-line basis over the lease periods.

**(n) Borrowing costs**

Borrowing costs are expensed as incurred, except for interest directly attributable to the acquisition, construction or production of an asset, which necessarily takes a substantial period of time to get ready for its intended use, in which case they are capitalized as part of the cost of that asset. Capitalization of borrowing costs commences when expenditures for the asset and borrowing costs are being incurred and the activities to prepare the asset for its intended use are in progress. Borrowing costs are capitalized up to the date when the project is completed and ready for its intended use.

To the extent that funds are borrowed specifically for the purpose of obtaining a qualifying asset, the amount of borrowing costs eligible for capitalization is determined as the actual borrowing costs incurred on that borrowing during the period less any investment income on the temporary investment of those borrowings.

To the extent that funds are borrowed generally and used for the purpose of obtaining a qualifying asset, the amount of borrowing costs eligible for capitalization is determined by applying a capitalization rate to the expenditures on that asset. The capitalization rate is the weighted average of the borrowing costs applicable to the borrowings of the Group that are outstanding during the period, other than borrowings made specifically for the purpose of obtaining a qualifying asset. The amount of borrowing costs capitalized during a period should not exceed the amount of borrowing cost incurred during that period. Other borrowing costs are recognized as expenses when incurred.

The capitalized borrowing rate represents the cost of capital for raising the related borrowings externally and varies from 4.54% to 5.73% for the year ended December 31, 2004 (2002: 4.54% to 6.24%, 2003: 4.44% to 5.76%).

**(o) Provisions**

Provisions are recognized when the Group has present obligations (legal or constructive) as a result of a past event, it is probable (i.e. more likely than not) that an outflow of resources embodying economic benefit will be required to settle the obligation, and a reliable estimate of the amount can be made. Provisions are reviewed at each balance sheet date and adjusted to reflect the current best estimate. Where the effect of the time value of money is material, the amount of a provision is the present value of the expenditures expected to be required to settle the obligation.

***(p) Revenue recognition***

(i) Revenue is recognized when it is probable that the economic benefits associated with a transaction will flow to the Group and when the revenue and cost can be measured reliably, on the following basis:

Usage fees are recognized when the service is rendered;

Monthly fees are recognized as revenue in the month during which the service is rendered;

Revenue from telephone cards, which represent prepaid service fees received from customers for telephone services, is recognized when the related service is rendered upon actual usage of the telephone cards by customers;

Leased line rental income is recognized on a straight-line basis over the lease term; and

Sales of telecommunications products, such as handsets, SIM cards, UIM cards, pagers and accessories etc, are recognized when title has been passed to the buyers.

**(ii) Interest income**

Interest income from deposits in banks or other financial institutions is recognized on a time proportion basis, taking into account the principal amounts and the interest rates applicable.

**(iii) Dividend income**

Dividend income is recognized when the rights to receive payment is established.

***(q) Foreign currency translation***



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The Group maintains its books and records in Renminbi ( RMB ), which is not freely convertible into foreign currencies. Transactions in foreign currencies are translated at the exchange rates at the dates of the transactions. Monetary assets and liabilities denominated in other currencies are translated at exchange rates ruling at the balance sheet date. Exchange differences arising from changes in exchange rates subsequent to the transaction dates are dealt with in the statement of income.

For the convenience of the reader, translation of amounts for RMB into United States dollars ( US ) has been made at the noon buying rate in New York city for cable transfer payables in foreign currencies as certified for customers purposes by the Federal Reserve Bank of New York on December 31, 2004 of US\$1.00=RMB8.2765. No representation is made that RMB amounts could have been, or could be, converted into US\$ at that rate on December 31, 2004, or at other rate.

***(r) Employee benefits***

**(i) Retirement benefits**

The Group's contributions to the defined contribution retirement scheme are expensed as incurred and are reduced by contributions forfeited by those employees who leave the scheme prior to vesting fully in the contributions.

**(ii) Housing benefits**

The Group's contributions to the housing fund, special monetary housing benefits and other housing benefits are expensed as incurred.

**(iii) Equity compensation benefits**

Share options are granted to directors and employees under the relevant share option schemes of the Company approved by the Board of Directors (see Note 30). The financial impact of the share options granted is not recorded in the financial statements until such time when the options are exercised. When the options are exercised, the proceeds received net of any transaction costs are credited to share capital (nominal value) and share premium.

***(s) Taxation***

**(i) Income tax**

Income tax is provided on the basis of income for statutory financial reporting purposes, adjusted for income and expense items, which are not assessable or deductible for tax purposes.

**(ii) Deferred taxation**

Deferred taxation is provided in full, using the liability method, on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the financial statements. Taxation rates enacted or substantively enacted at the balance sheet date are used to determine deferred taxation. Deferred tax assets are recognized to the extent that it is probable that future taxable profit will be available against

which the temporary differences can be utilized.

**(t) *Related parties***

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

***(u) Contingent liabilities and contingent assets***

A contingent liability is a possible obligation that arises from past events and whose existence will only be confirmed by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the Group. It can also be a present obligation arising from past events that is not recognized because it is not probable that outflow of economic resources will be required or the amount of obligation cannot be measured reliably.

A contingent liability is not recognized but is disclosed in the notes to the financial statements. When a change in the probability of an outflow occurs so that outflow is probable, the liability will then be recognized as a provision.

A contingent asset is a possible asset that arises from past events and whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain events not wholly within the control of the Group.

Contingent assets are not recognized but are disclosed in the notes to the financial statements when an inflow of economic benefits is probable. When an inflow is virtually certain, an asset is recognized.

***(v) Events after the balance sheet date***

Events after the balance sheet date that provide additional information about the position at the balance sheet date or those that indicate the going concern assumption is not appropriate (adjusting events) are reflected in the financial statements. Events after the balance sheet date that are not adjusting events are disclosed in the notes when material.

***(w) Segment reporting***

In accordance with the Group's internal financial reporting, the Group has determined that business segments be presented as the primary reporting format.

Unallocated costs primarily represent corporate expenses. Segments assets consist primarily of property, plant and equipment, other assets, prepayments, inventories, receivables and operating cash. Segment liabilities comprise operating liabilities. Capital expenditure mainly comprises additions to property, plant and equipment.

***(x) Earnings per share and per American Depositary Share ( ADS )***

Basic earnings per share have been computed by dividing net income by the number of weighted average number of ordinary shares outstanding during the year.

Diluted earnings per share has been computed by dividing the profit attributable to shareholders by the weighted average number of ordinary shares, after adjusting for the effects of the dilutive potential ordinary shares.

Basic and diluted net earnings per ADS have been computed by multiplying the net income per share by 10, which is the number of shares represented by each ADS.

#### 4. ACQUISITIONS

##### (a) Acquisition of Unicom New Century

Unicom New Century was a limited liability company established in the PRC on July 16, 2002 to engage in the provision of GSM and CDMA cellular telecommunications services in 6 provinces, 2 autonomous regions and 1 municipality in the PRC, namely, Sichuan, Heilongjiang, Jilin, Henan, Jiangxi, Shannxi, Guangxi, Xinjiang and Chongqing. The Cellular Business of Unicom New Century and the relevant net assets were previously owned and operated by various branches of Unicom Group.

Pursuant to the resolution passed by the Company's Board of Directors on November 20, 2002 and the extraordinary general meeting of the Company's shareholders on December 23, 2002, the Company acquired the entire equity interests in Unicom New Century (via the intermediary holding company, Unicom New Century (BVI) Limited) at a cash consideration of approximately RMB4,909 million (including other direct costs of acquisition of approximately RMB109 million). Thereafter, Unicom New Century has become a wholly-owned subsidiary of the Company.

The aforementioned acquisition of Unicom New Century became effective on December 31, 2002 when all the conditions to the acquisition were satisfied and cash consideration was settled by the Group. The Company has adopted the purchase method of accounting to account for this acquisition. The total fair value of the identifiable assets and liabilities of Unicom New Century as of December 31, 2002 amounted to approximately RMB2,624 million. The excess of purchase consideration over the fair value of identifiable assets and liabilities has been recorded as goodwill amounting to approximately RMB2,285 million, which is amortized using the straight-line method over the beneficial period of 20 years.

As the effective date of this acquisition was December 31, 2002, both the operating results and the financial position of Unicom New Century have been included in the consolidated financial statements of the Group for the year ended December 31, 2003. However, the 2002 comparatives only reflected the financial position of Unicom New Century in the consolidated balance sheet and excluded the operating results of Unicom New Century in the consolidated statements of income of the Group.

Operating revenue and net income for the year ended December 31, 2003 of Unicom New Century amounted to approximately RMB15,946 million and RMB364 million respectively.

On June 30, 2003, the Company entered into a share transfer agreement with Unicom New Century (BVI) Limited and acquired the entire share capital of Unicom New Century from Unicom New Century (BVI) Limited. Thereafter, Unicom New Century became a direct wholly-owned subsidiary of the Company. On July 30, 2004, CUCL combined with Unicom New Century.



The fair value of the net assets acquired and net cash outflow in respect of the acquisition of Unicom New Century as of December 31, 2002 was as following:

	As of December 31, 2002 RMB 000
Net assets acquired:	
Property, plant and equipment, net	23,330,775
Other assets	1,799,357
Deferred tax assets	56,368
Current portion of deferred tax assets	251,255
Amounts due from related parties	809,526
Amounts due from domestic carriers	20,601
Prepayments and other current assets	714,396
Inventories	1,201,310
Accounts receivable, net	715,331
Bank balances and cash	1,107,313
Payables and accrued liabilities	(4,940,983)
Amounts due to Unicom Group	(778,109)
Amounts due to related parties	(649,896)
Amounts due to domestic carriers	(160,018)
Current portion of long-term bank loans	(2,668,782)
Long-term bank loans	(15,465,331)
Taxes payable	(215,734)
Advances from customers	(1,496,228)
Short-term loans from Unicom Group	(724,127)
Short-term bank loans	(363,000)
	2,544,024
Goodwill	2,365,197
Less: Direct costs of acquisition	(109,221)
Consideration paid	4,800,000
Analysis of the net outflow in respect of the acquisition of Unicom New Century:	
Cash consideration	4,800,000
Bank balances and cash in hand acquired	(1,107,313)
Net cash outflow in respect of the acquisition of Unicom New Century	3,692,687

(b) **Acquisition of Unicom New World**

Unicom New World was a limited liability company established in the PRC on November 4, 2003 to engage in the provision of GSM and CDMA cellular telecommunications services in 6 provinces and 3 autonomous regions in the PRC, namely, Shanxi, Hunan, Hainan, Yunnan, Gansu, Qinghai, Inner Mongolia, Ningxia and Xizang. The Cellular business of Unicom New World and the relevant net assets were previously owned and operated by various branches of Unicom Group.



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Pursuant to the resolution passed by the Company's Board of Directors on November 20, 2003 and the extraordinary general meeting of the Company's shareholders on December 23, 2003, the Company acquired the entire equity interests in Unicom New World (via the intermediary holding company, Unicom New World (BVI) Limited) at a cash consideration of approximately RMB3,249 million (including other direct costs of acquisition of approximately RMB49 million). Thereafter, Unicom New World has become a wholly-owned subsidiary of the Company.

After all the conditions to the acquisition were satisfied and the cash consideration was settled by the Group, the acquisition of Unicom New World became effective on December 31, 2003. The Company has adopted the purchase method of accounting to account for this acquisition. The total fair value of the identifiable assets and liabilities of Unicom New World as of December 31, 2003 amounted to approximately RMB2,104 million, the excess of purchase consideration over the fair value of the identifiable assets and liabilities has been recorded as goodwill amounting to approximately RMB1,145 million, which is amortized using the straight-line method over the expected beneficial period of 20 years.

As the effective date of this acquisition was December 31, 2003, both the operating results and the financial position of Unicom New World have been included in the consolidated financial statements of the Group for the year ended December 31, 2004. However, the 2003 comparatives only reflected the financial position of Unicom New World in the consolidated balance sheet as of December 31, 2003 and excluded the operating results of Unicom New World in the consolidated statement of income of the Group for both 2002 and 2003.

For the year ended December 31, 2004, operating revenue and net income of Unicom New World amounted to approximately RMB9,041 million and RMB415 million respectively.

CUCL has planned to combine with Unicom New World in 2005, the relevant legal procedures regarding the combination is in process. For the details of this combination, please refer to Note 37(a).

The fair value of the net assets acquired and net cash outflow in respect of the acquisition of Unicom New World as of December 31, 2003 was as follows:

	Note	As of December 31, 2003 RMB 000
The fair value of the net assets acquired:		
Property, plant and equipment, net		12,106,458
Other assets		583,827
Deferred tax assets		14,010
Current portion of deferred tax assets		192,918
Amounts due from related parties		207,237
Amounts due from domestic carriers		5,745
Prepayments and other current assets		283,287
Inventories		307,503
Accounts receivable, net		357,880
Bank balances and cash	(i)	923,551
Payables and accrued liabilities		(1,951,215)
Amounts due to Unicom Group		(1,005,135)
Amounts due to related parties		(324,597)
Amounts due to domestic carriers		(52,473)
Current portion of long-term bank loans		(2,213,216)
Long-term bank loans		(5,473,734)
Taxes payable		(46,764)
Advances from customers		(604,862)
Short-term bank loans		(1,206,000)
		2,104,420
Goodwill		1,144,957
Less: direct costs of acquisition		(49,377)
Consideration paid		3,200,000
The net cash outflow in respect of the acquisition of Unicom New World was as follows:		
Cash consideration		3,200,000
Bank balances and cash acquired (less restricted bank deposits)	(i)	(873,551)
Net cash outflow in respect of the acquisition of Unicom New World		2,326,449

Note (i): As of December 31, 2003, approximately RMB50 million bank balances were restricted by the bank to secure the long-term bank loans.

(c) **Acquisition of Unicom International**

Unicom International was a limited liability company established in Hong Kong on May 24, 2000 to engage in voice wholesale business, telephone cards business, line leasing services, managed bandwidth services and mobile virtual network services. Unicom International's wholly-owned US subsidiary, China Unicom USA Corporation (Unicom USA), carries wholesale business of voice traffic between US and mainland China. Unicom International was a wholly-owned subsidiary of Unicom Group (HK).

Pursuant to the acquisition agreement signed between Unicom Group (HK) and the Company dated July 28, 2004, the Company agreed to acquire the entire equity interests in Unicom International from Unicom Group (HK) by a cash consideration of HK\$37,465,996 (equivalent to approximately RMB39,740,000, including direct costs of acquisition). After all the conditions to the acquisition were satisfied and cash consideration was settled by the Company, the acquisition of Unicom International became effective in September 2004. The Company has adopted the purchase method of accounting to account for this acquisition. The total fair value of the identifiable assets and liabilities of Unicom International in September 2004 amounted to approximately RMB47 million. The excess of the fair value of the identifiable assets and liabilities over purchase consideration has been recorded as negative goodwill amounting to RMB7.73 million, which is recognized in the consolidated statement of income of the Group using the straight-line method over the remaining weighted average useful life of the acquired identifiable non-monetary assets (approximately 6 years). As this acquisition was effective in September 2004, accordingly, the operating results of Unicom International for the period from the acquisition effective date to December 31, 2004 have been included in the consolidated statement of income of the Group in year 2004.

## 5. SALE OF DISCONTINUED OPERATION (GUOXIN PAGING)

Guoxin Paging was established as a limited liability company in the PRC in September 1998. Guoxin Paging originally operated a nationwide paging business through its 31 subsidiaries and branches in 27 provinces and autonomous regions and 4 municipalities in the PRC and was wholly-owned by CUCL.

The Group originally had 5 operating segments namely GSM Business, CDMA Business, Data and Internet Business, Long Distance Business and Paging Business (see Note 34). Pursuant to the ordinary resolution passed by the Company's Board of Directors on November 20, 2003, the Board of Directors announced the plan to dispose of the Paging Business to the ultimate parent company, Unicom Group. The disposal is consistent with the Group's long term strategy to focus its activities in the core telecommunication business. After obtaining the independent shareholders' approval in an extraordinary general meeting of the Company's shareholders on December 23, 2003, the Company completed the sale of the entire equity interests of Guoxin Paging to Unicom Group at a cash consideration of RMB2,750 million.

The sale of Guoxin Paging became effective on December 31, 2003 after all the conditions to the sale were satisfied, the majority of cash proceeds was settled by Unicom Group, and ownership as well as control was passed to Unicom Group. The total net assets of Guoxin Paging as of December 31, 2003 amounted to approximately RMB3,413 million, and the difference between the sale proceeds and the net assets disposed amounting to approximately RMB663 million, has been recorded as the loss on sale of discontinued operation in 2003.

Since the effective date of this sale was December 31, 2003, the operating results of Guoxin Paging have been included in the consolidated statements of income of the Group up to this date. For the year ended December 31, 2003, the operating revenue and loss after taxation of Guoxin Paging amounted to approximately RMB2,387 million and RMB1,404 million respectively (2002: approximately RMB3,972 million and RMB414 million respectively). Details of the sale were set forth in the related shareholders' circular "Connected Transactions" of the Company dated November 26, 2003.

(a) The total assets and total liabilities of Guoxin Paging as of December 31, 2003 comprised the following:

	<b>Guoxin Paging</b> <b>As of December 31</b> <b>2003</b> <b>RMB '000</b>
Non-current assets	3,914,492
Current assets	2,048,250
Total assets	5,962,742
Total liabilities	(1,997,772)

Minority interest	(551,691)
Net assets	3,413,279

(b) The net assets sold and net cash inflow in respect of the sale of Guoxin Paging as of December 31, 2003 was as follows:

	As of December 31, 2003 RMB 000
Net assets sold:	
Property, plant and equipment, net	3,647,083
Other assets	151,067
Investment securities	99,157
Investment in associated companies	17,185
Amount due from Unicom Group	9,440
Amount due from related parties	277,457
Amount due from domestic carriers	54,821
Prepayments and other current assets	207,813
Inventories	104,753
Accounts receivable, net	107,632
Trading securities	165,493
Short-term bank deposits	80,000
Bank balances and cash	1,040,841
Dividend payable	(8,260)
Payables and accrued liabilities	(1,491,890)
Amount due to related parties	(121,173)
Amount due to domestic carriers	(235,275)
Taxes payable	(17,669)
Advances from customers	(123,505)
Minority interests	(551,691)
	3,413,279
Less: sale proceeds	(2,750,000)
Loss on sale of discontinued operation	663,279
The net cash inflow in respect of the sale of discontinued operation was as follows:	
Sale proceeds received	2,300,000
Bank balances and cash disposed	(1,040,841)
Net cash inflow in respect of the sale of discontinued operation	1,259,159

(c) The operating results of the Group attributable to the continuing operations and discontinued operation (Guoxin Paging) were as follows:

	Continuing operations			Discontinued operation (Guoxin Paging)			Group as a whole		
	2002 RMB 000	2003 RMB 000	2004 RMB 000	2002 RMB 000	2003 RMB 000	2004 RMB 000	2002 RMB 000	2003 RMB 000	2004 RMB 000
Operating revenue (Turnover)	36,604,071	65,249,242	79,331,611	3,972,454	2,387,083		40,576,525	67,636,325	79,331,611
Operating expenses	(28,656,496)	(55,531,586)	(71,375,466)	(4,596,345)	(3,590,693)		(33,252,841)	(59,122,279)	(71,375,466)
Operating income (loss)	7,947,575	9,717,656	7,956,145	(623,891)	(1,203,610)		7,323,684	8,514,046	7,956,145
Loss on sale of discontinued operation					(663,279)			(663,279)	
Interest income	452,908	163,934	102,907	17,374	9,099		470,282	173,033	102,907
Finance costs	(1,466,093)	(1,930,784)	(1,688,418)	(8,348)	(5,238)		(1,474,441)	(1,936,022)	(1,688,418)
Other (loss) income, net	(41,352)	(31,797)	95,990	24,993	39,868		(16,359)	8,071	95,990
Income (loss) before taxation	6,893,038	7,919,009	6,466,624	(589,872)	(1,823,160)		6,303,166	6,095,849	6,466,624
Taxation	(1,895,987)	(2,307,596)	(2,079,625)	175,782	419,215		(1,720,205)	(1,888,381)	(2,079,625)
Income (loss) after taxation	4,997,051	5,611,413	4,386,999	(414,090)	(1,403,945)		4,582,961	4,207,468	4,386,999

(d) The cash flows of the Group attributable to the continuing operations and discontinued operation (Guoxin Paging) were as follows:

	Continuing operations			Discontinued operation (Guoxin Paging)			Group as a whole		
	2002 RMB 000	2003 RMB 000	2004 RMB 000	2002 RMB 000	2003 RMB 000	2004 RMB 000	2002 RMB 000	2003 RMB 000	2004 RMB 000
Net cash inflow from operating activities	12,692,415	22,141,521	23,819,295	361,863	423,738		13,054,278	22,565,259	23,819,295
Net cash outflow from investing activities	(4,579,122)	(18,660,174)	(18,958,603)	(586,917)	(391,129)		(5,166,039)	(19,051,303)	(18,958,603)
Net cash outflow from financing activities	(11,703,468)	(8,752,829)	(9,401,075)	(164,283)	(24,689)		(11,867,751)	(8,777,518)	(9,401,075)
Net (decrease)/increase in cash and cash equivalents	(3,590,175)	(5,271,482)	(4,540,383)	(389,337)	7,920		(3,979,512)	(5,263,562)	(4,540,383)



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Guoxin Paging subsequently changed its name to Unicom New Guoxin Telecommunications Corporation Limited (hereinafter referred to as New Guoxin ) on April 29, 2004.

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## 6. OPERATING REVENUE

Operating revenue primarily comprises usage fees, monthly fees, interconnection revenue, leased line rental income and sales of telecommunications products earned by the Group from GSM, CDMA, data, Internet, long distance and paging services. Tariffs for these services are subject to regulations by various government authorities, including the State Development and Reform Commission, the Ministry of Information Industry ( MII ) and the provincial price regulatory authorities.

Operating revenue is net of business tax and government surcharges.

The major components of operating revenue are as follows:

	Note	2002 RMB 000	2003 RMB 000	2004 RMB 000
<b>GSM Business</b>				
Usage fee	(i) (a)	20,274,987	29,072,249	31,997,020
Monthly fee	(ii)	4,169,129	7,042,299	6,922,400
Interconnection revenue	(iii)	1,709,771	1,926,907	2,614,268
Other revenue	(v)	1,234,038	2,262,156	5,045,547
Total GSM service revenue		27,387,925	40,303,611	46,579,235
<b>CDMA Business</b>				
Usage fee	(i) (a)	2,231,050	11,671,523	16,164,333
Monthly fee	(ii)	713,483	3,488,411	4,638,024
Interconnection revenue	(iii)	184,296	607,830	927,288
Other revenue	(v)	96,518	855,754	2,489,957
Total CDMA service revenue		3,225,347	16,623,518	24,219,602
<b>Data and Internet Business</b>				
Usage fee	(i) (b)	2,069,415	2,443,610	2,685,083
Monthly fee	(ii)	9,478	9,085	
Interconnection revenue	(iii)	348,248	361,514	131,371
Leased lines rental	(iv)	274,274	420,433	344,014
Other revenue	(v)	91,624	202,441	502,266
Total Data and Internet service revenue		2,793,039	3,437,083	3,662,734
<b>Long Distance Business</b>				
Usage fee	(i) (b)	1,223,051	1,148,040	879,281
Interconnection revenue	(iii)	664,302	365,724	454,383
Leased lines rental	(iv)	873,054	701,549	512,134
Other revenue	(v)	5,316	57,835	2,211
Total Long Distance service revenue		2,765,723	2,273,148	1,848,009
<b>Paging Business</b>				

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Monthly fee	(ii)	1,912,786	612,999	
Interconnection revenue	(iii)	113,123	1,654	
Other revenue	(v)	135,279	788,400	
Total Paging service revenue		2,161,188	1,403,053	
<b>Total service revenue</b>		<b>38,333,222</b>	<b>64,040,413</b>	<b>76,309,580</b>
Sales of telecommunications products		2,243,303	3,595,912	3,022,031
<b>Total operating revenue</b>		<b>40,576,525</b>	<b>67,636,325</b>	<b>79,331,611</b>

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Notes:

- (i) Usage fees comprise:
- (a) charges for incoming and outgoing calls made by cellular subscribers including charges for local calls, domestic direct dial ( DDD ) and international direct dial ( IDD ) as well as roaming fees for calls made by cellular subscribers outside their local service areas; and
  - (b) charges for IP telephone calls, data and Internet services and fixed line long distance calls.
- (ii) Monthly fees represent fixed amounts charged to cellular, data, Internet, and paging subscribers on a monthly basis for maintaining their access to the related services.
- (iii) Interconnection revenue represents amounts received from other operators, including Unicom Group, for calls from their networks to the Group's networks. It also includes roaming-in fees received from other operators, including Unicom Group, for calls made by their subscribers using the Group's cellular networks (see Notes 31(a) and 33(a)).
- (iv) Leased line rental income represents rentals received for leasing of transmission lines to Unicom Group, business customers and other domestic carriers in the PRC.
- (v) Other revenue mainly represents revenue from the provision of value-added services such as short message, CDMA1X wireless data service and secretarial services to subscribers.

**7. INCOME BEFORE TAXATION**

Income before taxation is stated after charging and crediting the following:

	Note	2002 RMB 000	2003 RMB 000	2004 RMB 000
<b>After charging/(crediting):</b>				
Share of (income) losses from associated companies	10	(553)	2,275	
Dividends from investment securities	10	(24,978)	(2,573)	
Realized gains on trading securities	10, 17	(1,876)	(12,045)	
Unrealized losses (gains) on trading securities	10, 17	27,461	(10,129)	
Realized gains on investment securities	10	(18,098)	(13,268)	
Gains on disposal of interests in associated company	10	(1,251)		
Interest income		(470,282)	(173,033)	(102,907)
Interest expense	9	1,879,663	2,523,512	2,316,318
Less: amounts capitalized in construction-in-progress	9	(422,927)	(604,137)	(647,851)
Total interest expenses		1,456,736	1,919,375	1,668,467
<b>Depreciation:</b>				
- Assets held under finance leases	21	20,046	12,154	111,473
- Other assets		10,830,635	15,963,117	18,116,132
Total depreciation	21	10,850,681	15,975,271	18,227,605
Amortization of goodwill	22	23,414	115,260	171,184
Other amortization	23	381,629	294,762	664,285
Amortization of deferred customer acquisition costs of contractual CDMA subscribers	20(a)	1,385,424	5,836,587	6,120,737
Loss on disposal of property, plant and equipment	8(iv)	82,467	49,940	10,537
Auditors remuneration		38,916	54,003	57,522

	Note	2002 RMB 000	2003 RMB 000	2004 RMB 000
<b>After charging/(crediting):</b>				
Operating lease expense:				
- Leased lines		691,358	805,018	809,202
- CDMA network capacities	31(a),32	891,897	3,515,364	6,588,926
- Other leasing expense	8(iv)	610,931	882,671	1,042,020
Total operating lease expense		2,194,186	5,203,053	8,440,148
Provision for doubtful debts:				
- GSM Business		802,914	1,116,523	1,317,374
- CDMA Business		42,050	397,810	645,470
- Data and Internet Business		70,922	125,676	164,514
- Long Distance Business		46,124	75,870	64,462
- Paging Business		9,979	34,008	
Total provision for doubtful debts	8(iv)	971,989	1,749,887	2,191,820
Cost of inventories		2,161,512	3,570,234	3,440,826
Write-down of inventories to net realizable value		7,156	47,101	69,475
Additional provision for impairment losses in investment securities		650		
Personnel:				
- Salaries and wages		2,654,845	3,676,168	3,647,629
- Contributions to defined contribution pension schemes	12	203,164	273,182	244,397
- Contributions to supplementary defined contribution pension schemes	12	11,066	39,854	41,596
- Special monetary housing benefits	13	277,944	109,210	21,907
- Contributions to other housing fund	13	92,549	170,614	224,686
- Other housing benefits	13	95,650	305,518	345,885
Total personnel		3,335,218	4,574,546	4,526,100
Additional provision for impairment of:				
- Property, plant and equipment	21		528,048	
- Goodwill		38,797		
Total provision for impairment	8(iv)	38,797	528,048	
Exchange losses, net	10	21,533	9,960	7,657

**8. OPERATING EXPENSES**

Major components of operating expenses are as follows:

- (i) Leased line charges incurred in association with leasing of transmission capacity from other operators and leasing expenses related to CDMA network capacities from Unicom New Horizon Mobile Telecommunication Company Limited ( Unicom New Horizon ) (see Notes 31(a), 32 and 33(a)).
- (ii) Interconnection charges represent amounts paid to other operators, including Unicom Group, for calls from the Group's networks to the networks of other operators.
- (iii) Personnel costs comprise staff salaries and wages, contributions to defined contribution pension schemes and housing benefits etc.
- (iv) General, administrative and other expenses are analyzed as follows:

	2002 RMB 000	2003 RMB 000	2004 RMB 000
Operating lease rental expenses	610,931	882,671	1,042,020
Repair and maintenance expenses	832,259	1,387,466	1,648,986
Provision for doubtful debts	971,989	1,749,887	2,191,820
Loss on disposal of property, plant and equipment	82,467	49,940	10,537
Provisions for impairment of property, plant and equipment and goodwill (see Notes 21 and 22)	38,797	528,048	
Traveling, entertainment and meeting expenses	850,876	1,242,166	1,322,438
Power and water charges	729,650	1,313,099	1,763,766
Office expenses	582,187	749,080	706,892
Other	932,694	1,210,028	1,761,782
	5,631,850	9,112,385	10,448,241

**9. FINANCE COSTS**

	2002 RMB 000	2003 RMB 000	2004 RMB 000
Interest on bank loans repayable over 5 years	41,115	124,105	537,261
Interest on bank loans repayable within 5 years	1,838,548	2,399,407	1,750,209
Interest element of finance lease	7,059	7,050	28,848
Less: Amounts capitalized in construction-in-progress	(422,927)	(604,137)	(647,851)
Total interest expenses	1,463,795	1,926,425	1,668,467
Bank charges	10,646	9,597	19,951
	1,474,441	1,936,022	1,668,418





**10. OTHER EXPENSE (INCOME), NET**

	2002 RMB 000	2003 RMB 000	2004 RMB 000
Share of (income) losses from associated companies	(553)	2,275	
Dividends from investment securities	(24,978)	(2,573)	
Realized gains on trading securities	(1,876)	(12,045)	
Unrealized losses (gains) on trading securities	27,461	(10,129)	
Realized gains on investment securities	(18,098)	(13,268)	
Compensation from vendors			(73,585)
Losses from exchange difference	21,533	9,960	7,657
Gain on disposal of interests in associated company	(1,251)		
Other	14,121	17,709	(30,062)
	16,359	(8,071)	(95,990)

**11. DIRECTORS , SENIOR EXECUTIVES AND SUPERVISORS EMOLUMENTS****(a) Directors emoluments**

The aggregate amounts of fees and emoluments payable to directors of the Company during the years 2002, 2003 and 2004 were set out below:

	2002 RMB 000	2003 RMB 000	2004 RMB 000
<u>Non-executive directors:</u>			
Fees	849	1,594	1,594
<u>Executive directors:</u>			
Fees			
Other emoluments			
- Salaries, allowance and other allowances	9,722	9,352	9,242
- Pension benefits/pension scheme contributions	38	106	128
- Bonuses paid and payable	5,887	9,688	5,676
	15,647	19,146	15,046
	16,496	20,740	16,640

Non-executive directors emoluments disclosed above include approximately RMB1,275,000 (2002: RMB636,000; 2003: RMB1,275,000) paid to independent non-executive directors.

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During 2004, 4,020,000 (2002: 2,802,000; 2003: 2,772,000) share options were granted to the directors under the amended Share Option Scheme approved by the independent non-executive directors on July 20, 2004 and December 21, 2004 respectively. See Notes 30(e) and 30(f) for the details of share options granted during the years.

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The emoluments of the directors analyzed by the number of directors and emolument ranges were as follows:

(All amounts expressed in Hong Kong dollars)	2002	Number of directors 2003	2004
\$nil - \$1,000,000	4	5	9
\$1,000,001 - \$1,500,000	2		
\$1,500,001 - \$2,000,000			1
\$2,000,001 - \$2,500,000	1	2	4
\$2,500,001 - \$3,000,000	1	1	1
\$3,000,001 - \$3,500,000	1		
\$3,500,001 - \$4,000,000	1	1	
\$6,500,001 - \$7,000,000		1	
	10	10	15

No directors waived the right to receive emoluments during the year.

**(b) Five highest paid individuals**

The five individuals whose emoluments were the highest of the Group for 2004 were all directors of the Company (2002: 4; 2003: 4) whose emoluments are reflected in the analysis presented above. The emoluments payable to the remaining individual during year 2002 and 2003 are as follows:

	2002 RMB 000	2003 RMB 000
Salaries, allowance and other allowances	1,432	1,435
Pension benefits/pension scheme contributions		38
Bonuses paid and payable	849	850
	2,281	2,323

The emoluments of the remaining individual during 2002 and 2003 both fell within the band of HK\$2,000,001- HK\$2,500,000.

No emolument was paid to the five highest paid individuals as an inducement to join or upon joining the Company or as compensation for loss of office.

## 12. RETIREMENT BENEFITS

All the full time employees of the Group are covered by a state-sponsored pension scheme under which the employees are entitled to an annual pension equal to their basic salaries at their retirement dates. The PRC government is responsible for the pension liability to these retired employees. The Group was required to make defined contributions to the pension scheme at the rate of 19% for the year ended December 31, 2004 (2002 and 2003: 19%) of the employees' basic salaries. Under this scheme, the Group has no obligation for post-retirement benefits beyond the annual contributions.

In addition, effective from August 11, 1998, a supplementary defined contribution pension plan managed by an independent insurance company was established. Under this plan, the Group makes a monthly defined contribution of 2% to 24% (2002 and 2003: 2% to 6%) of the monthly salary of each employee. There were no vested benefits attributable to past services upon adoption of the plan.

Retirement benefits charged to the statements of income were as follows:

	2002 RMB 000	2003 RMB 000	2004 RMB 000
Contributions to defined contribution pension schemes	203,164	273,182	244,397
Contributions to supplementary defined contribution pension schemes	11,066	39,854	41,596

## 13. HOUSING BENEFITS

Under housing reform schemes in accordance with government regulations at the provincial level in the PRC, the Group provided benefits to certain qualified employees to enable them to purchase living quarters at a discount. In the case of New Guoxin, the living quarters were provided by China Telecom prior to the establishment of New Guoxin and the related benefits were not charged to the Group. In the case of the GSM Business, certain of these living quarters were provided by Unicom Group and the related benefits were not charged to the Group. Housing benefits which were not charged to the Group amounted to approximately RMB14.9 million for 2004 (2002 and 2003: RMB18.5 million).

Subsequent to the establishment of New Guoxin, for living quarters purchased or built by the Group, the liability to provide the housing benefits was recognized by the Group upon finalization of the allocation of the housing units to specific employees. The amount of the benefits was the difference between the cost of the quarters purchased by the employees and the amount actually charged to the employees. The benefits are recorded as expenses over the estimated remaining average service life of the participating employees.

In addition, all of the full time employees of the Group are entitled to participate in a state-sponsored housing fund. The fund can be used for the construction of living quarters or may be withdrawn upon the retirement of the employees. The Group is required to make annual contributions to the housing fund at a rate on 10% (2002 and 2003: 10%) of the employees' basic salaries.

According to the central government policy on housing reform based on a State Council circular issued in 1998, monetary housing subsidies in the form of special cash payments are to be made by certain PRC enterprises to their employees in order to enable them to purchase living quarters. Under this general policy, enterprises are allowed to establish their own housing reform schemes taking into consideration the actual financial capability of the enterprises.

The Group finalized its monetary housing benefit scheme as a special employee incentive scheme for all qualified employees in year 2001. According to the scheme, the total amount of monetary housing benefit for each employee is determined based on the working age of the employee and the property market price prevailing in the relevant location. The total monetary housing benefit is divided into three annual payments in the proportion of 40%, 30% and 30% respectively. In order to be included in the incentive scheme, employees are required to sign a service contract with a minimum service period of three years. The employees will be entitled to the first 40% payment only when the following criteria are met:

- (i) the provincial branch in which the employees are working has achieved the annual performance budget set by head office management; and
- (ii) the employees continue to be under the employment of the Group at the time of the payment.

Similarly, the employees will only be entitled to the second and then the third annual payments when and only when the above two conditions are also fulfilled in subsequent years.

The Group accrues for each annual payment upon the fulfillment of the above criteria by the employees, at which time the liability is considered to have arisen.

For the years ended December 31, 2002, 2003 and 2004, certain provinces achieved the annual performance budget and were thus approved by management to distribute and pay out such monetary housing benefits. The provision for special monetary housing benefits for qualified employees of these provinces for the years ended December 31, 2002, 2003 and 2004 amounted to approximately RMB277,944,000, RMB109,210,000 and RMB21,907,000 respectively, based on the aforementioned distribution plan. The remaining provinces were not entitled to the special monetary housing benefits since they did not achieve their annual performance budget in 2002, 2003 and 2004 and accordingly, no provision for such benefits was made.

The expenses incurred by the Group in relation to the housing benefits described above were as follows (excluding those paid by Unicom Group and China Telecom and not charged to the Group):

	2002 RMB 000	2003 RMB 000	2004 RMB 000
Special monetary housing benefits	277,944	109,210	21,907
Contributions to housing fund	92,549	170,614	224,686
Other housing benefits	95,650	305,518	345,885
	466,143	585,342	592,478



**14. TAXATION**

Provision for taxation represents:

	<b>2002</b> <b>RMB 000</b> <b>As restated</b>	<b>2003</b> <b>RMB 000</b>	<b>2004</b> <b>RMB 000</b>
Provision for PRC enterprise income tax on the estimated taxable income for the year	1,192,801	1,064,968	1,422,635
Deferred taxation	527,404	823,413	656,990
	1,720,205	1,888,381	2,079,625

There is no Hong Kong income tax liability as the Group does not have any assessable income sourced from Hong Kong for 2002, 2003 and 2004.

The income tax liabilities of the Group were assessed as follows:

(a) The tax liabilities of CUCL and its wholly-owned subsidiaries for 2002, 2003 and 2004 were assessed in accordance with FIE ( Foreign Investment Enterprises ) taxation requirements on a consolidated basis as a single entity and settled income tax liabilities centrally in Beijing as approved by the tax authority;

(b) Prior to the acquisitions of Unicom New Century (which has been merged into and succeeded by CUCL) and Unicom New World at 2002 and 2003 year-end, Unicom Group was assessed for PRC enterprise tax liability under the relevant tax rules and regulations applicable to state-owned enterprises, and at the statutory rate of 33% on a consolidation basis as a single entity. The tax provision for Unicom New Century and Unicom New World were determined on a separate return basis using the same tax policy applicable to Unicom Group. Under this basis, the tax liabilities attributable to Unicom New Century and Unicom New World were determined as if it were assessed for income tax separately from Unicom Group. In 2003, tax liabilities of Unicom New Century was assessed in accordance with FIE taxation requirements on a consolidated basis as a single entity; and the tax liabilities of Unicom New World for 2004 was also assessed in accordance with FIE taxation requirements on a consolidated basis as a single entity; and.

(c) Various provincial branches/municipal cities of CUCL, Unicom New Century and Unicom New World were granted a preferential treatment by tax authorities to assess their enterprise income tax at the rates of 30%, 15% or 10% in years 2002, 2003 and 2004. The remaining provincial branches were assessed at the standard tax rate of 33%.





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The reconciliation of PRC enterprise income tax between the statutory tax rate of 33% and the effective tax rate actually recorded in the statements of income is as follows:

	2002 As restated	2003	2004
<b>PRC</b>			
Statutory tax rate of 33%	33.0%	33.0%	33.0%
Non-deductible expenses	1.5	0.3	2.0
Effect of preferential tax rates	(3.2)	(1.6)	(2.1)
Increase in opening deferred tax assets resulting from an increase in tax rate		(2.3)	(0.4)
Tax credits (see Note (a))	(2.8)		(0.3)
Additional expense deductible for tax purpose (see Note (b))		(0.9)	
Write-off of deferred tax assets previously recognized for New Guoxin		1.9	
<b>Effective PRC income tax rate</b>	<b>28.5%</b>	<b>30.4%</b>	<b>32.2%</b>
<b>Hong Kong</b>			
Statutory tax rate of 17.5%	16.0%	17.5%	17.5%
Non-deductible expenses		(96.9)	189.0
Non-taxable income:			
- Interest income	(16.0)	79.4	(170.8)
- Leased line income sourced from outside Hong Kong			(27.0)
<b>Effective HK income tax rate</b>			<b>8.7%</b>
<b>Total overall effective income tax rate</b>	<b>27.3%</b>	<b>31.0%</b>	<b>32.2%</b>

Tax effect of preferential tax rate is as follows:

	2002	2003	2004
Aggregate amount (RMB in millions)	191	97	135
Per share effect (RMB)	0.015	0.008	0.011

Notes:

(a) For 2002 and 2004, tax credits represented investment tax credits relating to the additions of certain domestic equipment that were deductible against current tax.

(b) During 2003, CUCL, Unicom New Century and Unicom New World confirmed with relevant tax authorities in the PRC that certain monetary housing benefits, which were previously treated as non-deductible expenses for income tax assessment purposes in prior years, could be used to deduct against enterprise income tax over 3 years.

Accordingly, all the related deferred tax assets have been recognized in 2003. Such deferred tax assets will be utilized on a straight-line basis over 3 years.

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The movement of the deferred tax assets is as follows:

	2002 RMB 000 As restated	2003 RMB 000	2004 RMB 000
Balance, beginning of year	1,581,408	1,815,234	1,198,749
Change in accounting policy:			
- Recognition of additional deferred tax assets in relation to provision for doubtful debts	3(a) 373,159		
Acquisition of Unicom New Century	388,071		
Acquisition of Unicom New World		206,928	
Acquisition of Unicom International			(2,090)
Deferred taxation charged to statements of income	(527,404)	(823,413)	(656,990)
Balance, end of year	1,815,234	1,198,749	539,669

Deferred taxation as of year-end represents the taxation effect of the following temporary differences:

	Note	2003 RMB 000	2004 RMB 000
<b>Deferred tax assets:</b>			
Interest on loans from CCF joint ventures	(a)	256,673	150,954
Loss arising from terminations of CCF Arrangements	(a)	236,249	174,637
Income tax on advances from customers for telephone cards		261,467	
Provision for impairment loss for property, plant and equipment		4,875	4,721
Provision for doubtful debts of Cellular Business		534,839	526,514
Write-off of other assets		7,563	
Write-down of inventories to net realizable value		15,905	39,103
Amortization of retirement benefits		18,549	6,678
Additional depreciation deductible for tax purpose		101,267	18,258
Differences on tax basis for the residual value of property, plant and equipment		7,608	10,045
Monetary housing benefits		56,826	17,171
Other		29,309	16,740
		1,531,130	964,821
<b>Deferred tax liabilities:</b>			
Change of depreciation period		(28,268)	
Accelerated depreciation for tax purpose			(26,280)
Capitalized interest already deducted for tax purpose		(304,113)	(398,872)
		(332,381)	(425,152)
Net deferred tax assets		1,198,749	539,669
Less: Current portion of deferred tax assets		(873,849)	(606,009)
		324,900	(66,340)



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Note:

(a) Prior to 2000, in the process of developing its cellular networks, the GSM Business has entered into cooperation agreements with certain contractual joint ventures (the CJVs) established in the PRC. Each CJV was established by one or more Chinese enterprises and one or more foreign parties, and the aforementioned cooperation arrangements are referred to as the China-China-Foreign Arrangement (the CCF Arrangements). Pursuant to the CCF Arrangements, the CJVs have extended funding to the GSM Business for the construction of telecommunications systems and network equipment in the PRC. Based on the terms of the cooperation agreements, the CCF Arrangements had been accounted for as secured financing arrangements to the GSM Business, and interest had been accrued by the GSM Business based on the funds provided by the CJVs and the then prevailing market borrowing rates. Afterwards, all CCF Arrangements had been terminated in 1999 and 2000, the related loss on the termination of CCF Arrangements was charged to the statements of income as incurred. Pursuant to the approval of relevant tax authorities, since all the interest costs and the loss on termination of these CCF Arrangements can be deducted against current tax over 7 years. The resulting deferred tax assets were recognized accordingly.

## 15. NET INCOME

(a) CUCL, Unicom New Century (which has been merged into and succeeded by CUCL), and Unicom New World were registered as foreign investment enterprises in the PRC. In accordance with the Articles of Association of CUCL and Unicom New World, they are required to provide for certain statutory reserves, namely, general reserve fund and staff bonus and welfare fund, which are appropriated from profit after tax and minority interests but before dividend distribution.

CUCL and Unicom New World are required to allocate at least 10% of their income after tax and minority interests determined under PRC GAAP to the general reserve fund until the cumulative amounts reach 50% of the registered capital. The statutory reserve can only be used, upon approval obtained from the relevant authority, to offset accumulated losses or increase capital.

Appropriation to the staff bonus and welfare fund is at the discretion of the directors. The staff bonus and welfare fund can only be used for special bonuses or the collective welfare of the employees and are not distributable as cash dividends. Under HK GAAP, the appropriations to the staff bonus and welfare fund will be charged to statements of income as expenses incurred since any assets acquired through this fund belong to the employees. For the years ended December 31, 2004, no appropriation to staff bonus and welfare fund has been made (2002 and 2003: Nil).

Accordingly, CUCL and Unicom New World appropriated approximately RMB387,185,000 (2002: RMB436,463,000; 2003: RMB382,030,000), and RMB42,115,000 (2002 and 2003: Nil) respectively to the general reserve fund for the year ended December 31, 2004. Unicom New Century appropriated approximately RMB37,236,000 to the general reserve fund for the year ended December 31, 2003.

As stated in Note 3(a), the change in accounting policy on income taxes has resulted in an increase of distributable reserves to shareholders of CUCL for the years ended December 31, 2002. As a result, CUCL has made additional appropriation to the statutory reserves amounting to approximately RMB37,316,000 and RMB40,530,000 in 2002 and 2003 respectively.

(b) At the annual general meeting held on May 12, 2004, the shareholders of the Company approved the payment of final dividend of RMB0.10 per ordinary share for the year ended December 31, 2003 totaling RMB1,256,159,607 which has been reflected as an appropriation of retained earning for 2004. As of December 31, 2004, such dividends have been fully paid by the Company.

At a meeting held on March 24, 2005, the Board of Directors of the Company proposed the payment of final dividend of RMB0.10 per ordinary share to the shareholders for the year ended December 31, 2004 totaling RMB1,256,349,207. This proposed dividend has not been reflected as a dividend payable in the financial statements as of December 31, 2004, but will be reflected as an appropriation of retained earning in the financial statements for the year ending December 31, 2005.

(c) For the year ended December 31, 2004, net income included a income of approximately RMB9,358,000 (2002: net income of approximately RMB287,492,000; 2003: loss of approximately RMB21,654,000) which has been dealt with in the financial statements of the Company. As of December 31, 2004, the amount of distributable reserves to shareholders of the Company amounted to approximately RMB1,330,427,000 (2002: RMB3,854,183,000; 2003: RMB2,577,229,000).

## 16. EARNINGS PER SHARE

### Earnings per share and per American Depository Share ( ADS )

Basic earnings per share for the years ended December 31, 2002, 2003 and 2004 were computed by dividing the net income by the weighted average number of ordinary shares in issue during the years.

Diluted earnings per share for the years ended December 31, 2002, 2003 and 2004 were computed by dividing the net income by the weighted average number of ordinary shares in issue during the years, after adjusting for the effects of the potential dilutive ordinary shares. All potential dilutive ordinary shares arose from share options granted under (i) the amended Pre-Global Offering Share Option Scheme; and (ii) the amended Share Option Scheme as described in Note 30. For 2003 and 2004, all potential dilutive shares arose from share options granted in 2002, 2003 and 2004 under the amended Share Option Scheme (see details in Note 30), which if converted to ordinary shares would decrease net income per share. For 2002, there was no dilution of earnings per share after taking into account the dilutive effect of the share options. The anti-dilutive shares arising from the share options in 2004 of approximately 31,944,000 shares (2002: 48,745,000 shares; 2003: 66,573,000 shares) were not included in the calculation of diluted earnings per share.

Basic and diluted earnings per ADS have been computed by multiplying the earnings per share by 10, which is the number of shares represented by each ADS.



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Reconciliation of the numerators and denominators of the basic and diluted earnings per share computations:

	2002			2003			2004		
	Net income RMB 000 As restated	Shares 000	Per share amount RMB As restated	Net income RMB 000	Shares 000	Per share amount RMB	Net income RMB 000	Shares 000	Per share amount RMB
Basic earnings	4,598,213	12,552,996	0.366	4,217,097	12,553,010	0.336	4,386,999	12,561,242	0.349
Effect of conversion of share options					15,673			45,999	
Diluted earnings	4,598,213	12,552,996	0.366	4,217,097	12,568,683	0.336	4,386,999	12,607,241	0.348

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**17. TRADING SECURITIES**

Trading securities represented listed equity securities in the PRC, which were carried at fair value. The realized gains on trading securities for the year ended December 31, 2002 and 2003 amounted to approximately RMB1,876,000 and RMB12,045,000 respectively; and the unrealized loss for the year ended December 31, 2002 amounted to RMB 27,461,000 and unrealized gains amounted to RMB10,129,000 for the year ended December 31, 2003 respectively. As of December 31, 2004, no trading securities are maintained by the Group after the sale of New Guoxin on December 31, 2003.

**18. ACCOUNTS RECEIVABLE, NET**

	<b>2003</b>	<b>2004</b>
	<b>RMB 000</b>	<b>RMB 000</b>
Accounts receivable for GSM services	5,268,041	4,464,963
Accounts receivable for CDMA services	2,408,093	3,448,273
Accounts receivable for Data and Internet services	696,802	537,418
Accounts receivable for Long Distance services	587,570	712,833
Sub-total	8,960,506	9,163,487
Less:		
Provision for doubtful debts for GSM services	(2,716,396)	(2,521,313)
Provision for doubtful debts for CDMA services	(508,970)	(1,110,024)
Provision for doubtful debts for Data and Internet services	(158,313)	(200,373)
Provision for doubtful debts for Long Distance services	(105,280)	(101,797)
	5,471,547	5,229,980

The aging analysis of accounts receivable was as follows:

	<b>2003</b>	<b>2004</b>
	<b>RMB 000</b>	<b>RMB 000</b>
Not yet due (within credit period)	3,433,584	3,595,337
Due within three months	1,744,568	1,373,240
Three months to six months	750,719	732,890
Six months to one year	1,299,386	1,398,175
More than one year	1,732,249	2,063,845
	8,960,506	9,163,487

The normal credit period granted by the Group is on average 30 days from the date of invoice.

Provision for doubtful debts was analyzed as follows:

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	2003 RMB 000	2004 RMB 000
Balance, beginning of year	1,733,972	3,488,959
Provision for the year	1,749,887	2,191,820
Acquisition of Unicom New World	199,904	
Acquisition of Unicom International		9,306
Sale of New Guoxin	(64,664)	
Written-off for the year	(130,140)	(1,756,578)
Balance, end of year	3,488,959	3,933,507

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**19. INVENTORIES**

	2003 RMB 000	2004 RMB 000
Handsets	1,133,027	2,045,502
Telephone cards	855,183	832,050
Other	181,144	237,080
	2,169,354	3,114,632

**20. PREPAYMENTS AND OTHER CURRENT ASSETS**

	Note	2003 RMB 000	2004 RMB 000
Prepaid rental		233,461	277,999
Deposits and prepayments		1,624,874	1,334,220
Interest receivable		4,872	1,414
Advances to employees		164,487	164,386
Deferred customer acquisition costs of contractual CDMA subscribers	(a)	535,521	860,225
Other		584,562	421,470
		3,147,777	3,059,714

The aging analysis of prepayments and other current assets was as follows:

	2003 RMB 000	2004 RMB 000
Within one year	3,109,944	2,855,331
Over one year	37,833	204,383
	3,147,777	3,059,714

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Note:

(a) As part of the arrangement with certain CDMA contractual subscribers under special promotion packages, CDMA handsets were provided to certain subscribers for their use at no additional charge during specified contract periods ranging from 6 months to 2 years.

Under the terms of these contracts, subscribers are required to spend a minimum amount of service fees during the contract period. In addition, to secure future performance, these subscribers are also required to (i) prepay service fees or deposits, (ii) maintain a restricted bank deposits in a designated commercial banks to secure the minimum contract amount, or (iii) provide the Group with a guarantor who will compensate the Group for any loss upon their non-performance. The costs of CDMA handsets under the above contractual arrangements are treated as deferred customer acquisition costs, to the extent recoverable based on management periodic assessment, and are amortized over the contractual period (not exceeding 2 years) to match with the Group's minimum contract revenue.

For the year ended December 31, 2004, amortization of these deferred customer acquisition costs of contractual CDMA subscribers amounted to approximately RMB6,121 million (2002: RMB1,385 million; 2003: RMB5,837 million), which was recorded in selling and marketing expenses. As of December 31, 2004, the carrying amount of unamortized deferred customer acquisition costs of contractual CDMA subscribers totaled approximately RMB4,745 million (2003 RMB4,447 million), with approximately RMB860 million (2003 RMB 536 million) recorded in prepayment and other current assets (for contract period within 1 year) and with approximately RMB3,885 million (2003: RMB3,911 million) recorded in other assets (for contract period over 1 year) (see Note 23).

In addition, the Group obtained certain CDMA handsets to develop the above CDMA contractual subscribers through finance lease arrangement (see Note 28). The carrying amount of these deferred customer acquisition costs of contractual CDMA subscribers arising from the finance lease amounted to approximately RMB896 million as of 31 December 2004.

As of December 31, 2004, the carrying amount of prepaid service fees and deposits obtained by the Group under the above contracts amounted to RMB2,301 million and RMB148 million (2003: RMB2,366 million and RMB153 million) respectively.

**21. PROPERTY, PLANT AND EQUIPMENT, NET**

	2004					2003	
	Land use rights and buildings RMB 000	Telecommunications equipment RMB 000	Office furniture, fixtures and others RMB 000	Leasehold improvements RMB 000	Construction in progress RMB 000	Total RMB 000	Total RMB 000
Cost or valuation:							
Beginning of year	13,103,955	115,221,436	4,494,776	1,054,779	21,741,746	155,616,692	138,317,709
Additions	301,360	1,029,561	413,399	92,837	17,196,742	19,033,899	18,806,907
Acquisition of Unicom New World							
							12,106,458
Acquisition of Unicom International							
		45,987			11,438	57,425	
Transfer from CIP	2,541,675	12,407,593	239,585	66,565	(15,255,418)		
Sale of New Guoxin							
							(12,421,053)
Disposals	(27,255)	(174,102)	(44,291)	(101,773)		(347,421)	(1,193,329)
End of year	15,919,735	128,530,475	5,103,469	1,112,408	23,694,508	174,360,595	155,616,692
Representing:							
At cost	13,548,962	128,530,475	5,103,469	1,112,408	23,694,508	171,989,822	153,245,919
At valuation	2,370,773					2,370,773	2,370,773
	15,919,735	128,530,475	5,103,469	1,112,408	23,694,508	174,360,595	155,616,692
Accumulated depreciation and impairment:							
Beginning of year	1,524,647	33,821,346	1,641,112	510,432	14,307	37,511,844	30,831,080
Charge for the year	994,931	16,106,795	892,457	233,422		18,227,605	15,975,271
Impairment losses							528,048
Sale of New Guoxin							
							(8,773,970)
Disposals	(7,893)	(139,184)	(34,064)	(101,773)		(282,914)	(1,048,585)
End of year	2,511,685	49,788,957	2,499,505	642,081	14,307	55,456,535	37,511,844
Net book value:							
End of year	13,408,050	78,741,518	2,603,964	470,327	23,680,201	118,904,060	118,104,848
Beginning of year	11,579,308	81,400,090	2,853,664	544,347	21,727,439	118,104,848	107,486,629

As of December 31, 2004, prepayments for property, plant and equipment to be used in construction amounting to approximately RMB1,604 million (2002: RMB4,164 million; 2003: RMB1,431 million) have been included in construction-in-progress.

For 2004, interest of approximately RMB648 million (2002: RMB423 million; 2003: RMB604 million) was capitalized to construction-in-progress.

As of December 31, 2004, the cost or valuation of land use rights (located in the PRC) and the accumulated depreciation amounted to approximately RMB525 million and RMB113 million respectively (2002: RMB348 million and RMB77 million; 2003: RMB303 million and RMB61 million).

Land use rights and buildings of the Group as of March 31, 2000 were valued by Sallmanns (Far East) Ltd., registered property valuers in Hong Kong, using the replacement cost or open market value approach, as appropriate. The resulting revaluation surplus and deficit amounted to RMB177 million and RMB28 million, respectively. Upon the sale of New Guoxin at December 31, 2003, the revaluation surplus of the Group amounted to RMB83 million as of December 31, 2003 and 2004. The additional depreciation attributable to the revaluation surplus amounted to approximately RMB4.16 million for 2004 (2002 and 2003: RMB8.80 million). The revaluation deficit was charged to the statements of income during the year ended December 31, 2000. As of December 31, 2004, for these land use right and buildings stated at revalued amounts, their carrying amount would have been approximately RMB1,695 million (2002: RMB2,032 million; 2003: RMB1,783 million) had they been carried at cost less accumulated depreciation.

Telecommunication equipment held under finance leases comprised of certain sub sea transmission cables and wireless public phone equipment. As of December 31, 2004, net book value of certain sub sea transmission cables and wireless public equipments held under finance leases amounted to approximately RMB134 million (2003: RMB147 million) and RMB468 million (2003 Nil) respectively (see Note (28)).

Impairment of assets for the Paging Business (discontinued in 2004):

Management conducts an impairment assessment at each balance sheet date to identify whether the carrying values of the property, plant and equipment may be impaired. In 2002 and 2003, the Group conducted such re-assessment of the recoverable amount of the paging assets based on the best estimates of the discounted net future cash flows expected to be generated from the Paging Business in the future years. Management has made key assumptions and estimations on the appropriate discount rate adopted (8% per annum), the period covered by the cash flow forecast, the impact of the continuous decline of traditional paging business, the future loss of subscribers, the expected trend in average revenue per subscriber, as well as incremental cash flows arising from new paging businesses and the effects of the adoption of cost reduction plans. All these assumptions and estimations are made based on historical trends adjusted for the current market situation (including physical conditions of these assets) and the forecast of the future development of new value-added paging businesses.

In 2002, the Group conducted re-assessment of the recoverable amount of the paging assets based on the best estimates of the discounted net future cash flows expected to be generated from the Paging Business in the future years. Management expected further reduction of cash inflows to be generated from the traditional Paging Business. Based on the estimate of the discounted net cash flows expected to arise from the continuing use of the paging assets, the Group concluded that the carrying amount of the paging assets as of December 31, 2002 did not exceed its recoverable amount and accordingly no additional impairment loss was recognized in 2002.

In 2003, based on the updated analysis and the worsening trend of the decline of the traditional Paging Business in the first half of 2003, despite the continuous growth of new value-added Paging Businesses, the Group expected that the related incremental future cash inflows to be generated from these new paging services could unlikely offset the effects of the rapid decline of the traditional Paging Business in future. Consequently, based on the latest estimate of the discounted future net cash flows expected to arise from the continuing operations of the Paging Business, after considering the unexpected rapid decline of the traditional Paging Business in the first half of 2003, the Group concluded that the carrying amount of paging assets as at June 30, 2003 had exceeded their expected recoverable amounts. Accordingly, the Group has recorded an additional impairment loss for property, plant and equipment of the Paging Business amounting to approximately RMB528 million for the year ended December 31, 2003.

In addition, the Group has also recognized losses on disposal of property, plant and equipment of approximately RMB11 million for the year ended December 31, 2004 (2002: RMB82 million; 2003: RMB50 million)



**22. GOODWILL**

	2003 RMB 000	2004 RMB 000
Cost:		
Goodwill arising from acquisition of Unicom New Century (see Note 4(a))	2,284,749	2,284,749
Goodwill arising from acquisition of Unicom New World (see Note 4(b))	1,144,957	1,144,957
Negative goodwill arising from acquisition of Unicom International (see Note 4(c))		(7,727)
	3,429,706	3,421,979
Less: Accumulated amortization	(114,238)	(285,422)
	3,315,468	3,136,557

Goodwill arising from the acquisition of Unicom New Century and Unicom New World represented the excess of purchase consideration over the fair value of the separately identifiable net assets acquired (see Note 4). The amortization charge of goodwill amounted to approximately RMB171,485,000 for the year ended December 31, 2004 (2003: RMB114,238,000).

Negative goodwill arising from the acquisition of Unicom International represented the excess of the fair value of the separately identifiable net assets acquired over the purchase consideration. The recognition of the negative goodwill amounted to approximately RMB301,000 for the year ended December 31, 2004.

**23. OTHER ASSETS**

	Note	2003 RMB 000	2004 RMB 000
Interconnection facilities		613,622	441,968
Other		1,588,839	1,852,818
		2,202,461	2,294,786
Less: Accumulated amortization		(1,162,464)	(1,401,973)
		1,039,997	892,813
Prepaid rental and leased line		897,783	958,886
Deferred customer acquisition costs of contractual CDMA subscribers	20(a)	3,911,650	3,884,685
		5,849,430	5,736,384

For the year ended December 31, 2004, amortization of other assets, excluding deferred customer acquisition costs of contractual CDMA subscribers and prepaid rental and leased line, amounted to approximately RMB664,285,000 (2002: RMB381,629,000; 2003: RMB294,762,000).



**24. INVESTMENT IN SUBSIDIARIES**

During 2004, the Company acquired the entire equity interest in Unicom International, which holds the entire equity interests in Unicom USA. The acquisition became effective in September 2004.

As of December 31, 2004, the details of the Company's subsidiaries were as follows:

Name	Place and date of incorporation and legal entity	Percentage of equity interests held		Issued and fully paid capital RMB '000	Principal activities
		Direct	Indirect		
China Unicom Corporation Limited	The PRC, April 21, 2000, limited liability company	100.00%		45,370,994	Telecommunications operation
(On July 30, 2004, CUCL combined with Unicom New Century, and Unicom New Century was legally dissolved) (see Note 1)					
Unicom New Century (BVI) Limited	British Virgin Islands, October 23, 2002, limited liability company	100.00%		12	Investment holding
Unicom New World (BVI) Limited	British Virgin Islands, November 5, 2003, limited liability company	100.00%		1	Investment holding
Unicom New World Telecommunications Co., Ltd.	The PRC, November 4, 2003, limited liability company		100.00%	2,054,770	Telecommunications operation
China Unicom International Limited	Hong Kong, May 24, 2000 limited liability company	100%		106	Telecommunications service
China Unicom USA Co.	USA, May 24, 2002, corporation		100%	83	Telecommunications service

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China Unicom (Macau) Limited	Macau, October 15, 2004, limited liability company	99.00%	1.00%	10,326	Telecommunications operation
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Amounts due to/from subsidiaries included in the Company's balance sheet are unsecured, non-interest bearing and repayable/receivable on demand.

**25. PAYABLES AND ACCRUED LIABILITIES**

	Note	2003 RMB 000	2004 RMB 000
Payables to contractors and equipment suppliers		11,789,366	10,592,518
Accrued expenses		1,417,750	1,355,183
Payables to telecommunications products suppliers		1,346,784	1,772,693
Customer deposits		1,198,812	1,370,015
Salary and welfare payables		494,794	465,154
Amounts due to Services Provider / Content Provider		369,330	573,804
Other	(a)	481,584	656,382
		17,098,420	16,785,749

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Note:

(a) Other includes miscellaneous accruals for housing fund and other government surcharges.

The aging analysis of payables and accrued liabilities is as follows:

	2003 RMB 000	2004 RMB 000
Less than six months	12,253,057	13,343,784
Six months to one year	3,051,167	2,257,802
More than one year	1,794,196	1,184,163
	17,098,420	16,785,749

**26. SHORT-TERM BANK LOANS**

Interest rates on RMB denominated short-term bank loans ranged from 4.54% to 5.31% per annum for 2004 (2002: 4.54% to 5.56%; 2003: 4.54% to 5.31%).

Supplemental information with respect to short-term bank loans was as follow:

	Balance at year end RMB 000	Weighted average interest rate at year end per annum	Maximum amount outstanding during the year RMB 000	Average amount outstanding during the year* RMB 000	Weighted average interest rate during the year** per annum
<b>December 31, 2003</b>					
RMB dominated bank loans					
- secured (see Note (a)(ii))	520,000				
- unsecured (see Note (a)(i))	10,455,199				
	10,975,199	5.22%	10,975,199	10,060,850	5.15%
<b>December 31, 2004</b>					
RMB dominated bank loans					
- secured (see Note (a)(ii))	100,000				
- unsecured (see Note (a)(i))	8,131,431				
	8,231,431	4.86%	10,975,199	9,603,315	5.06%
HK\$ dominated bank loans					
- unsecured (see Note (b))	696,986				
	696,986	0.90%	696,986	348,493	1.08%

\* The average amount outstanding is computed by dividing the total of outstanding principal balance as of January 1 and December 31, as applicable, by 2.

\*\* The weighted average interest rate is computed by dividing the total of weighted average interest rates as of January 1 and December 31, as applicable, by 2.

Notes:

(a) As of December 31, 2004, short-term bank loans of the Group denominated in RMB were secured by the following:

(i) Approximately RMB3,397 million (2003: RMB70 million) of short-term bank loans were guaranteed by Unicom Group.

(ii) Approximately RMB100 million (2003: RMB520 million) of short-term bank loans were secured by the future service fee revenue to be generated by the cellular operations.

(b) As of December 31, 2004, HK\$ denominated short-term bank loans of the Company of approximately HK\$655 million (equivalent to approximated RMB697 million) were to finance the working capital. The bank loans were repayable in 1 year and carried an interest rate of 0.22% over HIBOR per annum.

**27. LONG-TERM BANK LOANS**

Interest rates and final maturity		2003 RMB 000	2004 RMB 000
RMB denominated bank loans	Fixed interest rate ranging from 4.78% to 5.73% (2003: 4.44% to 5.76%) per annum with maturity through 2010 (2003: maturity through 2009) (see Note(a))		
- secured		10,622,366	6,804,566
- unsecured		26,994,612	20,487,127
		37,616,978	27,291,693
USD denominated bank loans	Floating interest rate of USD LIBOR plus interest margin of 0.28% to 0.44% per annum with maturity through 2010 (see Note (b))	5,793,690	9,931,800
Less: Current portion		(7,197,877)	(11,086,305)
		36,212,791	26,137,188

The repayment schedule of the long-term bank loans is as follows:

	2003 RMB 000	2004 RMB 000
Balances due:		
- not later than one year	7,197,877	11,086,305
- later than one year and not later than two years	15,549,832	10,226,776
- later than two years and not later than five years	18,837,560	14,092,792
Thereafter	1,825,399	1,817,620
	43,410,668	37,223,493
Less: Portion classified as current liabilities	(7,197,877)	(11,086,305)
	36,212,791	26,137,188

Notes:

(a) As of December 31, 2004, long-term bank loans of the Group denominated in RMB were secured by the following:

(i) Approximately RMB6,805 million (2003: RMB10,622 million) of long-term bank loans were secured by the future service fee revenue to be generated by the cellular operations of the relevant branches. Included in these



long-term bank loans, approximately RMB2,824 million (2003: RMB3,600 million) was also guaranteed by Unicom Group;

(ii) In addition to the above, approximately RMB3,955 million (2003: RMB8,004 million) of long-term bank loans above were guaranteed by Unicom Group; and

(iii) Approximately RMB26 million (2003: RMB50 million) of long-term bank loans were secured by restricted bank deposits.

(b) On September 26, 2003, the Company signed an agreement with 13 financial institutions for a long-term syndicated loan of USD0.7 billion (the Facility). The Facility was split into 3 tranches (i) USD0.2 billion 3-year loan; (ii) USD0.3 billion 5-year loan; and (iii) USD0.2 billion 7-year loan and carried an interest rate of 0.28%, 0.35% and 0.44% over US dollar LIBOR per annum for each tranche respectively. In October 2003, the company and CUCL entered into an agreement to lend the bank loans to CUCL with similar terms to finance the network constructions of CUCL.

In addition, on February 25, 2004, CUCL signed an agreement with various financial institutions for a long-term syndicated loan of USD0.5 billion to finance the working capital and network construction expenditure. This facility was repayable in 3 years and carried an interest rate of 0.40% over US dollar LIBOR per annum.

**28. OBLIGATIONS UNDER FINANCE LEASES**

Obligations under finance leases were analyzed as follows:

	2003 RMB 000	2004 RMB 000
Total minimum lease payments under finance leases repayable:		
- not later than one year	25,926	938,189
- later than one year and not later than two years	8,642	405,453
- later than two years and not later than five years	26,017	74,078
- later than five years	145,753	137,104
	206,338	1,554,824
Less: Future finance charges	(81,184)	(127,679)
Present value of minimum obligations	125,154	1,427,145
Representing obligations under finance leases:		
- current liabilities	25,435	938,189
- non-current liabilities	99,719	488,956
The present value of obligations under finance leases:		
- not later than one year	25,435	938,189
- later than one year and not later than two years	7,691	358,850
- later than two years and not later than five years	20,533	60,692
- later than five years	71,495	69,414
	125,154	1,427,145
Less: Portion classified as current liabilities	(25,435)	(938,189)
	99,719	488,956

Obligations under finance leases were related to the leasing of certain sub sea transmission cables (see Notes 21 and 33(b)), CDMA handsets (see Note 20(a)) and wireless public phone equipments (see Note 21).

Interest rates of obligations under finance leases ranged from 4% to 6% per annum.

**29. SHARE CAPITAL**

	2003 HK\$ 000	2004 HK\$ 000
Authorized:		
30,000,000,000 ordinary shares of HK\$0.1 each	3,000,000	3,000,000

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	Note	2003		2004		RMB equivalent 000	RMB equivalent 000
		Number of shares ( 000)	HK\$ 000	Number of shares ( 000)	HK\$ 000		
Issued and fully paid:							
-Unicom BVI		9,725,000	972,500	1,030,850	9,725,000	972,500	1,030,850
-Public investors	(a)	2,828,172	282,817	300,540	2,838,492	283,849	301,637
		12,553,172	1,255,317	1,331,390	12,563,492	1,256,349	1,332,487

Note: (a) Increase of 10,320,000 ordinary shares in year 2004 (2003: 176,000) represents the ordinary shares in issued under the share option scheme (see Note 30(g)).

**30. SHARE OPTION SCHEME**

The Company adopted a share option scheme (the Share Option Scheme) and a fixed award pre-global offering share scheme (Pre-Global Offering Share Option Scheme) on June 1, 2000 for the granting of share options to qualified employees, with terms amended on May 13, 2002 to comply with the requirements set out in the New Chapter 17 of the Listing Rules.

Movements in the number of share options outstanding during the years 2002, 2003 and 2004 are as follows:

	Number of share options involved		
	2002	2003	2004
Balance, beginning of year	33,840,600	69,868,600	172,367,400
Granted	36,028,000	105,956,000	113,322,000
Exercised		(176,000)	(10,320,000)
Cancelled		(3,281,200)	(1,306,000)
Balance, end of year	69,868,600	172,367,400	274,063,400

As of December 31, 2004, information of outstanding options is summarized as follows:

Date of options granted	The period during which an option may be exercised	The price per share to be paid on exercise of options	Number of shares outstanding as of December 31, 2004	Number of shares outstanding as of December 31, 2003
Shares granted under the Pre-Global Offering Share Option Scheme:				
June 22, 2000 (see Note (a))	June 22, 2002 to June 21, 2010	HK\$ 15.42	25,436,600	25,436,600
Shares granted under the Share Option Scheme:				
June 30, 2001 (see Note (b))	June 30, 2001 to June 21, 2010	HK\$ 15.42	6,508,000	6,508,000
August 2, 2002 (see Note (c))	July 10, 2003 to July 9, 2008	HK\$ 6.18	25,954,800	34,466,800
May 21, 2003 (see Note (d))	May 21, 2004 to May 20, 2009	HK\$ 4.30	102,476,000	105,590,000
May 30, 2003 (see Note (d))	May 21, 2004 to May 20, 2009	HK\$ 4.66	366,000	366,000

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July 20, 2004 (see Note (e))	July 20, 2005 to May 19, 2010	HK\$	5.92	112,668,000	
December 21, 2004 (see Note (f))	December 21, 2005 to December 20, 2010	HK\$	6.20	654,000	
				274,063,400	172,367,400

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(a) According to the resolution passed by the Board of Directors in June 2000, a total of the 27,116,600 options were granted on June 22, 2000 to the senior management, including directors, and certain other employees (which represent, on their full exercise, 27,116,600 shares of the Company) under the fixed award Pre-Global Offering Share Option Scheme adopted by the Company on June 1, 2000 in the following terms:

- (i) the exercise price is equivalent to the share issue price of the Global Offering of HK\$15.42 per share (excluding the brokerage fee and HKSE transaction levy); and
- (ii) the options are vested and exercisable after 2 years from the grant date and expire 10 years from the date of grant.

No further option can be granted under the Pre-Global Offering Option Scheme.

The Pre-Global Offering Option Scheme had been amended in conjunction with the amended terms of the Share Option Scheme on May 13, 2002. Apart from the above two terms, the principal terms are the same as the amended Share Option Scheme in all material aspects.

(b) On June 1, 2000, the Company adopted the Share Option Scheme pursuant to which the directors of the Company may, at their discretion, invite employees, including executive directors, of the Company or any of its subsidiaries, to take up options to subscribe for shares up to a maximum aggregate number of shares (including those that could be subscribed for under the pre-global offering share option scheme as described above) equal to 10% of the total issued share capital of the Company. According to the Share Option Scheme, the nominal consideration payable by a participant for the grant of options will be HK\$1.00. The exercise price payable by a participant upon the exercise of an option will be determined by the directors at their discretion at the date of grant, except that such price may not be set below a minimum price which is the higher of:

- (i) the nominal value of a share; and
- (ii) 80% of the average of the closing prices of shares on the HKSE on the five trading days immediately preceding the date of grant of the option on which there were dealings in the shares on the HKSE.

The period during which an option may be exercised will be determined by the directors at their discretion, except that no option may be exercised later than 10 years from June 22, 2000. According to a resolution of the Board of Directors in June 2001, the Company has granted 6,724,000 share options under the Share Option Scheme which represent, on their full exercise, 6,724,000 shares to certain employees of the Group in the following terms:

(i) the price of a share payable by a participant upon the exercise of an option shall be HK\$15.42 (excluding the brokerage fee and HKSE transaction levy); and

(ii) the period during which an option is vested and exercisable commences from the date of grant of the options and will end by June 22, 2010.

The terms of the Share Option Scheme were amended on May 13, 2002 to comply with the requirements set out in the New Chapter 17 of the Listing Rules which came into effect on September 1, 2001 with the following major amendments:

(i) share option may be granted to employees including executive directors of the Group or any of the non-executive directors;

(ii) the option period commences on a day after the date on which an option is offered but not later than 10 years from the offer date; and

(iii) minimum subscription price shall not be less than the higher of:

the nominal value of the shares;

the closing price of the shares of the Stock Exchange as stated in the Stock Exchange's quotation sheets on the offer date in respect of the options; and

the average closing price of the shares on the Stock Exchange's quotation sheets for the five trading days immediately preceding the offer date.

(c) According to resolution passed by the Board of Directors and the Independent Non-Executive Directors of the Company dated July 10, 2002, a total of 36,028,000 share options were granted to eligible individuals including directors, independent non-executive directors, and the non-executive directors of the Company under the amended Share Option Scheme in the following terms:

(i) aggregate of 2,802,000 options were granted to the executive directors, non-executive directors and independent non-executive directors of the Company;

(ii) the exercise price is HK\$6.18; and

(iii) the vesting dates and exercisable periods of the options are as follows:



Vesting dates	Exercisable periods	Portions
July 10, 2003	July 10, 2003 to July 9, 2008	40%
July 10, 2004	July 10, 2004 to July 9, 2008	30%
July 10, 2005	July 10, 2005 to July 9, 2008	30%

(d) According to resolutions passed by the Board of Directors and the Independent Non-Executive Directors of the Company dated May 21, 2003 and May 30, 2003, a total of 105,590,000 share options and 366,000 share options were granted to eligible individuals (including directors, independent non-executive directors, non-executive directors, middle to senior management of the Group) respectively, under the amended Share Option Scheme in the following terms:

(i) an aggregate of 2,772,000 options were granted to the executive directors, non-executive directors and independent non-executive directors of the Company;

(ii) the exercise price per share option are HK\$4.30 and HK\$4.66 respectively; and

(iii) the vesting dates and exercisable periods of the options are as follows:

Vesting dates	Exercisable periods	Portions
May 21, 2004	May 21, 2004 to May 20, 2009	40%
May 21, 2005	May 21, 2005 to May 20, 2009	30%
May 21, 2006	May 21, 2006 to May 20, 2009	30%

(e) According to resolutions passed by the Board of Directors and the Independent Non-Executive Directors of the Company dated July 20, 2004, a total of 112,668,000 share options were granted to eligible individuals (including directors, independent non-executive directors, non-executive directors, middle to senior management of the Group) respectively, under the amended Share Option Scheme in the following terms:

(i) an aggregate of 3,366,000 options were granted to the executive directors, non-executive directors and independent non-executive directors of the Company;

(ii) the exercise price per share option is HK\$5.92; and

(iii) the vesting dates and exercisable periods of the options are as follows:

Vesting dates	Exercisable periods	Portions
July 20, 2005	July 20, 2005 to July 19, 2010	40%
July 20, 2006	July 20, 2006 to July 19, 2010	30%
July 20, 2007	July 20, 2007 to July 19, 2010	30%

(f) According to resolutions passed by the Board of Directors and the Independent Non-Executive Directors of the Company dated December 21, 2004, a total of 654,000 share options were granted to the executive directors of the Company, under the amended Share Option Scheme in the following terms:

(i) the exercise price per share option is HK\$6.20; and

(ii) the vesting dates and exercisable periods of the options are as follows:

Vesting dates	Exercisable periods	Portions
December 21, 2005	December 21, 2005 to December 20, 2010	40%
December 21, 2006	December 21, 2006 to December 20, 2010	30%
December 21, 2007	December 21, 2007 to December 20, 2010	30%

All of the options granted are governed by the amended terms of the Share Option Scheme and Pre-Global Offering Share Option Scheme as mentioned above.

(g) Details of share options exercised during the year were as following:

<b>Period of option exercised</b>	<b>Exercise price HK\$</b>	<b>Weighted average closing price per share immediately before days of exercise of options HK\$</b>	<b>Proceeds received HK\$</b>	<b>Number of shares involved</b>
January 5, to September 22, 2004	6.18	9.42	52,604,160	8,512,000
May 25, to December 31, 2004	4.30	6.09	7,774,400	1,808,000
			60,378,560	10,320,000

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**31. RELATED PARTY TRANSACTIONS**

The table set forth below summarizes the name of significant related parties and nature of relationship with the Company as of December 31, 2004:

Name of related parties	Nature of relationship with the Company
China United Telecommunications Corporation ( Unicom Group )	Ultimate parent company
Unicom NewSpace Co., Ltd ( Unicom NewSpace )	A subsidiary of Unicom Group
Unicom Xingye Science and Technology Trade Co. ( Unicom Xingye )	A subsidiary of Unicom Group
Unicom Import and Export Company Limited ( Unicom I/E Co )	A subsidiary of Unicom Group
Unicom New Horizon Mobile Telecommunications Company Limited ( Unicom New Horizon )	A subsidiary of Unicom Group
Unicom New Guoxin Telecommunication Corporation Limited ( New Guoxin , originally known as Guoxin Paging , which changed to its present name on April 29, 2004)	A subsidiary of Unicom Group
UNISK (Beijing) Information Technology Corporation Limited ( UNISK )	A joint venture company of Unicom Group
China Unicom Corporation Limited ( CUCL )	A subsidiary of the Company
Unicom New Century Telecommunications Corporation Limited ( Unicom New Century )	A subsidiary of the Company
Unicom New World Telecommunications Corporation Limited ( Unicom New World )	A subsidiary of the Company
China Unicom International Limited ( Unicom International )	A subsidiary of the Company
China Unicom USA Corporation ( Unicom USA )	A subsidiary of the Company

**(a) Transactions with Unicom Group and its subsidiaries**

The following is a summary of significant recurring transactions carried out with Unicom Group and its subsidiaries. These transactions also constitute connected transactions under the Listing Rules. In the director's opinion, these transactions were carried out on normal commercial terms in the ordinary course of business.

	Note	2002 RMB 000	2003 RMB 000	2004 RMB 000
<b>Transactions with Unicom Group and its subsidiaries:</b>				
Interconnection and roaming revenues	(i), (iii)	1,678,637	1,002,702	220,174
Interconnection and roaming charges	(ii), (iii)	331,179	316,271	63,891
Revenue remitted in respect of cellular subscriber value-added service	(iv), (v)			858,778
Charge for customer services	(iv), (vi)			524,718
Charge for cellular subscriber value-added service by UNISK	(vii)			4,228
Rental charges for premises, equipment and facilities	(viii)	17,817	17,936	25,528
Rental income for premises and facilities	(iv), (ix)			19,475
Revenue for leasing of transmission line capacity	(x)	566,519	185,086	38,853
CDMA network capacity lease rental	(xi)	891,897	3,515,364	6,588,926
Constructed capacity related cost of CDMA network	(xii)			305,903
Charges for the international gateway services	(xiii)	15,626	8,631	17,062
Leasing of satellite transmission capacity	(xiv)	35,153	26,400	14,152
Sales of CDMA handsets	(xv)	487,850	64,929	
Purchase of CDMA handsets	(xvi)			14,655
Purchase of telecom cards	(xvii)	877,221	1,186,500	1,087,498
Commission expenses for sales agency services incurred for telecom cards	(xviii)	18,497	16,175	16,023
Agency fee incurred for subscriber development	(iv), (xix)			9,054
Agency fee incurred for procurement of telecommunications equipment	(xx)	13,992	17,904	17,759
Rental for the PRC corporate office	(xxi)	7,598		
Sales of telecommunications equipment	(xxii)	16,088		

- (i) Interconnection revenues represent the amounts received or receivable from Unicom Group for calls from its networks to the Group's networks. Roaming revenues represent revenue for calls made using the Group's networks by Unicom Group's subscribers.
- (ii) Interconnection charges are for calls made from the Group's networks to Unicom Group's networks. Roaming expenses represent expenses for calls made by the Group's subscribers using Unicom Group's networks.
- (iii) Interconnection settlement between Unicom Group's network and the Group's network is based on standards established from time to time by the MII. In the case of calls between cellular subscribers in different provinces, settlement is based on either the standards established by the MII or an internal settlement arrangement applied by Unicom Group based on their respective internal costs of providing this service. Also, charges for roaming services between the Group and Unicom Group are based on their respective internal costs of providing these services.

- (iv) Related party transactions existed between the Group and New Guoxin after the sale of New Guoxin by CUCL on December 31, 2003. The nature, terms and conditions of these new related party transactions with New Guoxin have been set forth in the shareholders' circular "Connected Transactions" of the Company issued on November 26, 2003. Such transactions mainly included (i) cellular subscriber value-added services, (ii) customer services, (iii) agency services, and (iv) provision of premises.
- (v) Pursuant to the Comprehensive Operator Service Agreement ( "Comprehensive Service Agreement" ) signed between the Group and New Guoxin dated November 20, 2003, New Guoxin provides operator-based value-added services to the Group's cellular subscribers through its comprehensive business network. The respective branches of New Guoxin and the Group may agree on the proportion for sharing the revenue derived from such value-added services, on the condition that such agreed proportion for New Guoxin shall not be higher than the average proportion for independent value-added telecommunications content providers who provide value-added telecommunications content to the Group in the same region.
- (vi) Pursuant to the Comprehensive Service Agreement, New Guoxin provides business inquiries, tariff inquiries, account maintenance, complaints handling, and customer interview and subscriber retention services to the Group's customers through the use of its 1001 paging network. The service fee payable by the Group shall be calculated on the basis of the customer service costs plus a profit margin, which shall not exceed 10%. The customer service costs were determined by the actual cost per operator seat and the number of effective operator seats.
- (vii) CUCL and UNISK signed a Cellular Subscriber Value-Added Services Agreement (the "Agreement" ) in March 2004. According to the Agreement, CUCL agreed to provide its telecommunication channel and network subscriber resources to UNISK to enable UNISK to provide value-added services to subscribers through CUCL's cellular telecommunications network and data platform. The Agreement also stipulates that the content service fees paid by subscribers for using UNISK's value-added services are shared between CUCL and UNISK based on agreed proportion. The content service fees are collected from subscribers by CUCL and the relevant portion is paid to UNISK on a regular basis.
- (viii) CUCL, Unicom New Century (which has been merged into and succeeded by CUCL) and Unicom New World respectively signed service agreements with Unicom Group to mutually lease premises, equipment and facilities from each other. Rentals are based on the lower of depreciation costs and market rates.
- (ix) Pursuant to the Guoxin Premises Leasing Agreement signed between the Group and New Guoxin dated November 20, 2003, the Group agreed to provide premises to New Guoxin. The rental amount in each case is based on the higher of depreciation costs and market price for similar premises in that locality.

- (x) Unicom Group leases transmission line capacity from the Group in accordance with the relevant provision of the services agreement. Revenue for leases of transmission line capacity is based on tariffs stipulated by MII from time to time less a discount of up to 10%.

In addition, according to the leased line agreement entered into between the Group and Unicom USA, the Group leases transmission line to Unicom USA. The revenue for the leases of transmission line was recognized based on the market price amounted to approximately RMB14 million for the nine months ended September 2004 (2003: Nil). Such transaction became inter-group transactions and has been eliminated in the Group's consolidated financial statements after the acquisition of Unicom International in September 2004.

- (xi) According to the CDMA Lease Agreements entered among CUCL, Unicom Group and Unicom New Horizon, Unicom New Horizon agreed to lease the capacity of CDMA network to CUCL covering 9 provinces and 3 municipalities. The lease fee per unit of capacity is calculated on a basis that if full capacity is leased, it would permit Unicom New Horizon to recover its investment in constructing the CDMA network in 7 years, together with an internal return of 8%. In addition, Unicom New Century (which has been merged into and succeeded by CUCL) and Unicom New World have also entered into CDMA capacity lease agreements with Unicom Group and Unicom New Horizon. The terms of the leasing arrangements are in all material respects the same as those contained in the CDMA Lease Agreement entered into by CUCL (see Note 32 for details).

- (xii) CUCL and Unicom New World entered into a supplemental agreement with Unicom New Horizon on November 22, 2004 in respect of CDMA capacity lease agreement. Pursuant to the supplemental agreement, the constructed capacity related costs shall be borne by the Group only to the extent of such part of costs that corresponds to the proportion of capacity actually leased under the relevant CDMA lease agreements. Such part of the constructed capacity related costs that corresponds to the proportion of capacity not actually leased under the relevant CDMA lease shall be borne by Unicom New Horizon.

The constructed capacity related costs are defined as the costs of operating and managing the CDMA network which relate directly to the constructed capacity of the CDMA network, including the rental fees for stations and base stations and related expenses including water and electricity charges, heating charges and fuel charges for the relevant equipment etc., as well as maintenance costs of a non-capital nature.

- (xiii) Charges for international gateway services represent the amounts paid or payable to Unicom Group for international gateway services provided for the Group's international long distance networks. The charge for this service is based on the cost of operation and maintenance of the international gateway facilities incurred by Unicom Group, including depreciation, together with a margin of 10% over cost.
- (xiv) Satellite transmission capacity leasing fees represent the amounts paid or payable to Unicom NewSpace for the use of satellite transmission capacity. The charges are based on the MII regulations then in effect less the applicable discount up to 10% as agreed with Unicom NewSpace.

In the second half of 2004, Unicom NewSpace sold the entire assets of satellite transmission to Unicom Group. The rights and liabilities of satellite transmission capacity lease agreement were succeeded by Unicom Group.

- (xv) According to the sales of CDMA handsets agreement entered into between Unicom Group and Unicom Guomai Communications Corporation Limited (previously a subsidiary of New Guoxin and sold to China Satellite Communications Corporation in August 2004, Unicom Guomai ) on January 1, 2003, Unicom Group agreed to purchase CDMA handsets from Unicom Guomai. The selling price was negotiated on an arm's length basis, which is not lower than the price sold by Unicom Guomai to independent third parties. Upon the completion of sales of New Guoxin on December 31, 2003, transactions between Unicom Guomai and Unicom Group did not constitute a related party transaction of the Company.
- (xvi) According to the purchase of CDMA handset agreement entered into between Unicom NewSpace and certain subsidiaries of the Group, the Group agreed to purchase CDMA handsets from Unicom NewSpace. The purchase price approximated market price.
- (xvii) The Group signed a service agreement with Unicom Group to purchase telephone cards from Unicom Group (to be imported by Unicom Xingye) at cost plus a margin to be agreed from time to time, but not to exceed 20%, and subject to appropriate volume discounts.
- (xviii) Unicom International provided sales agency services such as selling of telecommunications cards, leased lines and transfer calls to the Group. The commission expenses are charged based on contractual prices which approximated market rates.

Prior to September 2004, the Group's transactions with Unicom International (previously a subsidiary of Unicom Group) were treated as related party transaction, and had been included in the related party transactions described above for the year ended December 31, 2002, 2003 and 2004. Such transaction became inter-group transactions and has been eliminated in the Group's consolidated financial statements starting from September 2004.

- (xix) Pursuant to the Comprehensive Service Agreement, New Guoxin provides subscriber development services to the Group through telephone or other channels by utilizing its paging network, equipment and operators. The agency fee chargeable to the Group does not exceed the average of agency fees chargeable by any independent third party agent in the same region.
- (xx) The Group signed a service agreement with Unicom I/E Co., in which Unicom I/E Co. agreed to provide equipment procurement services to the Group. Unicom I/E Co. charges the Group 0.7% of the value of imported equipment and 0.5% of the value of domestic equipment for such services.

On November 22, 2004, the Group entered into an amendment agreement with Unicom I/E Co., with respect to the above service agreement. Accordingly, with effect from July 1, 2004, the charge rates for the equipment procurement service have been changed to 0.55% (for contract with an amount of US\$30 million (inclusive)) and 0.35% (for contract with an amount of more than US\$30 million) of the value of imported equipment, and 0.25% (for contract with an amount of RMB200 million (inclusive)) and 0.15% (for contract with an amount more than RMB200 million) of the value of domestic equipment.

- (xxi) CUCL signed a rental agreement with Beijing Xingye, under which Beijing Xingye leases office premises to CUCL at its PRC corporate office. Monthly rental is calculated on the basis of US\$20 per square meter. This rental agreement was terminated in September 2002.
- (xxii) Based on a resolution passed by the shareholders of Unicom Guomai on April 23, 2002, Unicom Guomai agreed to sell telecommunications equipment to certain branches of Unicom Group, these contracts were obtained by Unicom Guomai through a tendering process and the contract prices were negotiated on an arm's length basis.



(xxiii) Unicom Group is the registered proprietor of the Unicom trademark in English and the trademark bearing the Unicom logo, which is registered at the PRC State Trademark Bureau. Pursuant to an exclusive PRC trademark license agreement entered into between Unicom Group and CUCL, CUCL and its affiliates are granted the right to use these trademarks on a royalty free basis for an initial period of 5 years, renewable at CUCL's option.

As part of the acquisition arrangements of Unicom New Century and Unicom New World, Unicom New Century and Unicom New World entered into PRC trademark license agreement with Unicom Group respectively. Unicom New Century (which has been merged into and succeeded by CUCL) and Unicom New World are granted the right to use these trademarks on a royalty free basis for an initial period of 10 years, renewable for another 10 years at CUCL and Unicom New World's options.

(xxiv) According to the Multiple Service Agreement (the Agreement) signed between the Group and Unicom Paging Limited (Unicom Paging, a subsidiary of Unicom Group) dated August 1, 2001, the Group and Unicom Paging agree to share the right to use the other party's logo and trademark in the Paging Business (discontinued in 2004) at no cost. In addition, the Agreement also specifies the basis of allocating common expenses incurred by each party for any shared resources and facilities. For the years ended December 31, 2002 and 2003, the amount of common expenses involved was insignificant.

**(b) Amounts due from and to related parties/Unicom Group**

Amounts due from and to related parties or Unicom Group are unsecured, non-interest bearing, repayable on demand and arise in the ordinary course of business in respect of transactions with Unicom Group or the subsidiaries of Unicom Group as described in (a) above.

**(c) Amount due to/(from) Unicom Group**

	2002 RMB '000	2003 RMB '000	2004 RMB '000
Due to Unicom Group, beginning of year	947,934	562,633	432,047
Interconnection and roaming revenues	(1,678,637)	(1,002,702)	(220,174)
Interconnection and roaming charges	331,179	316,271	63,891
Revenue for leasing of transmission line capacity, premises and facilities	(566,519)	(185,086)	(38,853)
Rental charges for premises, equipment and facilities	17,817	17,936	25,528
Sales of CDMA mobile handsets	(487,850)	(64,929)	
Charges for the international gateway services	15,626	8,631	17,062
Leasing of satellite transmission capacity			7,076
Network construction costs paid by Unicom Group for CUCL of fixed-line networks	112,474		
Settlement made during the year	1,032,163	224,158	(797,978)
Proceeds (receivable)/ received from sale of New Guoxin		(450,000)	450,000
Amounts due to Unicom Group by Unicom New Century	838,446		
Amounts due to Unicom Group by Unicom New World		1,005,135	
Due to/(from) Unicom Group, end of year	562,633	432,047	(61,401)

**(d) Bank loans guaranteed by Unicom Group**

As of December 31, 2004, the Group had approximately RMB6,779 million (2003: RMB11,604 million) of long-term bank loans and approximately RMB3,397 million (2003: RMB70 million) of short-term bank loans guaranteed by Unicom Group.

**32. LEASING OF CDMA NETWORK CAPACITY**

In November 2001, CUCL entered into a CDMA capacity lease agreement (the CDMA Lease Agreement) with Unicom Group and Unicom New Horizon. Pursuant to the CDMA Lease Agreement, Unicom New Horizon agreed to lease the capacity of CDMA network to CUCL covering the 9 provinces of and 3 municipalities.

Major terms of the CDMA Lease Agreement include the following:

CUCL has the exclusive right to lease and operate the CDMA network capacity in the above regions;

The term of the CDMA Lease Agreement is for an initial period of 1 year (the Initial Lease Term), renewable for further one year terms at the option of the CUCL;

The lease fee per unit of capacity is calculated on a basis that if full capacity is leased, it would permit Unicom New Horizon to recover its investment in constructing the CDMA network in 7 years, together with an internal return of 8%;

CUCL has the option to add or reduce the capacity leased by giving specified period of advance notice. There is no minimum requirement on the network capacity to be leased beyond the Initial Lease Term; and

CUCL has the option to purchase the network assets. The acquisition price will be negotiated between the CUCL and Unicom New Horizon, based on the appraised value of the network determined by an independent appraiser, provided that it will not exceed such price as would, add together with any lease payments made previously, enable Unicom New Horizon to recover its investment with an internal rate of return of 8%.

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Commencement of the CDMA Lease Agreement was conditional upon, among others, the testing and initial acceptance and delivery of phase I of the CDMA network and the receipt of all necessary government approvals. Upon the fulfillment of all the conditions precedent to the commencement of the CDMA Lease Agreement, the Initial Lease Term commenced on January 8, 2002. This lease arrangement has been accounted for as an operating lease of the network capacities. On January 8, 2004, CUCL renewed the CDMA Lease Agreement with Unicom New Horizon for a further one year.

Unicom New Century (which has been merged into and succeeded by CUCL) and Unicom New World have also entered into CDMA capacity lease agreements with Unicom Group and Unicom New Horizon in November 2002 and November 2003 respectively. The terms of these leasing arrangements are in all material respects the same as those contained in the CDMA Lease Agreement entered into by CUCL as described above except for the leased capacity. Under these lease agreements, Unicom New Horizon agreed to lease the capacity of CDMA network to CUCL covering 6 provinces, 2 autonomous regions and 1 municipality and to Unicom New World covering 6 provinces and 3 autonomous regions. On December 31, 2003, CUCL renewed the CDMA Lease Agreement with Unicom New Horizon for a further year.

The aforementioned CDMA network capacity leases have constituted continuing connected transactions for the Company and were granted waivers from strictly compliance with the relevant provisions of the Listing Rules by the Stock Exchange of Hong Kong Limited on December 27, 2001, December 31, 2002 and December 31, 2003 respectively. Such waivers will expire by the end of 2004, 2005 and 2006 respectively. According to the shareholders' circular "Continuing Connected Transactions" of the Company dated December 1, 2004, CUCL and Unicom New World have determined to renew the CDMA Lease Agreements with Unicom New Horizon with the same terms as contained in the above CDMA Lease Agreement, effective on January 8, 2005 and December 31, 2004 respectively. The above continuing connected transactions to renew the leasing of CDMA network capacity have been approved and resolution passed by the minority shareholders of the Company pursuant to the extraordinary shareholders' meeting held by the Company on December 23, 2004.

The Group entered into a new CDMA capacity lease agreement with Unicom New Horizon to replace the old one from January 1, 2005 after the approval of the shareholders on May 12, 2005. For details of the changes of key terms in the new agreement, please refer to Note 37(b)(i).

### 33. TRANSACTIONS WITH DOMESTIC CARRIERS

The Group's telecommunications networks depend, in large part, on interconnection with domestic carriers' public switched telephone network and on transmission lines leased from major domestic carriers. Major domestic carriers include China Telecommunications Corporation and its subsidiaries (China Telecom), China Mobile Communications Corporation and its subsidiaries (China Mobile) and China Network Communication Group Corporation and its subsidiaries (China Netcom).

#### (a) Transactions with domestic carriers

The following is a summary of significant transactions with domestic carriers in the ordinary course of business:

	Note	2002 RMB '000	2003 RMB '000	2004 RMB '000
Interconnection revenue	(i)	771,751	1,647,221	2,889,497
Interconnection charges	(i)	2,666,186	5,301,792	7,003,262
Leased line revenue	(ii)		218,974	247,676
Leased line charges	(ii)	680,508	722,684	628,173

Notes:

- (i) The interconnection revenue and charges mainly represent the amounts due from or to domestic carriers for telephone calls made between the Group's networks and the public switched telephone network of domestic carriers. The interconnection settlements are calculated in accordance with interconnection agreements reached between the branches of the Group and

domestic carriers on a provincial basis. The terms of these agreements are set in accordance with the standard settlement arrangement stipulated by the MII.

- (ii) Leased line charges are paid or payable to domestic carriers by the Group for the provision of transmission line. At the same time, the Group leases transmission line to domestic carriers in return of leased line rental income. The charges are calculated at a fixed charge per line, depending on the number of lines being used by the Group and domestic carriers.

**(b) Amounts due from and to domestic carriers**

	2003 RMB 000	2004 RMB 000
Amounts due from domestic carriers		
- Receivable for interconnection revenue and leased line revenue	184,729	270,068
- Less: provision for doubtful debts	(116)	(149)
	184,613	269,919
Amounts due to domestic carriers		
- Payables for interconnection charges and leased lines charges	778,841	948,574
Long-term payable due to domestic carriers		
- Payables for obligations under finance leases:		
- Current portion of obligations under finance leases	25,435	25,926
- Obligations under finance leases	99,719	97,638
	125,154	123,564

All amounts due from and to domestic carriers were unsecured, non-interest bearing and repayable within one year.

Long-term payable for obligations under finance lease was related to the leasing of certain sub sea transmission cables from a domestic carrier for a period of 25 years (see Note 28).

**34. SEGMENT INFORMATION**

Operating segments represent components of an enterprise regarding which separate financial information is available for regular evaluation by the chief operating decision maker, or decision making group, when considering how to allocate resources and in assessing performance.

The Group organizes its business segments based on the various types of telecommunications services provided to customers in the PRC. The major business segments operated by the Group are classified as below:

GSM Business the provision of GSM telephone and related services;

CDMA Business the provision of CDMA telephone and related services, through a leasing arrangement of CDMA network capacities from Unicom New Horizon (see Note 32);

Data and Internet Business the provision of domestic and international data, Internet and other related services;

Long Distance Business the provision of domestic and international long distance and other related services; and

Paging Business the provision of paging and related services (discontinued in 2004).

The operating segments are managed separately because each operating segment represents a strategic business unit that provides various kinds of telecommunication services. All the operating segments of the Group have been aggregated into the above reportable segments since they are expected to exhibit similar future economic characteristics under central management at separate locations.

The Group's primary measure of segment results is based on segment income or loss before taxation.

## (a) Business segments

	2004							Total RMB 000
	Continuing operations							
	GSM Business RMB 000	CDMA Business RMB 000	Internet and Data Business RMB 000	Long Distance Business RMB 000	Unallocated amounts RMB 000	Elimination RMB 000		
Operating revenue (Turnover):								
Usage fee	31,997,020	16,164,333	2,685,083	879,281				51,725,717
Monthly fee	6,922,400	4,638,024						11,560,424
Interconnection revenue	2,614,268	927,288	131,371	454,383				4,127,310
Leased lines rental			344,014	512,134				856,148
Other revenue	5,045,547	2,489,957	502,266	2,211				8,039,981
Total services revenue	46,579,235	24,219,602	3,662,734	1,848,009				76,309,580
Sales of telecommunications products	886,527	2,118,321	14,782	2,401				3,022,031
Total operating revenue from external customers	47,465,762	26,337,923	3,677,516	1,850,410				79,331,611
Intersegment revenue	135,521	107,477	2,059,881	1,264,140		(3,567,019)		
Total operating revenue	47,601,283	26,445,400	5,737,397	3,114,550				79,331,611
Operating expenses:								
Leased lines and network capacities	(284,092)	(6,685,059)	(361,412)	(67,565)				(7,398,128)
Interconnection charges	(6,452,988)	(2,794,843)	(917,294)	(918,480)		3,567,019		(7,516,586)
Depreciation and amortization	(16,170,745)	(438,957)	(1,795,499)	(530,695)	(5,133)	(122,045)		(19,063,074)
Personnel	(2,917,299)	(861,614)	(443,466)	(279,664)	(24,057)			(4,526,100)
Selling and marketing	(5,755,780)	(11,337,638)	(1,387,453)	(463,477)				(18,944,348)
General, administrative and other expenses	(7,016,838)	(2,206,458)	(865,889)	(320,115)	(38,941)			(10,448,241)
Cost of telecommunications products sold	(742,177)	(2,708,699)	(22,371)	(5,742)				(3,478,989)
Total operating expenses	(39,339,919)	(27,033,268)	(5,793,384)	(2,585,738)	(68,131)			(71,375,466)
Operating income (loss)	8,261,364	(587,868)	(55,987)	528,812	(68,131)			7,956,145
Loss on sale of discontinued operation (New Guoxin)								7,956,145
Interest income	67,526	11,093	5,504	3,653	129,512	(114,381)		102,907
Finance costs	(1,599,084)	(36,755)	(17,569)	(36,962)	(112,429)	114,381		(1,688,418)
Other income (expense), net	14,725	42,695	(1,195)	140	39,625			95,990
Segment income (loss) before taxation and minority interests	6,744,531	(570,835)	(69,247)	495,643	(11,423)			6,466,624
Taxation								(2,079,625)
Income after taxation								4,386,999
Minority interests								
Net income								4,386,999
Other information:								
Provision for doubtful debts	1,317,374	645,470	164,514	64,462				2,191,820
Impairment loss recognized in the statement of income								
Capital expenditures for segment assets (1)	6,396,406		2,444,623	1,949,202	7,595,817			18,386,048

	2003		Elimination	Total
	Continuing operation	Discontinued operation		



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	GSM Business	CDMA Business	Internet and Data Business	Long Distance Business	Paging Business	Unallocated amounts		
	RMB 000	RMB 000	RMB 000	RMB 000	RMB 000	RMB 000	RMB 000	RMB 000
Operating revenue (Turnover):								
Usage fee	29,072,249	11,671,523	2,443,610	1,148,040				44,335,422
Monthly fee	7,042,299	3,488,411	9,085		612,999			11,152,794
Interconnection revenue	1,926,907	607,830	361,514	365,724	1,654			3,263,629
Leased lines rental			420,433	701,549				1,121,982
Other revenue	2,262,156	855,754	202,441	57,835	788,400			4,166,586
Total services revenue	40,303,611	16,623,518	3,437,083	2,273,148	1,403,053			64,040,413
Sales of telecommunications products	862,777	1,956,452	7,814	14,914	753,955			3,595,912
Total operating revenue from external customers	41,166,388	18,579,970	3,444,897	2,288,062	2,157,008			67,636,325
Intersegment revenue	41,057	41,725	1,826,222	866,728	230,075		(3,005,807)	
Total operating revenue	41,207,445	18,621,695	5,271,119	3,154,790	2,387,083			67,636,325
Operating expenses:								
Leased lines and network capacities	(339,410)	(3,576,498)	(294,888)	(78,027)	(80,084)		48,525	(4,320,382)
Interconnection charges	(5,478,520)	(1,684,749)	(732,210)	(752,521)			2,727,207	(5,920,793)
Depreciation and amortization	(13,117,906)	(306,754)	(1,305,239)	(419,346)	(1,144,922)		(5,650)	(16,385,293)
Personnel	(2,605,475)	(660,894)	(525,726)	(333,051)	(415,554)		(33,846)	(4,574,546)
Selling and marketing	(4,605,600)	(9,141,877)	(883,495)	(405,904)	(126,018)		6,059	(15,156,835)
General, administrative and other expenses	(5,571,493)	(1,363,927)	(761,405)	(462,081)	(916,418)		(37,550)	(9,112,385)
Cost of telecommunications products sold	(765,926)	(2,177,168)	(22,250)	(4,231)	(907,697)		225,227	(3,652,045)
Total operating expenses	(32,484,330)	(18,911,867)	(4,525,213)	(2,455,161)	(3,590,693)		(77,046)	(59,122,279)
Operating income (loss)	8,723,115	(290,172)	745,906	699,629	(1,203,610)		(77,046)	8,514,046
Loss on sale of discontinued operation (New Guoxin)							(663,279)	(663,279)
								7,850,767
Interest income	58,006	7,013	4,589	3,400	9,099	106,734	(15,808)	173,033
Finance costs	(1,754,050)	(32,078)	(62,791)	(56,946)	(5,238)	(40,727)	15,808	(1,936,022)
Other income (expense), net	(21,609)	3,680	(4,741)	1,488	39,868	(10,615)		8,071
Segment income (loss) before taxation and minority interests	7,005,462	(311,557)	682,963	647,571	(1,159,881)		(21,654)	6,095,849
Taxation								(1,888,381)
Income after taxation								4,207,468
Minority interests								9,629
Net income								4,217,097
Other information:								
Provision for doubtful debts	1,116,523	397,810	125,676	75,870	34,008			1,749,887
Impairment loss recognized in the statement of income					528,038			528,038
Capital expenditures for segment assets (1)	8,906,166		4,128,985	2,555,252	35,126	4,129,690		19,755,219

As of 31 December 2004

Elimination

Total

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	<b>GSM Business</b>	<b>CDMA Business</b>	<b>Internet and Data Business</b>	<b>Long Distance Business</b>	<b>Unallocated amounts</b>		
	<b>RMB 000</b>	<b>RMB 000</b>	<b>RMB 000</b>	<b>RMB 000</b>	<b>RMB 000</b>	<b>RMB 000</b>	<b>RMB 000</b>
Total segment assets	100,220,012	6,183,758	9,470,980	18,042,840	62,101,761	(50,390,158)	145,629,193
Total segment liabilities	48,676,856	7,663,420	4,437,311	5,408,689	6,632,463		72,818,739

As of 31 December 2003

	<b>GSM Business</b>	<b>CDMA Business</b>	<b>Internet and Data Business</b>	<b>Long Distance Business</b>	<b>Unallocated amounts</b>	<b>Elimination</b>	<b>Total</b>
	<b>RMB 000</b>	<b>RMB 000</b>	<b>RMB 000</b>	<b>RMB 000</b>	<b>RMB 000</b>	<b>RMB 000</b>	<b>RMB 000</b>
Total segment assets	104,430,531	4,717,167	8,611,873	19,061,967	63,234,534	(50,218,142)	149,837,930
Total segment liabilities	56,837,496	6,561,772	3,975,293	6,918,025	5,929,854		80,222,440

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	2002					Unallocated amounts RMB 000	Elimination RMB 000	Total RMB 000
	GSM Business RMB 000	Continuing operation CDMA Business RMB 000	Internet and Data Business RMB 000	Long Distance Business RMB 000	Discontinued operation Paging Business RMB 000			
Operating revenue (Turnover):								
Usage fee	20,274,987	2,231,050	2,069,415	1,223,051				25,798,503
Monthly fee	4,169,129	713,483	9,478		1,912,786			6,804,876
Interconnection revenue	1,709,771	184,296	348,248	664,302	113,123			3,019,740
Leased lines rental			274,274	873,054				1,147,328
Other revenue	1,234,038	96,518	91,624	5,316	135,279			1,562,775
Total services revenue	27,387,925	3,225,347	2,793,039	2,765,723	2,161,188			38,333,222
Sales of telecommunications products	721,100	423,057	5,631	13,258	1,080,257			2,243,303
Total operating revenue from external customers	28,109,025	3,648,404	2,798,670	2,778,981	3,241,445			40,576,525
Inter segment revenue			559,888	682,423	731,009		(1,973,320)	
Total operating revenue	28,109,025	3,648,404	3,358,558	3,461,404	3,972,454			40,576,525
Operating expenses:								
Leased lines and network capacities	(205,374)	(932,994)	(221,028)	(93,079)	(136,024)		5,244	(1,583,255)
Interconnection charges	(3,386,592)	(279,440)	(408,843)	(555,470)			1,400,705	(3,229,640)
Depreciation and amortization	(8,322,549)	(100,902)	(697,188)	(687,420)	(1,442,836)	(4,829)		(11,255,724)
Personnel	(1,780,173)	(281,243)	(396,150)	(290,977)	(555,261)	(31,414)		(3,335,218)
Selling and marketing	(2,663,531)	(2,126,475)	(651,594)	(305,505)	(238,640)		4,797	(5,980,948)
General, administrative and other expenses	(3,370,938)	(506,715)	(590,531)	(501,657)	(597,427)	(65,726)	1,144	(5,631,850)
Cost of telecommunications products sold	(744,640)	(408,791)	(11,299)	(5,049)	(1,626,157)		559,730	(2,236,206)
Total operating expenses	(20,473,797)	(4,636,560)	(2,976,633)	(2,439,157)	(4,596,345)	(101,969)		(33,252,841)
Operating income (loss)	7,635,228	(988,156)	381,925	1,022,247	(623,891)	(101,969)		7,323,684
Interest income	48,503	4,146	4,525	5,516	17,374	390,218		470,282
Finance costs	(1,287,443)	(47,979)	(72,864)	(48,789)	(8,348)	(9,018)		(1,474,441)
Other (expense) income, net	(46,889)	(10)	(2,562)	(152)	24,993	8,261		(16,359)
Segment income (loss) before taxation and minority interest	6,349,399	(1,031,999)	311,024	978,822	(589,872)	287,492		6,303,166
Taxation								(1,720,205)
Income after taxation								4,582,961
Minority interests								15,252
Net income								4,598,213
Other information:								
Provision for doubtful debts	802,914	42,050	70,922	46,124	9,979			971,989
				38,797				38,797

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Impairment loss recognized in the statements of income							
Capital expenditures for segment assets							
(1)	7,899,442		3,247,507	3,343,330	208,460	4,236,036	18,934,775

	As of December 31, 2002							
	GSM Business RMB 000	CDMA Business RMB 000	Internet and Data Business RMB 000	Long Distance Business RMB 000	Paging Business RMB 000	Unallocated amounts RMB 000	Elimination RMB 000	Total RMB 000
Total segment assets	97,888,808	5,724,427	7,081,704	13,876,837	8,410,871	58,016,167	(41,370,609)	149,628,205
Total segment liabilities	67,666,655	5,788,290	2,785,794	3,826,692	2,205,343	136,639		82,409,413

(1) Capital expenditures classified under unallocated amounts represent capital expenditures on common facilities, which benefit all business segments.

**(b) Geographical segments**

The Group's services users are mainly in the PRC. There is no other geographical segment with segment revenue from external customers equal to or greater than 10% of total consolidated revenue from sales to all external customers.

Although the Group has its corporate headquarters in Hong Kong, a substantial portion of the Group's non-current assets (including property, plant and equipment and other assets) are situated in mainland China, as the Group's principal activities are conducted in the PRC. For the year ended December 31, 2004, substantially all capital expenditures were incurred to acquire assets located in the mainland China. There is no other geographical segment with segment assets equal to or greater than 10% of the total assets of all geographical segments.

**(c) Discontinued operation**

The subsidiary that carried out the Paging Business, New Guoxin, was disposed of on December 31, 2003, which has been reported as a discontinued operation (see Note 5).

**35. FAIR VALUE OF FINANCIAL INSTRUMENTS**

Financial assets of the Group include bank balances and cash, short-term bank deposits, accounts receivable, prepayment and other current assets, amounts due from related parties and domestic carriers. Financial liabilities of the Group include accounts payable and accrued liabilities, bank loans, lease payables and amounts due to related parties and domestic carriers.

Bank balances and cash and short-term bank deposits denominated in foreign currencies as summarized below, have been translated to RMB at the applicable rates quoted by the People's Bank of China as of December 31, 2003 and 2004.

	Original currency 000	2003 Exchange rate	RMB equivalent RMB 000	Original currency 000	2004 Exchange rate	RMB equivalent RMB 000
<b>Bank balances and cash:</b>						
- denominated in HK\$	19,126	1.06	20,382	75,562	1.06	80,406
- denominated in US dollars	81,888	8.27	677,764	4,803	8.28	39,753
Sub-total			698,146			120,159
<b>Short-term deposits:</b>						
- denominated in US dollars	110,285	8.27	912,794	79,946	8.28	661,675
Sub-total			912,794			661,675

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Total	1,610,940	781,834
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The Group did not have and does not believe it will have any difficulty in exchanging its foreign currency cash into RMB at the exchange rates quoted by the People's Bank of China. The carrying amounts of the Group's bank balances and cash, short-term bank deposits, other current financial assets and liabilities approximated their fair value as of December 31, 2003 and 2004 due to the nature or short maturity of those instruments.

The carrying amounts of receivables and payables which are all subject to normal trade credit terms approximate their fair values.

The carrying amounts of long-term bank loans approximate their fair values based on prevailing market borrowing rates available for comparable bank loans with similar terms and maturities.

### 36. CONTINGENCIES AND COMMITMENTS

#### (a) Capital commitments

As of December 31, 2003 and 2004, the Group had capital commitments, mainly in relation to the construction of telecommunications networks, as follows:

	Land and buildings RMB 000	2004 Equipment RMB 000	Total RMB 000	2003 Total RMB 000
Authorized and contracted for	659,435	4,387,705	5,047,140	6,711,938
Authorized but not contracted for	145,997	1,344,328	1,490,325	1,195,162
Total	805,432	5,732,033	6,537,465	7,907,100

As of December 31, 2004, approximately RMB126 million (2003: RMB83 million) of capital commitment outstanding was denominated in US dollars (equivalent to US\$15 million (2003 US\$10 million)).

**(b) Operating lease commitments**

As of December 31, 2003 and 2004, the Group had total future aggregate minimum operating lease payments under operating leases as follows:

	2004			2003	
	Land and buildings RMB 000	Equipment RMB 000	CDMA network capacities (Note (a)) RMB 000	Total RMB 000	Total RMB 000
<b>Leases expiring:</b>					
- not later than one year	612,169	138,852	5,930,037	6,681,058	7,150,023
- later than one year and not later than five years	1,703,163	211,034		1,914,197	1,391,120
- later than five years	1,011,280	56,423		1,067,703	953,917
<b>Total</b>	<b>3,326,612</b>	<b>406,309</b>	<b>5,930,037</b>	<b>9,662,958</b>	<b>9,495,060</b>

Note (a): In relation to the above CDMA network capacities commitment, it is estimated based on 90% of the total amount of lease fee paid by the Group to Unicom New Horizon in 2004 pursuant to the New CDMA Lease (see Note 37(b)(i) for details). The New CDMA Lease is to be approved by the minority shareholders of the Company.

**(c) Commitment to purchase CDMA handsets**

As of December 31, 2004, the Group committed to purchase CDMA handsets amounted to approximately RMB1,968 million (2003: RMB920 million).

**37. EVENTS AFTER BALANCE SHEET****(a) Combination of Unicom New World**

With approval of Ministry of Commerce, CUCL has planned to combine with Unicom New World. After the combination, Unicom New World will be legally dissolved and succeed by CUCL. As of June 16, 2005, the relevant legal procedures regarding the combination have not been completed.



**(b) New connected transaction agreements**

On March 24, 2005, CUCL and Unicom New World entered into the new agreements of New Comprehensive Service Agreement , New CDMA Lease , New Comprehensive Operator Services Agreement and New Guoxin Premises Leasing Agreement with Unicom Group, Unicom New Horizon and New Guoxin to replace the old agreements. The above new connected transaction agreements were effective from January 1, 2005, which have been approved and resolution passed by the minority shareholders of the Company pursuant to extraordinary shareholders meeting held by the Company on May 12, 2005. Changes of key terms in the new agreements and the old agreements are set out as follows:

(i) New CDMA Lease

Pursuant to the New CDMA Lease, the CDMA lease has an initial term of two years (the Initial Term), and the lease fee of the CDMA Network shall be determined on the basis of the lessee's services revenue, details as follows:

i. in 2005, the lease fee shall be 29% of the audited CDMA service revenue of the lessee for that year, but shall not less than 90% of the total amount of lease fee paid by the Group to Unicom New Horizon pursuant to the old lease agreements for 2004 (see Note 32); and

ii. in 2006, the lease fee shall be 30% of the audited CDMA service revenue of the lessee for that year, but shall not less than 90% of the total amount of lease fee paid by the Group to Unicom New Horizon pursuant to the New CDMA Lease agreement for 2005.

Pursuant to the New CDMA Lease, the constructed capacity related costs, including the rental fees for the exchange centers and the base stations, water and electricity charges, heating charges and fuel charges for the relevant equipment etc., as well as the maintenance costs of a non-capital nature, shall be borne by the lessor and lessee together. The proportion of the constructed capacity related costs to be borne by the lessee shall be calculated on a monthly basis by reference to the actual number of cumulative CDMA subscribers of the Group at the end of the month prior to the occurrence of the costs divided by 90%, as a percentage of the total capacity available on the Network.

(ii) New Comprehensive Operator Services Agreement

Pursuant to the New Comprehensive Operator Services Agreement, the Group shall retain 40% of the actually received revenue generated from the value-added services provided to the Group's subscribers and allocate 60% of such revenue to New Guoxin and the settlement should be made among branches of the Group and New Guoxin respectively.

### 38. COMPARATIVE FIGURES

Certain comparative figures have been adjusted to reflect the retrospective adjustment of deferred tax assets in accordance with SSAP 12 adopted in 2003.

### 39. APPROVAL OF FINANCIAL STATEMENTS

**The financial statements were approved by the Board of Directors on June 16, 2005.**



#### **40. SIGNIFICANT DIFFERENCES BETWEEN HK GAAP AND US GAAP**

The consolidated financial statements of the Group prepared under HK GAAP differ in certain material respects from those prepared under generally accepted accounting principles in the United States of America ( US GAAP ). Significant differences between HK GAAP and US GAAP relating to the Group are summarized below:

##### **(A) Effect of the acquisitions of entities under common control**

Under HK GAAP, the Group has adopted the purchase method of accounting to account for the acquisitions of Unicom New Century, Unicom New World and Unicom International (the Acquisitions ). Under the purchase method, the operating results of these acquired subsidiaries have been included in the consolidated statements of income of the Group after the Acquisitions were effective. The differences between the costs of Acquisitions and the fair values of the separately identifiable net assets acquired have been recorded as goodwill/negative goodwill, which are amortized using the straight-line method over the relevant beneficial periods.

As the Group, Unicom New Century, Unicom New World and Unicom International were under the common control of Unicom Group prior to the Acquisitions, these Acquisitions are considered as a transfer of businesses under common control and the acquired assets and liabilities are accounted for at historical cost under US GAAP. Furthermore, the consolidated financial statements prepared under US GAAP for all periods presented have been retroactively restated as if Unicom New Century, Unicom New World and Unicom International were always part of the Group. The cash considerations paid by the Company are treated as capital distribution in the respective years of the acquisitions. Goodwill/negative goodwill arising from the acquisitions and the related amortization of goodwill/negative goodwill recognized under HK GAAP have been reversed under US GAAP. Transaction costs, which are capitalized as part of the cost of investment under HK GAAP, have been expensed in full under US GAAP.

##### **(B) Effect of the disposal of entity under common control**

Under HK GAAP, the sale of New Guoxin has been accounted for as a sale of discontinued operation by the Group. The difference between the sale proceeds and the carrying amount of net assets of New Guoxin as of December 31, 2003 (the effective date of disposal) was recorded as the loss on sale of discontinued operation in the consolidated statements of income of the Group. The operating results of New Guoxin for 2003 were included in the consolidated statements of income of the Group up to the effective date of the sale.

Under US GAAP, the sale of New Guoxin to Unicom Group is considered a transfer of business between entities under common control and accounted for at historical cost of the net assets transferred, after reduction, if appropriate, for an indicated impairment of value (see Note (H)). In addition, under US GAAP, the results of operations of a component, including a segment of an entity that has been disposed of should be reported in discontinued operations as a separate

component of income, separately from continuing operations, in the period in which the disposal occurred as well as in prior periods. Accordingly, all the operating results of New Guoxin have been grouped into and reported in the statements of income for the years ended December 31, 2002 and 2003 as Discontinued operation-Loss from discontinued operation under US GAAP.

**(C) Consolidation of variable interest entities**

Under HK GAAP, consolidation of business enterprises is based on voting control. Under US GAAP, pursuant to Financial Accounting Standard Board ( FASB ) Interpretation No. 46 (revised in December 2003), Consolidation of Variable Interest Entities ( FIN 46R ), consolidation of business enterprises is based on an economic risks and rewards model rather than a traditional voting interest model. Entities subject to consolidation under the economic risks and rewards model is called a Variable Interest Entity ( VIE ). In accordance with the provision of FIN 46R, the Group has identified one VIE, Unicom New Horizon, in which it holds a variable interest in the form of lease renewal options. Unicom New Horizon is a 100% owned subsidiary of the Group's controlling shareholder, from which the Group leases its CDMA assets on a capacity-used basis under operating leases, subject to indefinite renewal options. The Group has concluded that its controlling shareholder is the primary beneficiary of Unicom New Horizon, since it absorbs all of Unicom New Horizon's expected losses (through its ownership of 100% of Unicom New Horizon's equity and an unconditional guarantee of 100% of Unicom New Horizon debt) and is indirectly associated with the operations of the leased CDMA assets through its majority ownership of the Group. As such, the adoption of FIN 46R did not result in any differences from the Group's HK GAAP consolidated financial statements.

**(D) Revenue and costs recognition**

**(i) Upfront non-refundable revenue and related incremental cost**

Under HK GAAP, upfront non-refundable revenue, such as connection fee, is recognized when received upon completion of activation services. Under US GAAP, in accordance with Staff Accounting Bulletin ( SAB ) No. 101, Revenue Recognition in Financial Statements , which was superseded by SAB No.104, Revenue Recognition , upfront non-refundable revenue and the related direct incremental costs incurred are deferred and recognized over the estimated customer service periods. The expected customer service period for the Cellular Business is estimated based on the expected stabilized churn rates. On this basis, the weighted average customer service period based on current estimation considering the prevailing market environment is approximately 4 years (2002: 6 years; 2003: 4 years). The effects of the change of accounting estimate were to increase the net income and earnings per share by approximately RMB 70 million and RMB 0.006 respectively for the year ended December 31, 2003.

**(ii) Revenue arrangements with multiple deliverables**

Under HK GAAP, revenue should be measured at the fair value of the consideration received and receivable. When the selling price of a product includes an identifiable amount for subsequent servicing, that amount is deferred and recognized as revenue over the period during which the service is performed. The amount deferred is that which will cover the expected costs of the services under the agreement, together with a reasonable income on those services.

Under US GAAP, pursuant to the Emerging Issues Task Force Issue 00-21, Accounting for Revenue Arrangements with Multiple Deliverables ( EITF Issue 00-21 ), revenue-generating arrangements involving multiple deliverables should be divided into separate units of accounting and accounted for separately, if (i) the deliverables are independently functional or sufficiently separable and (ii) there is sufficient evidence of related fair values. In 2004, the Group adopted the provisions of EITF Issue 00-21, which after an analysis of its various revenue-generating arrangements, except for (i) above, did not result in any differences from the Group's HK GAAP consolidated financial statements.





**(E) Employee housing schemes**

Prior to the establishment of New Guoxin and CUCL, both China Telecom (the previous owner of New Guoxin prior to its restructuring into the Group) and Unicom Group provided housing benefits to qualified employees of the Group to enable them to purchase living quarters at a discount. Under HK GAAP, housing benefits incurred and borne by China Telecom and Unicom Group for these employees were not recognized by the Group. Under US GAAP, the amount of such housing benefits is being recognized as part of the Group's operating expenses over the estimated average service life of the participating employees. The corresponding credits are being accounted for as capital contributions. Upon the completion of sale of New Guoxin on December 31, 2003, the related housing benefits have been correspondingly accounted for with the net assets transferred.

**(F) Deferred taxation**

Upon the adoption of SSAP 12 in 2003 under HK GAAP, which has been retroactively applied to all periods presented, there is no longer a difference in accounting for deferred taxation between HK GAAP and US GAAP. The remaining adjustment related to deferred taxation represents the deferred tax effects of other US GAAP adjustments.

**(G) Revaluation of property, plant and equipment**

Under HK GAAP, revaluation surplus in relation to buildings is recorded by the Group as part of the property, plant and equipment. Thereafter, depreciation is provided based on the revalued amounts. Under US GAAP, all property, plant and equipment are stated at historical cost less accumulated depreciation, and prepaid land use rights are stated at the unamortized prepaid amount as part of other assets.

**(H) Impairment of goodwill and long-lived assets**

The carrying amounts of property, plant and equipment and goodwill under HK GAAP are reviewed periodically in order to assess whether the recoverable amount has declined below the carrying amount. When such a decline occurs, the carrying amount is reduced to the recoverable amount based on the expected future cash flows generated by the assets discounted to their present value. A subsequent increase in the recoverable amount is written back to the statements of income when circumstances and events that led to the write-down or write-off cease to exist.

**(i) Goodwill**

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Under HK GAAP, goodwill is amortized using the straight-line method over the expected beneficial lives of the acquired businesses.

Under US GAAP, upon the adoption of Statements of Financial Accounting Standards No. 142 Goodwill and Other Intangible Assets ( SFAS 142 ), the Group no longer amortizes goodwill but, rather, assesses the goodwill of each identified reporting unit for impairment annually starting from January 1, 2002. The adoption of SFAS 142 has resulted in a cumulative effect of accounting change of approximately RMB42,175,000 (net of tax approximately RMB20,773,000) on January 1, 2002 and has been reflected in the condensed statements of income for the year ended December 31, 2002 under US GAAP. Under US GAAP, there was no goodwill as of December 31, 2003 and 2004.

**(ii) Long-lived assets**

On January 1, 2002, the Company has adopted Statements of Financial Accounting Standard No. 144 ( SFAS 144 ), which supersedes SFAS 121 and Accounting Principles Board Opinion No. 30, Reporting the Results of Operations, Reporting the Effects of Disposal of Segment of a Business and Extraordinary, Unusual and Infrequently Occurring Events and Transactions . SFAS 144 retains the previous accounting for the impairment of long-lived assets to be held and used in operation as prescribed under SFAS 121, but also establishes more restrictive criteria that must be met to classify long-lived assets as held-for sale, and differentiates between long-lived assets that are disposed of by sale from those disposed of other than by sale. SFAS 144 also increases the range of dispositions that qualify for reporting as discontinued operations, and changes the manner in which expected future operating losses from such operations are to be reported.

Under SFAS 144, long-lived assets excluding goodwill are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is evaluated by a comparison of the carrying amount of an asset to future undiscounted net cash flows expected to be generated by the asset. If such assets are considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying amounts of the assets exceed the fair value of the assets, which is determined based on the estimated future discounted net cash flows expected to be generated by the asset held for continuous use. Assets impaired or to be disposed of are reported at the lower of the carrying amounts or fair values less costs to sell, which result in a new cost basis for the impaired assets. This new cost basis is not to be adjusted for subsequent recoveries in value.

Based on the above assessment performed and taking into account of the adoption of SFAS 144, no material differences arose in respect of the timing and the amount of impairment for equipment for the years ended December 31, 2002, 2003 and 2004.

For the year ended December 31, 2003, as described in Note (B) above, the disposal of New Guoxin has been treated as a transfer of business between entities under common controls. For this kind of distribution of a business to the owner in a spin-off, a re-assessment of the impairment of the long-lived assets of the business is required while they are classified as held and used and prior to the spin-off. An impairment loss would be recognized when the carrying amounts of the long-lived assets of the business as of the effective date of disposal exceeded their fair values. After considering the above impairment assessment, any difference between the sale proceeds and the new carrying values of assets and liabilities of the business is treated contribution by (or distribution to) the owner, as appropriate. Accordingly, an additional provision of impairment loss of the Paging assets amounting to approximately RMB608 million was recorded under US GAAP as at the effective date of the sale of New Guoxin. There was no adjustment to the shareholders' equity since the sale proceeds approximated the new carrying values of the net assets of New Guoxin, after taking into consideration the additional impairment provision described above.

**(I) Share option scheme**

Under HK GAAP, the proceeds received from the exercise of the share options granted under the fixed award amended Share Option Scheme and Pre-Global Offering Share Option Scheme are to be recognized as an increase to capital upon the exercise of the share options as stated in Note 30 of the financial statements.

Under US GAAP, the Company applies Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees ( APB 25 ) to account for its fixed award stock options issued to employees. Under APB 25, compensation expense is recorded in the amount of the excess, if any, of the quoted market price of the shares on the date of grant over the exercise price of the options, which is amortized over the vesting period of the option. Since the market price of the underlying stock on the date of grant did not exceed the exercise price of the options granted, no compensation cost for options has been recognized in the reconciliation of net income to US GAAP. In accordance with Accounting for Stock-Based Compensation ( SFAS 123 ) as further amended by Statement of Financial Accounting Standards, No. 148,

Accounting for Stock-Based Compensation-Transition and Disclosure ( SFAS 148 ) which is effective for the year ended December 31, 2002, the required pro forma information to be disclosed is set forth below:

	2002	2003	2004
<b>Net income:</b>			
As reported (RMB 000)	5,035,767	4,736,121	4,712,687
Less: Total stock-based employee compensation expense determined under fair value based method (RMB 000)	(90,288)	(86,855)	(146,541)
<b>Pro forma (RMB 000)</b>	<b>4,945,479</b>	<b>4,649,266</b>	<b>4,566,146</b>
<b>Basic earnings per share:</b>			
As reported (RMB)	0.401	0.377	0.375
Pro forma (RMB)	0.394	0.370	0.364
<b>Diluted earnings per share:</b>			
As reported (RMB)	0.401	0.377	0.374
Pro forma (RMB)	0.394	0.370	0.362
<b>Basic earnings per ADS:</b>			
As reported (RMB)	4.012	3.773	3.752
Pro forma (RMB)	3.940	3.704	3.635
<b>Diluted earnings per ADS:</b>			
As reported (RMB)	4.012	3.768	3.738
Pro forma (RMB)	3.940	3.699	3.622

**(J) Investment in equity securities**

Under HK GAAP, negotiable equity securities including ownership interest in an enterprise, which are intended to be held on a continuing basis, are classified as investment securities and are stated at cost. The carrying amounts of investment securities are written down to reflect any diminution in value expected to be other than temporary. Provisions against the carrying value are reversed when the circumstances and events that led to the write-downs or write-offs cease to exist and if there is persuasive evidence that the new circumstances and events will persist for the foreseeable future.

Under US GAAP, equity securities which are not marketable and do not have readily determinable fair values are classified as other investments, which are stated at cost less impairment in value other than temporary. If impairment in value is judged to be other than temporary, the cost of the investment is written down to its recoverable amount as a new cost basis and the amount of the write-down is included in the statements of income. The new cost basis is not changed for subsequent recoveries in value.

During the years ended December 31, 2003 and 2004, the Group did not have any investment in equity securities under HK GAAP and US GAAP. Accordingly, there was no recovery in the value of investments in equity securities under HK GAAP.

**(K) New Accounting Pronouncements**

In December 2004, FASB issued Statement of Financial Accounting Standards No. 123(R) Share-Based Payment ( SFAS 123(R) ), which is a revision of SFAS 123 and supersedes APB 25. SFAS 123(R) requires all share-based payments to employees, including grants of employee stock options, to be valued at fair value on the date of grant, and to be expensed over the applicable vesting period. Pro forma disclosures of the statement of income effects of share-based payments are no longer an alternative. SFAS 123(R) is effective for all stock-based awards granted on or after June 15, 2005. In addition, companies must also recognize compensation expense related to any awards that are not fully vested as of June 15, 2005. Compensation expense for the unvested awards will be measured based on the fair value of the awards previously calculated in developing the pro forma disclosures in accordance with the provisions of SFAS 123 and will be amortized over the remaining vesting period. The Group is currently assessing the impact of adopting SFAS 123(R) to its consolidated operating results and financial position.

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Differences between HK GAAP and US GAAP which affect net income of the Group are summarized below:

	Note	2002 RMB 000 As restated	2003 RMB 000 As restated	2004 RMB 000
Net income under HK GAAP	(1)	4,598,213	4,217,097	4,386,999
Impact of US GAAP adjustments:	(2)			
Effect of acquisition of Unicom New Century	(A)	648,006		
Transaction costs for the acquisition of Unicom New Century	(A)	(109,221)		
Reversal of goodwill amortization and recognition of depreciation expenses based on historical cost of property, plant and equipment of Unicom New Century	(A)		88,794	85,476
Effect of acquisition of Unicom New World	(A)	(118,879)	350,947	
Transaction costs for the acquisition of Unicom New World	(A)		(49,378)	
Reversal of goodwill amortization and recognition of depreciation expenses based on historical cost of property, plant and equipment of Unicom New World	(A)			36,507
Effect of acquisition of Unicom International	(A)	7,351	7,698	6,167
Transaction costs for the acquisition of Unicom International	(A)			(325)
Deferral of upfront non-refundable revenue	(D)	(860,490)	(1,417,474)	(1,275,664)
Amortization of upfront non-refundable revenue	(D)	526,982	1,223,938	1,303,683
Deferral of direct incremental cost	(D)	776,387	1,417,474	1,273,515
Amortization of direct incremental cost	(D)	(435,385)	(1,071,450)	(1,188,804)
Employee housing benefits	(E)	(18,532)	(18,532)	(14,942)
Reversal of depreciation for revalued property, plant and equipment	(G)	7,485	7,485	4,127
Difference in provision for impairment and disposal loss of New Guoxin	(B)		55,078	
Reversal of differences in provision for impairment loss of equipment upon depreciation and disposal	(H)	(3,538)	(3,538)	
Deferred tax effects of US GAAP adjustments	(F)	59,563	(72,018)	95,948
Effect of change in accounting policy:				
Transitional adjustment of goodwill impairment upon the adoption of SFAS 142 (net of tax RMB20,773,000)	(H)	(42,175)		
Net income under US GAAP (as restated in 2002 and 2003)	(2)	5,035,767	4,736,121	4,712,687

Differences between HK GAAP and US GAAP which affect shareholders' equity of the Group are summarized below:

	Note	2003 RMB 000 As restated	2004 RMB 000
Shareholders' equity under HK GAAP	(1)	69,615,490	72,810,454
Impact of US GAAP adjustments:	(2)		
Effect of acquisition of Unicom New Century	(A)	(2,052,554)	(2,052,554)
Transaction costs for the acquisition of Unicom New Century	(A)	(109,221)	(109,221)
Reversal of goodwill amortization and recognition of depreciation expenses based on historical cost of property, plant and equipment of Unicom New Century	(A)	88,794	174,270
Effect of acquisition of Unicom New World	(A)	(946,370)	(946,370)
Transaction costs for the acquisition of Unicom New World	(A)	(49,378)	(49,378)
Reversal of goodwill amortization and recognition of depreciation expenses based on historical cost of property, plant and equipment of Unicom New World	(A)		36,507
Effect of acquisition of Unicom International	(A)	33,641	392
Transaction costs for the acquisition of Unicom International	(A)		(325)
Deferred upfront non-refundable revenue	(D)	(5,953,520)	(7,229,184)
Accumulated amortization of upfront non-refundable revenue	(D)	2,646,464	3,950,147
Deferred direct incremental cost	(D)	5,037,375	6,310,890
Accumulated amortization of direct incremental cost	(D)	(2,088,332)	(3,277,136)
Reversal of revaluation surplus of property, plant and equipment:			
Cost	(G)	(82,531)	(82,531)
Accumulated depreciation	(G)	15,351	19,478
Deferred tax effects of US GAAP adjustments	(F)	(209,065)	(113,117)
Shareholders' equity under US GAAP (as restated in 2003)	(2)	65,946,144	69,442,322

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Notes:

(1) Under HK GAAP, prior to 2003, deferred taxation was accounted for at the current taxation rate in respect of timing differences between net income as computed for taxation purpose and net income as stated in the statements of income. A deferred tax asset was not recognized unless the related benefits are expected to crystallize in the foreseeable future. Upon the adoption of SSAP 12 in 2003, deferred taxation is provided in full, using the liability method, on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the financial statements. Taxation rates enacted or substantively enacted at the balance sheet date are used to determine deferred taxation. Deferred tax assets are recognized to the extent that it is probable that future taxable income will be available against which the temporary differences can be utilized.

The change in the accounting policy has resulted in an increase of opening retained earnings as of January 1, 2002 and 2003 by approximately RMB373,159,000 and RMB405,300,000, respectively, representing the deferred tax assets relating to the provision for doubtful debts previously not recognized. This change has resulted in an increase in deferred tax assets at January 1, 2003 by approximately RMB405,300,000. The net income for the year ended December 31, 2002 has also been increased by approximately RMB32,141,000.

The adoption of SSAP 12 has also resulted in an increase of the deferred tax assets of Unicom New Century as of December 31, 2002 by approximately RMB80,448,000.

Under HK GAAP, the adoption of SSAP 12 in 2003 represents a change in accounting policy which has been applied retrospectively so that the comparatives presented have been restated to conform to the changed policy.

(2) In accordance with the US GAAP accounting as described in Note (A) above, the financial statements under US GAAP for prior periods presented have been retroactively restated to include Unicom New Century, Unicom New World and Unicom International since the beginning of the earliest period presented.



The following summarized the combined results of operations and the financial positions for the separate entities on a combined basis as of and for the years ended December 31, 2002, 2003 and 2004, restated to reflect the impact of the effects of the disposal of New Guoxin and Acquisition of entities under common control, which is accounted for at historical cost under US GAAP with prior periods restated as if the entities were always combined, and other differences between HK GAAP and US GAAP.

	<b>The Group (before the acquisition of Unicom International) (Note(a)) RMB 000</b>	<b>Unicom International (Note(b)) RMB 000</b>	<b>Elimination RMB 000</b>	<b>The Group (after the acquisition of Unicom International) RMB 000</b>
<b><u>For the year ended December 31, 2002</u></b>				
Results of operations:				
Operating revenue (Turnover)	50,415,248	24,322	(18,497)	50,421,073
Net income from continuing operations	5,492,804	7,351		5,500,155
Net loss from discontinued operation	(422,213)			(422,213)
Effect of change in accounting policy	(42,175)			(42,175)
Net income	5,028,416	7,351		5,035,767
Basic earnings per share (RMB)	0.401			0.401
<b><u>As of/for the year ended December 31, 2003</u></b>				
Results of operations:				
Operating revenue (Turnover)	71,958,253	46,265	(24,208)	71,980,310
Net income from continuing operations	6,070,263	7,698		6,077,961
Net loss from discontinued operation	(1,341,840)			(1,341,840)
Net income	4,728,423	7,698		4,736,121
Basic earnings per share (RMB)	0.377			0.377
Financial position:				
Non-current assets	128,169,420	60,621		128,230,041
Current assets	22,243,284	97,186	(93,115)	22,247,355
Total assets	150,412,704	157,807	(93,115)	150,477,396
Non-current liabilities	40,593,548			40,593,548
Current liabilities	43,906,653	124,166	(93,115)	43,937,704
Total liabilities	84,500,201	124,166	(93,115)	84,531,252
Net assets	65,912,503	33,641		65,946,144

	The Group (before the acquisition of Unicom International) (Note(a)) RMB 000	Unicom International (Note(b)) RMB 000	Elimination RMB 000	The Group (after the acquisition of Unicom International) RMB 000
<b><u>As of/for the year ended December 31, 2004</u></b>				
Results of operations:				
Operating revenue (Turnover)	79,361,238	135,688	(108,612)	79,388,314
Net income	4,703,312	8,988	387	4,712,687
Basic earnings per share (RMB)	0.374			0.375
Financial position:				
Non-current assets	128,697,817	64,865		128,762,682
Current assets	17,865,977	148,991	(162,776)	17,852,192
Total assets	146,563,794	213,856	(162,776)	146,614,874
Non-current liabilities	31,045,613	3,262		31,048,875
Current liabilities	46,118,868	167,972	(163,163)	46,123,677
Total liabilities	77,164,481	171,234	(163,163)	77,172,552
Net assets	69,399,313	42,622	387	69,442,322

Note (a): The above balances include the operating results and financial position of Unicom New Century and Unicom New World as of the end of and for all periods presented. Further, as described in Note (B) above, New Guoxin was sold to Unicom Group effective on December 31, 2003. As a result, the balance sheet of the Group did not include the financial positions of New Guoxin as of December 31, 2003.

Note (b): The above represent the operating results and financial conditions of Unicom International for the whole years ended December 31 and as of year end.

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The following are the condensed statements of income, changes in shareholders' equity and cash flow information for the years ended December 31, 2002, 2003 and 2004, condensed balance sheets information for the Group as of December 31, 2003 and 2004, and additional financial information as of and for the years ended December 31, 2002, 2003 and 2004, restated to reflect the impact of the effects of the disposal of New Guoxin and Acquisition of entities under common control which is accounted for at historical cost with retroactive restatement under US GAAP.

**Condensed Statements of Income**

	Note	2002 RMB 000	2003 RMB 000	2004 RMB 000
Operating revenue (Turnover):	(g)	50,421,073	71,980,310	79,388,314
Operating expenses:				
Leased lines and network capacities	(g)	(2,102,165)	(4,729,159)	(7,398,429)
Interconnection charges	(g)	(3,953,324)	(6,111,437)	(7,508,866)
Depreciation and amortization		(14,154,837)	(16,757,294)	(18,944,473)
Personnel		(3,860,783)	(4,654,670)	(4,547,892)
Selling and marketing	(g)	(8,100,225)	(16,689,275)	(18,989,186)
General, administrative and other expenses	(g)	(7,286,952)	(9,204,349)	(10,471,208)
Cost of telecommunications products sold	(g)	(1,203,368)	(3,124,558)	(3,342,797)
Total operating expenses		(40,661,654)	(61,270,742)	(71,202,851)
Operating income from continuing operations		9,759,419	10,709,568	8,185,463
Interest income		477,490	170,486	103,441
Finance costs		(2,765,871)	(2,319,096)	(1,688,418)
Other (expenses) income, net		(45,734)	(29,837)	95,932
Net income from continuing operations before taxation, discontinued operation and effect of change in accounting policy		7,425,304	8,531,121	6,696,418
Taxation	(c)	(1,925,149)	(2,453,160)	(1,983,731)
Net income before discontinued operation, and effect of change in accounting policy		5,500,155	6,077,961	4,712,687
Discontinued operation				
Loss from discontinued operation		(578,389)	(1,762,222)	
Add: related tax impact	(c)	156,176	420,382	
Loss from discontinued operation, net of tax		(422,213)	(1,341,840)	
Net income before effect of change in accounting policy		5,077,942	4,736,121	4,712,687
Effect of change in accounting policy:				
Transitional adjustment of goodwill impairment upon the adoption of SFAS 142		(62,948)		
Less: related tax impact	(c)	20,773		
		(42,175)		
Net income		5,035,767	4,736,121	4,712,687

The financial statements were approved by the Board of Directors on June 16, 2005.



	Note	2002	2003	2004
<b>Basic earnings per share (RMB):</b>				
Earnings per share before discontinued operation and effect of change in accounting policy	(1)	0.438	0.484	0.375
Loss from discontinued operation, net of tax		(0.034)	(0.107)	
Effect of change in accounting policy, net of tax		(0.003)		
Net income	(1)	0.401	0.377	0.375
<b>Diluted earnings per share (RMB):</b>				
Earnings per share before discontinued operation and effect of change in accounting policy	(2)	0.438	0.484	0.374
Loss from discontinued operation, net of tax		(0.034)	(0.107)	
Effect of change in accounting policy, net of tax		(0.003)		
Net income	(2)	0.401	0.377	0.374
<b>Basic earnings per ADS (RMB):</b>				
Earnings per share before discontinued operation and effect of change in accounting policy	(1), (3)	4.382	4.842	3.752
Loss from discontinued operation, net of tax		(0.336)	(1.069)	
Effect of change in accounting policy, net of tax		(0.034)		
Net income	(1), (3)	4.012	3.773	3.752
<b>Diluted earnings per ADS (RMB):</b>				
Earnings per share before discontinued operation and effect of change in accounting policy	(2), (3)	4.382	4.836	3.738
Loss from discontinued operation, net of tax		(0.336)	(1.068)	
Effect of change in accounting policy, net of tax		(0.034)		
Net income	(2), (3)	4.012	3.768	3.738

## Notes:

(1) Basic earnings per share before or after discontinued operation and effect of change in accounting policy for the years ended December 31, 2002, 2003 and 2004 were computed by dividing the net income before or after discontinued operation and effect of change in accounting policy for the financial years under US GAAP by the weighted average number of ordinary shares in issue during the years.

(2) Diluted earnings per share before or after discontinued operation and effect of change in accounting policy for the years ended December 31, 2002, 2003 and 2004 were computed by dividing the net income before or after discontinued operation and effect of change in accounting policy for the financial years under US GAAP by the weighted average number of ordinary shares in issue during the years, after adjusting for the cumulative effects of the dilutive potential ordinary shares. All potential dilutive shares arose from share options granted (i) under the amended Pre-Global Offering Share Option Scheme; and (ii) under the amended Share Option Scheme as described in Note 30. For 2004, all potential dilutive ordinary shares arose from additional share options granted in 2004 under the amended Share Option Scheme (see Note 30), which if converted to ordinary shares would decrease earnings per share. The anti-dilutive shares arising from the share options of approximately 31,944,000 shares (2002: 48,745,000 shares; 2003: 66,573,000 shares) were not included in the calculation of diluted earnings per share.

(3) Basic and diluted earnings per ADS before or after discontinued operation and effect of change in accounting policy were computed by multiplying the earnings per share by 10, which is the number of shares represented by each ADS.

*Condensed Balance Sheets*

	Note	2003 RMB 000	2004 RMB 000
<b>Assets</b>			
<b>Current assets:</b>			
Current portion of deferred tax assets	(c)	873,849	606,009
Amounts due from Unicom Group			61,401
Amounts due from related parties		176,061	193,048
Amounts due from domestic carriers		184,613	269,919
Prepayments and other current assets	(d)	3,156,310	3,059,714
Inventories		2,172,115	3,114,632
Accounts receivable		8,992,234	9,163,487
Less: Provision for doubtful debts		(3,498,305)	(3,933,507)
Accounts receivable, net		5,493,929	5,229,980
Short-term bank deposits		912,794	662,025
Bank balances and cash		9,277,684	4,655,464
<b>Total current assets</b>		<b>22,247,355</b>	<b>17,852,192</b>
<b>Non-current assets:</b>			
Property, plant and equipment, net	(a)	118,170,805	118,700,674
Other assets	(b)	9,936,454	10,062,008
Deferred tax assets	(c)	122,782	
<b>Total assets:</b>		<b>150,477,396</b>	<b>146,614,874</b>
<b>Liabilities and equity</b>			
<b>Current liabilities:</b>			
Payables and accrued liabilities	(e)	17,127,113	16,785,749
Amounts due to Unicom Group		432,047	
Amounts due to related parties		110,272	5,760
Amounts due to domestic carriers		778,841	948,574
Current portion of obligations under finance leases		25,435	938,189
Current portion of long-term bank loans	(f)	7,197,877	11,086,305
Taxes payable		623,929	395,688
Advances from customers		6,666,991	7,034,995
Short-term bank loans		10,975,199	8,928,417
<b>Total current liabilities</b>		<b>43,937,704</b>	<b>46,123,677</b>
<b>Non-current liabilities:</b>			
Long-term bank loans	(f)	36,212,791	26,137,188
Obligations under finance leases		99,719	488,956
Deferred revenue		4,277,761	4,249,733
Deferred tax liabilities	(c)		170,420
Other long-term liabilities		3,277	2,578
<b>Total non-current liabilities</b>		<b>40,593,548</b>	<b>31,048,875</b>
<b>Shareholders equity</b>		<b>65,946,144</b>	<b>69,442,322</b>
<b>Total liability and shareholders equity</b>		<b>150,477,396</b>	<b>146,614,874</b>





*Condensed Statements of Changes in Shareholders' Equity*

RMB 000

Balance as of January 1, 2002, as previously reported before adjusting for the acquisition of Unicom International	61,884,081
Adjustment for the acquisition of Unicom International	36,535
Balance as of January 1, 2002, as adjusted for the acquisition of Unicom International	61,920,616
Net income for the year ended December 31, 2002	5,035,767
Deemed capital contribution from owner for employee housing benefits	18,532
Contribution from owner	2,083,967
Deemed capital distribution relating to the payment to Unicom Group for the transfer of Unicom New Century	(4,800,000)
Balance as of December 31, 2002, as adjusted for the acquisition of Unicom International	64,258,882
Net income for the year ended December 31, 2003	4,736,121
Deemed capital contribution from owner for employee housing benefits	18,532
Contribution from owner	1,673,693
Deemed capital distribution relating to the payment to Unicom Group for the transfer of Unicom New World	(3,200,000)
Distribution to owner	(286,942)
Dividend paid	(1,255,300)
Exercise of share options	1,158
Balance as of December 31, 2003, as adjusted for the acquisition of Unicom International	65,946,144
Net income for the year ended December 31, 2004	4,712,687
Deemed capital contribution from owner for employee housing benefits	14,942
Deemed capital distribution relating to the payment to Unicom Group for the transfer of Unicom International	(39,416)
Dividend paid	(1,256,160)
Exercise of share options	64,125
Balance as of December 31, 2004	69,442,322

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*Condensed Cash Flow Statements*

	2002 RMB 000	2003 RMB 000	2004 RMB 000
Net cash inflows (outflows) from:			
Operating activities	18,235,412	25,992,889	24,510,430
Investing activities	(10,260,814)	(20,295,426)	(19,668,070)
Financing activities	(12,772,555)	(11,397,136)	(9,440,491)
Net decrease in cash and cash equivalents	(4,797,957)	(5,699,673)	(4,598,131)
Cash and cash equivalents, beginning of year	19,725,314	14,927,357	9,227,684
Cash and cash equivalents, end of year	14,927,357	9,227,684	4,629,553
Interest paid (net of amount capitalized)	(2,697,644)	(2,322,892)	(1,662,419)

**Supplemental information**

Payables to equipment suppliers for construction-in-progress during 2004 decreased by approximately RMB 775 million (2002: RMB1,502 million; 2003: RMB3,799 million).

*(a) Property, Plant and Equipment, net*

	2003 RMB 000	2004 RMB 000
Buildings	12,800,363	15,395,232
Telecommunication equipment	116,385,370	128,797,453
Office furniture, fixtures and others	4,498,081	5,103,469
Leasehold improvements	1,057,051	1,112,408
Construction-in-progress	21,743,621	23,694,508
	156,484,486	174,103,070
Less: Accumulated depreciation	(38,313,681)	(55,402,396)
	118,170,805	118,700,674

**(b) Other Assets**

	2003 RMB 000	2004 RMB 000
Inter-connection facilitates	629,595	441,968
Deferred direct incremental costs	6,465,485	7,738,673
Other	1,588,851	1,852,818
	8,683,931	10,033,459
Less: Accumulated amortization	(3,860,502)	(6,161,207)
	4,823,429	3,872,252
Prepaid rental and leased line	1,201,375	2,305,071
Deferred customer acquisition costs of contractual CDMA subscribers	3,911,650	3,884,685
	9,936,454	10,062,008

**(c) Taxation**

Detailed description of the assessment basis of income tax liability of the Group was set forth in Note 14 of the financial statements.

The income tax liability of Unicom International was assessed as follows:

(i) In 2003, the government enacted a change in the profits tax rate in Hong Kong from 16% in 2002 to 17.5%. Unicom International was assessed at tax rate of 16% for the year 2002, and 17.5% for the years ended December 31, 2003 and 2004. Its subsidiary Unicom USA was assessed at tax rate of 8.84% in the United States for the years ended December 31, 2002, 2003 and 2004; and

(ii) Unicom International had no Hong Kong tax liability for the years ended December 31, 2002, 2003 and 2004 as it does not have any assessable income sourced from Hong Kong after offsetting prior year's accumulated tax loss.

The components of income tax are as follows:

2002	2003	2004
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	RMB 000	RMB 000	RMB 000
Provision for PRC enterprise income tax of the estimated taxable income for the year	1,578,591	1,078,096	1,422,689
Deferred taxation	169,609	954,682	561,042
	1,748,200	2,032,778	1,983,731

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The reconciliation of PRC enterprise income tax at the statutory tax rate of 33% and the effective tax rate actually recorded in the statements of income is as follows:

	2002	2003	2004
<b>PRC</b>			
Statutory tax rate of 33%	33%	33%	33%
Non-deductible expenses:			
Housing benefits	0.1		0.1
Personnel expenses	1.7		0.4
Selling and marketing expenses	0.2		0.3
Other	1.0	0.6	1.2
Additional expenses for tax deductible purposes:			
Interest on loans from CCF joint ventures	(0.9)	(0.3)	
Depreciation expenses	(0.2)	(0.1)	
Monetary housing benefits		(0.8)	
Effect of preferential tax rates	(3.2)	(2.1)	(2.0)
Tax credits	(4.6)		(2.3)
Increase in opening deferred tax asset resulting from an increase in tax rate		(2.1)	(0.4)
Write-off deferred tax assets previously recognized for New Guoxin		1.8	
<b>Effective PRC income tax rate</b>	<b>27.1%</b>	<b>30.0%</b>	<b>30.3%</b>
<b>Effective HK income tax rate</b>			<b>8.7%</b>
<b>Total overall effective income tax rate</b>	<b>25.9%</b>	<b>30.1%</b>	<b>29.6%</b>

Effect of preferential tax rates is as follows:

	2002	2003	2004
Aggregate amount (RMB in millions)	209	143	135
Per share effect (RMB)	0.017	0.011	0.011

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The movement of deferred tax assets is as follows:

	2003 RMB 000	2004 RMB 000
Balance, beginning of year	1,955,485	996,631
Deferred taxation charged to statements of income	(954,682)	(561,042)
Deferred taxation relating to sale of New Guoxin	(4,172)	
<b>Balance, end of year</b>	<b>996,631</b>	<b>435,589</b>

Deferred taxation represents the taxation effect of the following temporary differences:

	2003 RMB 000	2004 RMB 000
<b>Non-current deferred tax assets:</b>		
Net amount of deferral and amortization of upfront non-refundable revenue and incremental costs	1,063,541	1,187,448
Interest on loans from CCF joint ventures	256,673	150,954
Loss arising from terminations of CCF Arrangements	236,249	174,637
Provision for impairment loss of property, plant and equipment	4,875	4,721
Write-off of other assets	7,563	
Amortization of retirement benefits	18,549	
Additional depreciation deductible for tax purpose	101,267	18,258
Differences in tax basis for the residual value of the property, plant and equipment	7,608	10,045
Other	24,497	197
	<b>1,720,822</b>	<b>1,546,260</b>
Less: Valuation allowance		
	<b>1,720,822</b>	<b>1,546,260</b>
<b>Non-current deferred tax liabilities:</b>		
Net amount of deferral and amortization of upfront non-refundable revenue and incremental costs	(1,263,560)	(1,291,528)
Change of depreciation period	(30,367)	(26,280)
Capitalized interest already deducted for tax purposes	(304,113)	(398,872)
	<b>(1,598,040)</b>	<b>(1,716,680)</b>
<b>Net non-current deferred tax assets/(liabilities)</b>	<b>122,782</b>	<b>(170,420)</b>
<b>Current portion of deferred tax assets</b>		
Income tax on advances from customers for telephone cards	261,467	
Write-down of inventory to net realizable value	15,905	39,103
Provision for doubtful debts of Cellular Business	534,839	526,514
Monetary housing benefits	56,826	17,171
Other	4,812	23,221
	<b>873,849</b>	<b>606,009</b>
<b>Total</b>	<b>996,631</b>	<b>435,589</b>

The financial statements were approved by the Board of Directors on June 16, 2005.



*(d) Prepayment and Other Current Assets*

	2003 RMB 000	2004 RMB 000
Prepaid rental	233,461	277,999
Deposits and prepayments	1,633,199	1,351,022
Interest receivables	4,872	1,414
Advances to employees	164,495	164,386
Deferred customer acquisition costs of contractual CDMA subscribers	535,521	860,225
Others	584,762	404,668
	3,156,310	3,059,714

*(e) Payables and Accrued Liabilities*

	2003 RMB 000	2004 RMB 000
Payables to contractors and equipment suppliers	11,811,532	10,592,518
Accrued expenses	1,418,034	1,355,183
Payables to telecommunications products suppliers	1,352,307	1,772,693
Customer deposits	1,199,532	1,370,015
Salary and welfare payables	494,794	465,154
Amounts due to Service Providers/Content Providers	369,330	573,804
Other	481,584	656,382
	17,127,113	16,785,749



*(f) Long-term Bank Loans*

	Interest rate and final maturity	2003 RMB 000	2004 RMB 000
RMB denominated bank loans	Fixed interest rate ranging from 4.78% to 5.73% (2003: 4.44% to 5.76%) per annum with maturity through 2010 (2003: maturity through 2009)		
secured		10,622,366	6,804,566
unsecured		26,994,612	20,487,127
		37,616,978	27,291,693
USD denominated bank loans	Floating interest rate of USD LIBOR plus interest margin of 0.28% to 0.44% per annum with maturity through 2010	5,793,690	9,931,800
		43,410,668	37,223,493
Less: Current portion		(7,197,877)	(11,086,305)
		36,212,791	26,137,188

The repayment schedule of the long-term bank loans was as follows:

	2003 RMB 000	2004 RMB 000
Balances due:		
2004	7,197,877	
2005	15,549,832	11,086,305
2006	11,700,060	10,226,776
2007	3,020,930	10,439,494
2008	4,116,570	2,639,490
2009	1,825,399	1,013,808
Thereafter		1,817,620
	43,410,668	37,223,493
Less: Portion classified as current liabilities	(7,197,877)	(11,086,305)
	36,212,791	26,137,188

As of December 31, 2004, long-term bank loans denominated in RMB were secured by the following:

- (i) Approximately RMB6,805 million (2003: RMB10,622 million) of long-term bank loans were secured by the future service fee revenue to be generated by the cellular operations of the relevant branches. Included in these long-term bank loans, approximately RMB2,824 million (2003: RMB3,600 million) was also guaranteed by Unicom Group;

- (ii) Approximately RMB3,955 million (2003: RMB8,004 million) of long-term bank loans were guaranteed by Unicom Group; and
  
- (iii) Approximately RMB26 million (2003: RMB50 million) of long-term bank loans were secured by restricted bank deposit.

**(g) Related Party Transactions**

	2002 RMB 000	2003 RMB 000	2004 RMB 000
<b>Transactions with Unicom Group and its subsidiaries:</b>			
Interconnection and roaming revenues	34,167	155,464	212,292
Interconnection and roaming charges	50,132	47,615	56,171
Charge for cellular subscriber value-added service			858,778
Charge for customer services			524,718
Charge for cellular subscriber value-added service by UNISK			4,228
Rental charges for premises, equipment and facilities	21,601	17,936	25,528
Rental income for premises and facilities			19,475
Constructed capacity related cost of CDMA network			305,903
Revenue for leasing of transmission line capacity	12,557	10,717	24,822
Sales of CDMA handsets	6,129	23,484	
Purchase of CDMA handsets			14,655
Charges for the international gateway services	15,626	8,631	17,062
Leasing of satellite transmission capacity	35,153	26,400	14,152
Purchase of telecom cards	1,391,811	1,326,641	1,087,498
CDMA network capacity lease rental	1,299,286	3,909,148	6,588,926
Agency fee incurred for subscriber development			9,054
Agency fee incurred for procurement of telecommunications equipment	19,634	20,705	17,759
Rental for the PRC corporate office	7,598		
Sales of telecommunications equipment	16,088		

Detail description of the nature and terms of the related party transactions are set forth in Note 31 of this financial statement.

**Movement of significant provisions**

(a) Provision for deferred taxation valuation allowance was analyzed as follows:

	2002 RMB 000	2003 RMB 000	2004 RMB 000
Balance, beginning of year	107,299	107,299	
Provision for the year			
Disposal of New Guoxin		(107,299)	
Balance, end of year	107,299		

(b) Provision for doubtful debts was analyzed as follows:

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	2002 RMB 000	2003 RMB 000	2004 RMB 000
Balance, beginning of year	1,378,799	1,901,752	3,498,305
Provision for the year	1,392,909	2,019,470	2,191,780
Written-off for the year	(869,956)	(358,253)	(1,756,578)
Disposal of New Guoxin		(64,664)	
Balance, end of year	1,901,752	3,498,305	3,933,507

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(c) Other than those described in the above notes, there was no other significant movement of provisions for the years ended December 31, 2002, 2003 and 2004.

### Comprehensive Statements of income

According to SFAS No.130 Reporting of Comprehensive Income, certain items shown as components of common equity must be more prominently reported in a separate statement as components of comprehensive income. For the years ended December 31, 2002, 2003 and 2004, apart from the net income, there was no other comprehensive income which should be included in the statement of comprehensive income.

### Share option scheme

As disclosed in Note 30, information relating to the share options outstanding under the amended Pre-Global Offering Share Option Scheme and Share Option Scheme as of December 31, 2002, 2003 and 2004 is as follows:

	2002		2003		2004	
	Options outstanding	Weighted average exercise price HK\$	Options outstanding	Weighted average exercise price HK\$	Options outstanding	Weighted average exercise price HK\$
Outstanding, beginning of year	33,840,600	15.42	69,868,600	10.66	172,367,400	6.72
Granted during the year	36,028,000	6.18	105,956,000	4.30	113,322,000	5.92
Exercised during the year			(176,000)	6.18	(10,320,000)	5.85
Cancelled during the year			(3,281,200)	12.26	(1,306,000)	4.30
Outstanding, end of year	69,868,600	10.66	172,367,400	6.72	274,063,400	6.45

As of December 31, 2004, 87,611,360 share options (2002: 33,840,600 share options; 2003: 45,947,320 share options) were exercisable and the weighted average exercise price was HK\$8.69 (2002: HK\$15.42; 2003: HK\$12.65). Also, as of December 31, 2004, weighted average remaining contractual life of the options outstanding was approximately 4.9 years (2002: approximately 6.5 years; 2003: approximately 5.5 years).

The SFAS 123 method of accounting is based on several assumptions and should not be viewed as indicative of the operation of the Company in future periods. The estimated fair value of each option granted to the employees of the Group on the date of grant is estimated to be HK\$2.48, HK\$1.26 and HK\$1.54 for 2002, 2003 and 2004 respectively, using the Black-Scholes option pricing method with the assumptions as follows:

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	2002		2003		2004	
Estimated fair value (in HK\$)	HK\$	2.48	HK\$	1.26	HK\$	1.54
Risk free interest rate		3%		3%		3%
Expected life (in years)		5		3		3
Expected dividend yield		0%		2%		2%
Volatility		41%		35%		40%

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Had the compensation costs for the plans been determined based on the estimated fair value at the grant dates for awards under the plans consistent with the method of SFAS 123, the Group's net income and earnings per share under US GAAP on a pro forma basis for the years ended December 31, 2002, 2003 and 2004 are disclosed in the aforementioned Note (I).