



Financial Analysis

As China's economy and its telecommunication industry continued its steady and rapid growth, the Company achieved sound financial results in 2002 by providing superior services and improving network quality. The Company will continue to pursue technological advance and service innovation, and focus on the optimum allocation and integrated usage of telecommunications resources.

Management's Discussion and Analysis of Financial Condition and Results of Operations

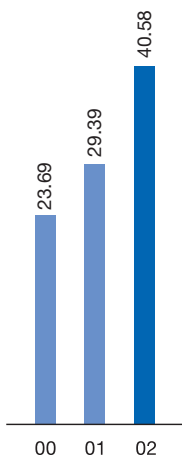
I. Overview

As China's economy grew steadily and as the telecommunications industry grew rapidly, we achieved sound financial results in 2002 by providing superior services and improving network quality. We continue to pursue technological advance and service innovation and focus on the optimum allocation and integrated usage of telecommunications resources.

Annual operating revenue increased by 38.0% from 2001 to RMB40.58 billion. Annual operating profit increased by 39.1% from 2001 to RMB7.32 billion and net income increased by 2.5% from 2001 to RMB4.57 billion. Earning per share was RMB0.364 increased by 2.5% compared with last year.

EBITDA increased by 37.4% from 2001 to RMB18.58 billion and EBITDA margin (EBITDA as a percentage of operating revenue), at 45.8%, remained comparable to 46.0% in 2001. Of the total EBITDA, EBITDA for the GSM Cellular Business increased by 42.9% from 2001 to RMB15.96 billion and EBITDA margin for this business increased from 52.4% in 2001 to 56.8% in 2002. Annual capital expenditure decreased by 39.4% from RMB31.25 billion in 2001 to RMB18.94 billion in 2002, resulting in a saving of 12.8% from RMB21.72 billion projected in the beginning of 2002. Free cash flow (net income + depreciation and amortisation - capital expenditure) improved significantly from RMB-18.53 billion in 2001 to RMB-3.12 billion in 2002.

Operating revenue from our Cellular Business maintained a high growth rate of 48.9% in 2002. Through the coordinated development of our GSM and CDMA networks, the operating profit from our GSM Cellular Business maintained a rapid growth rate of 36.0% to reach RMB7.64 billion in 2002. However, as our CDMA Cellular Business was in its initial phase, the operating loss in the CDMA Cellular Business for the second half of 2002 was RMB0.39 billion, which was smaller than the RMB0.60 billion loss recorded in the first half of 2002. Annual operating revenue and operating profit from our Long Distance, Data and Internet Business increased by 68.6% and 99.6%, respectively. We were able to significantly enhance our competitiveness by steadily increasing revenue generation and operational efficiency and further improving our free cash flow.

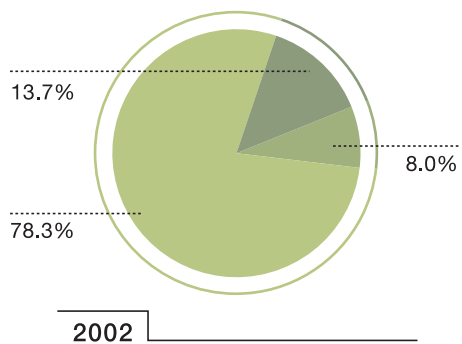
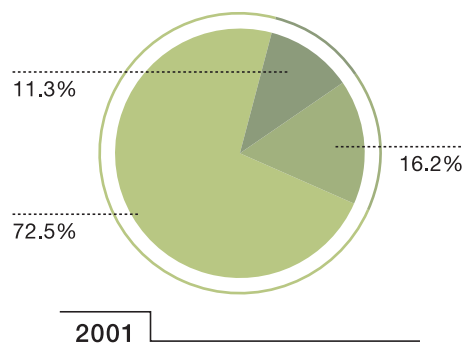
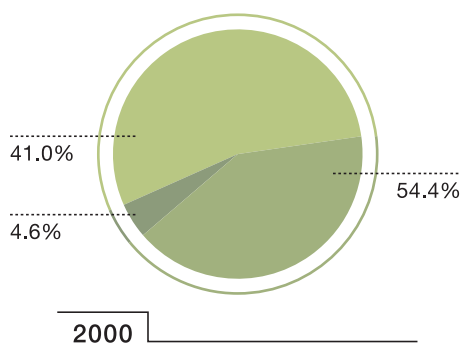


Total operating revenue
(RMB in billion)

II. Operating revenue

In 2002, revenue growth remained strong as we significantly strengthened our overall competitiveness. Our annual operating revenue increased by 38.0%, from RMB29.39 billion in 2001 to RMB40.58 billion in 2002.

Our operating revenue is mainly generated by the GSM and CDMA Cellular Business, the Long Distance, Data and Internet Business and the Paging Business. The table below sets forth the changes in revenue composition and their percentage of total operating revenue for each of our business segments for the years 2000, 2001 and 2002.



- Cellular
- Long distance, data and Internet
- Paging

Revenue structure

	2000		2001		2002	
	RMB in million	% of Total Operating Revenue	RMB in million	% of Total Operating Revenue	RMB in million	% of Total Operating Revenue
Total operating revenue						
Cellular	12,884	54.4%	21,326	72.5%	31,757	78.3%
GSM	12,884	54.4%	21,326	72.5%	28,109	69.3%
CDMA	—	—	—	—	3,648	9.0%
Long Distance, Data and Internet	1,096	4.6%	3,309	11.3%	5,578	13.7%
Long Distance	—	—	1,489	5.1%	2,779	6.8%
Data and Internet	—	—	1,820	6.2%	2,799	6.9%
Paging	9,712	41.0%	4,758	16.2%	3,241	8.0%
Total	23,692	100.0%	29,393	100.0%	40,577	100.0%

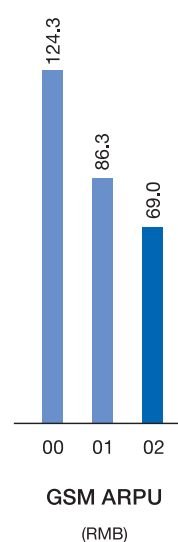
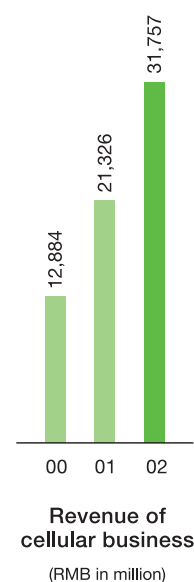
Operating revenue from our Cellular Business grew steadily and continued to be the major force behind the growth in our total operating revenue in 2002, with its share of total operating revenue increasing from 72.5% in 2001 to 78.3% in 2002. Operating revenue from our Long Distance, Data and Internet Business increased rapidly, increasing its share of total operating revenue from 11.3% in 2001 to 13.7% in 2002. In the same period, operating revenue from the Paging Business as a percentage of total operating revenue decreased from 16.2% in 2001 to 8.0% in 2002. The changes in our operating revenue composition reflect our focus on high growth businesses.

1. Steady growth of revenue in cellular business

As our cellular subscriber base and total cellular usage expanded substantially, the contribution to our total operating revenue by this business continued to grow. Operating revenue from the Cellular Business increased by 48.9%, from RMB21.33 billion in 2001 to RMB31.76 billion in 2002.

GSM cellular business

Revenue from the GSM Cellular Business increased by 31.8%, from RMB21.33 billion in 2001 to RMB28.11 billion in 2002, primarily due to the increase in our subscriber base and continued growth in total usage. As a result of continuing cellular penetration expansion, the increased number of low-usage subscribers among new subscribers and increasing market competition, the average revenue per user (“ARPU”) from this business dropped from RMB86.3 in 2001 to RMB69.0 in 2002. Post-paid ARPU decreased by RMB12.6, from RMB94.8 in 2001 to RMB82.2 in 2002, while pre-paid ARPU decreased by RMB9.3, from RMB63.4 in 2001 to RMB54.1 in 2002.



The table below sets forth the revenue composition of our GSM Cellular Business and their respective share of operating revenue from the GSM Cellular Business in the years 2000, 2001 and 2002.

	2000		2001		2002	
	RMB in million	As percentage of total	RMB in million	As percentage of Total	RMB in million	As percentage of total
Operating Revenue	12,884	100.0%	21,326	100.0%	28,109	100.0%
(1) Service Revenue	12,188	94.6%	20,505	96.2%	27,388	97.4%
Include: Usage Fee	8,212	63.7%	14,938	70.0%	20,275	72.1%
Monthly Fee	2,476	19.2%	3,660	17.2%	4,169	14.8%
Connection Fee	518	4.0%	205	1.0%	—	—
Interconnection Revenue	754	5.9%	1,262	5.9%	1,710	6.1%
Others	228	1.8%	440	2.1%	1,234	4.4%
(2) Sales of Telecommunications Products	696	5.4%	821	3.8%	721	2.6%

Due to the growth in total usage of our GSM cellular services and the increasing proportion of pre-paid cellular subscribers, usage fees for GSM cellular services, which reached RMB20.27 billion in 2002, increased from 72.8% of total service revenue from GSM Cellular Business in 2001 to 74.0% in 2002, while monthly fees for GSM cellular services decreased from 17.9% of total service revenue from GSM Cellular Business in 2001 to 15.2% in 2002. Interconnection revenue for GSM cellular services rose by 35.5%, from RMB1.26 billion in 2001 to RMB1.71 billion in 2002. The increase in our interconnection revenue is a result of the rapid growth in incoming traffic from other networks as cellular coverage and subscriber bases continued to expand.

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 by five-fold in 2002, from RMB0.14 billion in 2001 to RMB0.84 billion in 2002. Its share of total GSM service revenue increased from 0.7% in 2001 to 3.1% in 2002. Of the total revenue from GSM value-added cellular services, revenue from short messaging services increased 3.6 times from RMB0.10 billion in 2001 to RMB0.46 billion in 2002, increasing its share of the total GSM service revenue from 0.5% in 2001 to 1.7% in 2002. Revenue from value-added services contributed greatly to the increase of our total GSM cellular revenue and will continue to enhance our competitiveness in the GSM Cellular Business.

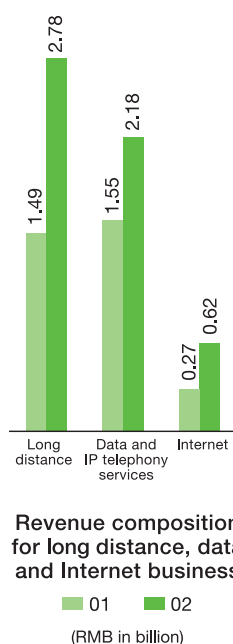
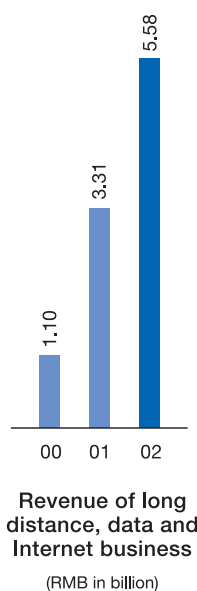
CDMA cellular business

We began to provide CDMA cellular services on a trial basis on January 8, 2002. Since then, the CDMA subscriber base has expanded rapidly as the market became more familiar with our CDMA services. The growth in our CDMA subscriber base boosted revenue from the CDMA Cellular Business. Operating revenue from our CDMA Cellular Business reached RMB3.65 billion in 2002, RMB3.19 billion of which was realised in the second half of 2002, an increase of 6.0 times from the first half of the year. Our CDMA marketing strategy, which seeks to differentiate such service from GSM services, has resulted in a rapid increase in the CDMA subscriber base, while successfully positioning the CDMA Business in the marketplace as a service that targets mid- and high-end customers and at the same time encompasses the mass market. ARPU for our CDMA Cellular Business reached RMB172.3 in 2002, RMB90.2 higher than the ARPU of RMB82.2 for GSM post-paid cellular services.

The table below sets forth the revenue composition of our CDMA Cellular Business and their respective share of operating revenue from CDMA Cellular Business in the first half of 2002 and for the year ended 2002.

	As of June 30 2002		As of December 31 2002	
	RMB in million	As percentage of total	RMB in million	As percentage of Total
Operating Revenue	454	100.0%	3,648	100.0%
(1) Service Revenue	354	78.0%	3,225	88.4%
Include: Usage Fee	244	53.7%	2,231	61.2%
Monthly Fee	86	18.9%	713	19.5%
Interconnection Revenue	18	4.0%	184	5.0%
Others	6	1.3%	97	2.7%
(2) Sales of Telecommunications Products	100	22.0%	423	11.6%

CDMA usage fees reached RMB2.23 billion in 2002, representing 69.2% of the service revenue from CDMA Cellular Business, while monthly fee from CDMA Cellular Business reached RMB0.71 billion, representing 22.1% of the service revenue from this business. Service revenue as a percentage of operating revenue from CDMA Cellular Business increased from 78.0% in the first half of 2002 to 88.4% for the year ended 2002. At the same time, revenue from sales of telecommunications products as a percentage of the operating revenue from CDMA Cellular Business decreased from 22.0% in the first half of 2002 to 11.6% for the year ended 2002.



2. Rapid growth in revenue from long distance, data and Internet business

Operating revenue from our Long Distance, Data and Internet Business reached RMB5.58 billion, an increase of 68.6% from 2001. The rapid growth in our Long Distance, Data and Internet Business demonstrates our positive long-term development outlook as an integrated telecommunications operator.

Revenue from PSTN long distance business

As our nationwide long distance coverage expanded and interconnection improved, revenue from our PSTN Long Distance Business increased from RMB1.49 billion in 2001 to RMB2.78 billion in 2002, an increase of 86.7%.

Revenue from data and IP telephony business

We fully leveraged our competitive advantages as an integrated telecommunications operator and, by using our uniform and advanced integrated data communication platform, we continued to effectively expand the usage of our IP telephony services (both domestic and international) while focusing on the development of high value-added data services such as FR, ATM and VPN services. At the same time, we actively pursued the development of integrated data, voice and video connection services. As a result of these efforts, revenue from Data and IP Telephony Business increased from RMB1.55 billion in 2001 to RMB2.18 billion in 2002, an increase of 40.6%.

Revenue from Internet business

During 2002, while we continued to develop dedicated and dial-up connection services, we also explored other markets according to demand, such as VPN/VPDN, IDC, in-bound and out-bound international roaming and actively developed mobile Internet businesses, such as "Ruyi" mailboxes, short message download and mobile payment. Revenue from our Internet Business increased from RMB0.27 billion in 2001 to RMB0.62 in 2002, an increase of 129.6%.

3. Continuing decline in revenue of paging business

During 2002, revenue from our Paging Business was RMB3.24 billion. Paging service revenue (excluding sales of paging-related telecommunications products) was RMB2.16 billion, representing a decline of 50.2% from RMB4.34 billion in 2001.

In accordance with the terms of a CDMA handset procurement framework agreement entered into by Unicom Guomai Communications Company Limited ("Guomai"), an indirect non-wholly-owned subsidiary of our company, and China United Telecommunications Corporation ("Unicom Group"), the controlling shareholder of our company, Unicom Group and our company have been purchasing CDMA handsets through Guomai in an effort to accelerate the growth of the CDMA handset market and CDMA services. This connected transaction resulted in an increase of revenue from sales of paging-related telecommunications products from RMB0.42 billion in 2001 to RMB1.08 billion in 2002.

III. Operating expenses

In 2002, in addition to boosting revenue, we also focused on tightening cost control through increasing operational efficiency from economies of scale and sharing of networks, businesses, subscribers and sales resources. Due to the increase in fixed costs, such as depreciation and amortisation, and sales expenditures in connection with the launch of our CDMA business, our operating expenses increased from RMB24.13 billion in 2001 to RMB33.25 billion in 2002, an increase of 37.8%. The percentage increase in operating expenses is slightly lower than the 38.0% increase in operating revenue. We will continue to focus on cost control and optimisation of our expense structure in order to ensure continued growth in earnings.

The table below illustrates the major expense items from 2000, 2001 and 2002 and their respective share of total operating revenue.

	2000		2001		2002	
	RMB in million	% of Total Revenue	RMB In million	% of Total Revenue	RMB in million	% of Total Revenue
Total Operating Expenses	18,470	78.0%	24,129	82.1%	33,253	82.0%
Leased lines and network capacities	1,158	4.9%	853	2.9%	1,583	3.9%
Interconnection charges	1,380	5.8%	2,073	7.1%	3,230	8.0%
Depreciation and amortisation	5,734	24.2%	8,262	28.1%	11,256	27.7%
Personnel	1,770	7.5%	2,487	8.5%	3,335	8.2%
Selling and marketing	2,492	10.5%	3,613	12.2%	5,981	14.8%
General, administrative and other expenses	3,743	15.8%	5,499	18.7%	5,632	13.9%
Cost of telecommunications products sold	2,193	9.3%	1,342	4.6%	2,236	5.5%

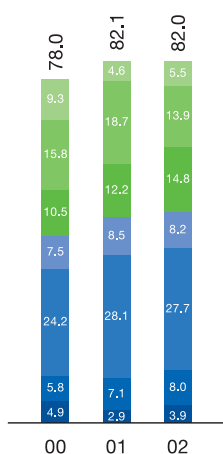
1. Leased lines and network capacities

We effectively reduced our leased line expenses by extending and optimising our nationwide fiber optic network and improving the allocation and coordination of network resources. However, as a result of the additional lease expenses incurred in connection with the lease of CDMA network capacities from Unicom Group since 2002, our leased line and network capacity expenses increased from RMB0.85 billion in 2001 to RMB1.58 billion in 2002. Their share of total operating expenses increased from 2.9% in 2001 to 3.9% in 2002. Of the total, CDMA network capacities lease expenses in 2002 were RMB0.89 billion.

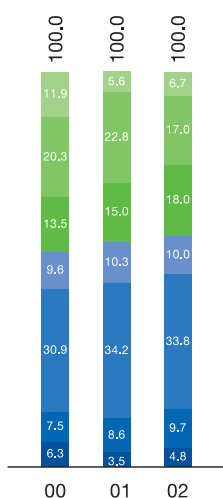
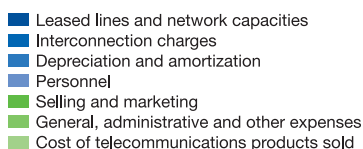
2. Interconnection charges

Due to the expansion of our network and the steady increases in our subscriber base and interconnection traffic, and along with the rapid growth in our interconnection revenue, interconnection charges increased from RMB2.07 billion in 2001 to RMB3.23 billion in 2002, representing an increase of 55.8%. In addition, interconnection charges in our Cellular Business and Long Distance, Data and Internet Business increased by 67.0% and 52.0%, respectively. As our various business segments continued to develop, interconnection charges as a percentage of total operating revenue also increased, from 7.1% in 2001 to 8.0% in 2002.

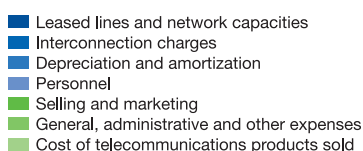
Analysis of operating expenses



Percentage of expenses to total revenue (%)



Composition of operating expenses (%)



3. Depreciation and amortisation

Depreciation and amortisation expenses increased by RMB3.0 billion from RMB8.26 billion in 2001 to RMB11.26 billion in 2002, representing an increase of 36.2%. The increase in depreciation and amortisation expenses constituted 32.9% of total increase in operating expenses, amounting to RMB9.12 billion, making this expense the biggest factor in the increase in operating expenses. Rising depreciation and amortisation expenses resulted from expanded network capacity in connection with the development of the GSM Cellular Business and further growth in assets scale. The share of depreciation and amortisation expenses as a percentage of total operating revenue decreased from 28.1% in 2001 to 27.7% in 2002.

4. Personnel

Despite the consistent and rapid growth of our various business segments, we emphasised reasonable allocation of human resources and fully utilised employee compensation as incentives. Through our compensation structure, which ties individual performance to our financial results, we are able to promote competition, retain and attract talented employees and make our company more dynamic, thereby steadily raising our productivity. As of the end of 2002, we employed 29,332 employees, a decrease of 2.1% from 29,973 at the end of 2001. Our personnel expenses were RMB3.34 billion in 2002, constituting 8.2% of total operating revenue, a decrease from 8.5% in 2001. In order to align the interest of our employees with that of our shareholders, we have set up an employee share option scheme. During 2002, total share options involving 36,028,000 shares in the company were granted under our share option scheme. For more information regarding our share option scheme, please refer to Report from the Directors and Note 30 to the Financial Statements.

5. Selling and marketing

Our major selling and marketing expenses include commissions, promotion and advertising expenses and amortisation of deferred customer acquisition costs of certain CDMA contractual subscribers. Selling and marketing expenses totaled RMB5.98 billion in 2002, an increase by RMB2.37 billion, or 65.5%, from RMB3.61 billion in 2001. Of the RMB9.12 billion in the increase in total operating expenses, the increase in selling and marketing expenses accounted for 26.0%, making it the second major factor in the increase in total operating expenses, after the increase in depreciation and amortisation expenses. Of the total selling and marketing expenses, RMB3.66 billion were commissions (an increase of 27.1% from 2001), RMB0.98 billion were promotion and advertising expenses (an increase of 24.1% from 2001), and RMB1.39 billion were amortisation expenses related to the deferred customer acquisition costs of certain CDMA contractual subscribers. Selling and marketing expenses as a percentage of operating revenue increased from 12.2% in 2001 to 14.8% in 2002, mainly due to the continued growth in the customer base of our various business segments,

which consequently increased our commission payments to sales agents and marketing expenditures in connection with the promotion for our CDMA Cellular Business.

6. General, administrative and other expenses

As a result of our strict control of administrative expenses, our expenses in this category totaled RMB5.63 billion in 2002, an increase of only 2.4% from RMB5.50 billion in 2001. General, administrative and other expenses as a percentage of total operating revenue decreased from 18.7% in 2001 to 13.9% in 2002. Due to increasing market competition, doubtful debts have kept pace with the growth in revenue. In 2002, the provision for doubtful debts was RMB0.97 billion, an increase of 79.7% from 2001. Provision for doubtful debts as a percentage of service revenue has increased, from 1.9% in 2001 to 2.5% in 2002. This increase is the main reason for the increase in our general, administrative and other expenses.

7. Cost of telecommunications products sold

The cost of telecommunications products sold increased by 66.6%, from RMB1.34 billion in 2001 to RMB2.24 billion in 2002, mainly due to our entrance into the CDMA handset sales market in order to boost the CDMA market.

IV. Net profit

1. Operating profit

In 2002, our operating revenue increased by 38.0% and our operating expenses increased by 37.8%. The rapid rise in operating revenue and the effective control of operating expenses resulted in an increase in operating profit from RMB5.26 billion in 2001 to RMB7.32 billion in 2002, an increase of 39.1%. The operating margin also changed from 17.9% in 2001 to 18.0% in 2002.

During 2002, operating profit from our GSM Cellular Business increased from RMB5.61 billion in 2001 to RMB7.64 billion, an increase of 36.0%. In the same period, although operating loss from our CDMA Cellular Business changed from RMB0.60 billion for the first six months of 2002 to RMB0.99 billion for the year ended 2002, our loss in the second half of 2002 in the amount of RMB0.39 billion, was significantly lower than our loss in the first half of 2002. Operating profit from our Long Distance, Data and Internet Business increased from RMB0.70 billion in 2001 to RMB1.40 billion in 2002, representing an increase of 99.6%. Operating profit from our Long Distance alone increased from RMB0.97 billion in 2001 to RMB1.02 billion in 2002 and operating profit from our Data and Internet Business increased from a loss of RMB0.27 billion in 2001 to a profit of RMB0.38 billion in 2002. Operating loss from our Paging Business declined from RMB0.97 billion in 2001 to RMB0.62 billion in 2002.



2. Financial income and expenses

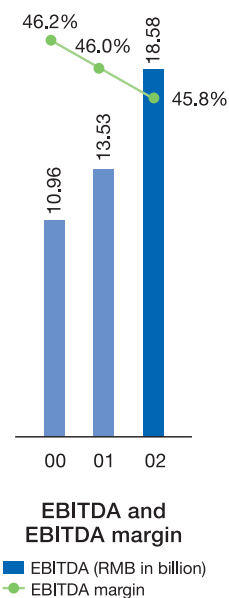
Our financial income decreased from RMB2.10 billion in 2001 to RMB0.47 billion in 2002, mainly due to the decline in the interest income from our deposits at bank, which were the proceeds originated from our initial public offering, having been utilised for network construction in mainland China. Our financial expenses in 2002 were RMB1.47 billion, a decrease by 23.1% from RMB1.92 billion in 2001. The above factors result in a net financial expense of RMB1.00 billion in 2002, as compared to a net financial income of RMB0.18 billion in 2001.

3. Income tax

Our income tax increased from RMB1.04 billion in 2001 to RMB1.75 billion in 2002. Our effective tax rates in 2001 and 2002 were 19.1% and 27.8%, respectively. The higher effective tax rate in 2002 was due to the fact that the interest on the proceeds from our initial public offering, which were placed on deposit in Hong Kong, was not subject to income tax in previous years.

4. Net profit

During 2002, our CDMA Cellular Business incurred losses because it was still in its initial phases. However, our net profit grew by 2.5%, from RMB4.46 billion in 2001 to RMB4.57 billion in 2002, largely because of the sound development of our GSM Cellular Business and our Long Distance, Data and Internet Business. Earnings per share rose by 2.5%, from RMB0.355 in 2001 to RMB0.364 in 2002.



V. Adjusted EBITDA (Note 1)

Our EBITDA increased by 37.4% from 2001 to RMB18.58 billion in 2002, demonstrating a sound growth trend. EBITDA margin (EBITDA as a percentage of operating revenue) maintained a relative high level of 45.8%. This reflects the further optimisation of our revenue structure and the result of our improved internal management and control of operating expenses.

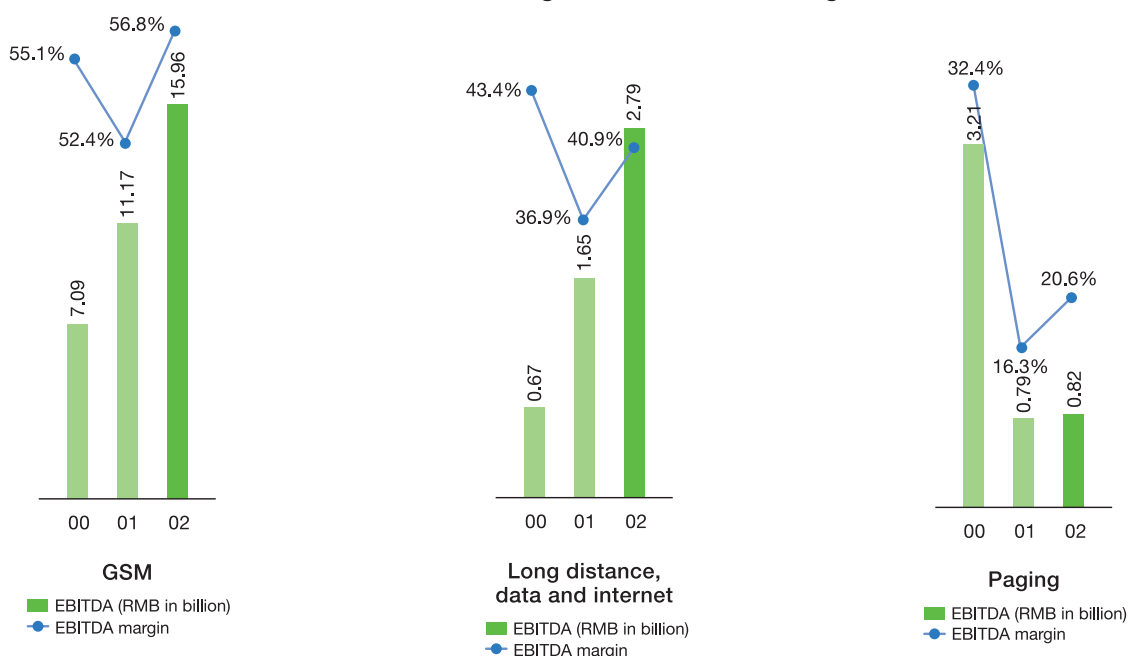
EBITDA for the GSM Cellular Business rose by 42.9% from 2001 to RMB15.96 billion in 2002. EBITDA margin for the GSM Cellular Business increased from 52.4% in 2001 to 56.8% in 2002. The rise in EBITDA margin for the GSM Cellular Business was mainly due to the rapid growth in revenue, effective control of expenses and decline in cash expenses as a percentage of operating revenue. EBITDA for the CDMA Cellular Business was RMB-0.89 billion in 2002 largely because this business is still in its initial phase and is conducted through the lease of the CDMA network capacity.

EBITDA for the Long Distance, Data and Internet Business grew by 68.9% from 2001 to RMB2.79 billion in 2002. EBITDA margin for this business rose from 36.9% in 2001 to 40.9% in 2002, principally due to rapid growth in operating revenue from this business and declining operating expenses as a percentage of operating revenue.

EBITDA for the Paging Business increased by 4.0%, from RMB0.79 billion in 2001 to RMB0.82 billion in 2002. EBITDA margin also rose from 16.3% in 2001 to 20.6% in 2002.

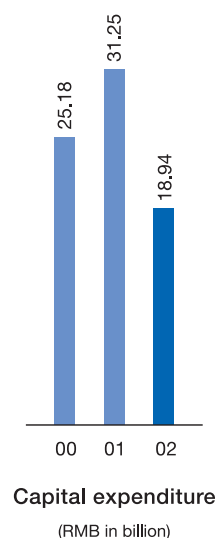
Note (1): Adjusted EBITDA represents net profit before interest income, finance costs, net other (expense) income, taxation, depreciation and amortisation, loss arising from the terminations of CCF Arrangements and minority interests.

EBITDA and EBITDA margin for each business segment



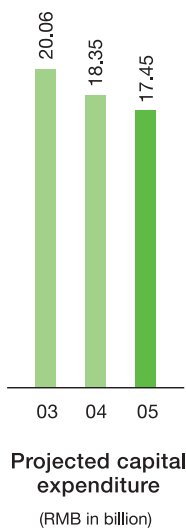
VI. Capital expenditure and free cash flow

During 2002, while we focused on the rapid development of our various businesses, we also emphasised the comprehensive management and control of projected capital expenditures and projects and endeavored to lower the unit construction cost by improving our bidding process. Our efforts were effective in realising in savings in our capital expenditures. Capital expenditure for our various businesses totaled RMB18.94 billion in 2002. Capital expenditures attributable to the GSM Cellular Business, the Long Distance, Data and Internet Business, the Paging business, the transmission network and other projects were RMB7.90 billion, RMB1.94 billion, RMB0.21 billion, RMB4.65 billion and RMB4.24 billion, respectively. Expenditures for other projects were mainly related to the set up of the billing, customer service and information system, office building, operational maintenance and research and development.



The following table sets forth the capital expenditure in each business segment for 2000, 2001 and 2002 and our planned capital expenditure for 2003 to 2005.

	2000	2001	Year Ended December 31			2004	2005	
			2002	2003				
	(RMB in billion)							
				Total	CUCL	Unicom New Century		
Total	25.18	31.25	18.94	20.06	17.98	2.08	18.35	17.45
Cellular	17.28	20.78	7.90	5.11	3.48	1.63	4.16	5.16
Long Distance, Data and Internet	5.71	7.33	1.94	2.49	2.49	—	2.00	2.00
Paging	2.19	0.55	0.21	0.11	0.11	—	0.10	0.09
Transmission network	—	—	4.65	6.24	6.24	—	6.00	5.00
Others	—	2.59	4.24	6.11	5.66	0.45	6.09	5.20



Note 1: The capital expenditures for 2000 to 2002 reflect capital expenditures for our Cellular Business in 12 provinces, municipalities and autonomous regions operated by CUCL; while capital expenditures for 2003 to 2005 represent 21 provinces, municipalities and autonomous regions, including 9 provinces, municipalities and autonomous regions acquired at the end of 2002.

Note 2: Investment in transmission network refers to investment in the inter-province and intra-province backbone transmission network, the local network and the access network.

Note 3: Other investments represent investment in telecom equipment buildings, supporting systems and miscellaneous items.

Our capital expenditure in 2002 declined by 39.4% from that in 2001. Free cash flow, i.e. net income plus depreciation and amortisation minus capital expenditure, correspondingly improved from RMB-18.53 billion in 2001 to RMB-3.12 billion in 2002.

Projected capital expenditures for 2003 is RMB20.06 billion (RMB17.98 billion for the Cellular Business in the original 12 provinces, municipalities and autonomous regions and RMB2.08 billion for the Cellular Business in the additional nine provinces, municipalities and autonomous regions acquired in 2002), which will mainly focus on obtaining positive free cash flow through the improvement of the GSM network, value-added business and supporting systems, supporting infrastructure for services, information systems and certain targeted areas with high investment returns. We principally rely on cash generated by operations, capital market financings and appropriate bank loans for our capital expenditure needs.

VII. Acquisition and effects of adjustments

In December 2002, we acquired for cash the GSM cellular assets and businesses and CDMA cellular businesses of Unicom New Century in the following nine provinces, municipalities and autonomous regions: Jilin, Heilongjiang, Jiangxi, Henan, Guangxi, Chongqing, Sichuan, Shaanxi and Xinjiang. We are pleased with the operating results of the Cellular Business in these areas in 2002. Operating revenue of the acquired Cellular Business was RMB11.70 billion in 2002, 69.3% higher than the RMB6.91 billion in 2001, and net profit was RMB0.62 billion, 92.7% higher than the RMB0.32 billion in 2001. Taking into account the operating results of the acquired Cellular Business, the Unaudited Pro Forma combined revenue was RMB50.24 billion in 2002, representing an increase of 41.3% from 2001, the Pro Forma EBITDA was RMB23.09 billion in 2002, representing an increase of 38.7% and the Pro Forma combined net profit was RMB4.99 billion in 2002, representing an increase of 10.5% from 2001.

The following table set forth the Unaudited Pro Forma information combining the results of the Group and Unicom New Century ("the Combined Group") for the years ended 31 December 2002 and 2001.

	Unaudited pro forma information of the combined group For the year ended	
	2002 RMB'000	2001 RMB'000
Operating revenue (Turnover):		
GSM Business	36,689,518	26,711,929
CDMA Business	4,345,756	—
Data and Internet Business	2,156,933	1,224,918
Long Distance Business	2,620,811	1,748,184
Paging Business	2,042,465	4,333,967
Total service revenue	47,855,483	34,018,998
Sales of telecommunications products	2,388,385	1,532,772
Total revenue	50,243,868	35,551,770
Operating expenses:		
Leased lines and network capacities	(2,020,833)	(989,907)
Interconnection charges	(3,754,488)	(2,407,600)
Depreciation and amortisation	(14,348,249)	(10,299,148)
Personnel	(4,006,412)	(2,913,920)
Selling and marketing	(7,851,008)	(4,376,640)
General, administrative and other expenses	(7,087,199)	(6,493,528)
Cost of telecommunications products sold	(2,433,276)	(1,724,268)
Total operating expenses	(41,501,465)	(29,205,011)
Operating profit	8,742,403	6,346,759
Finance costs	(1,918,189)	(639,186)
Other (expenses) income, net	(21,193)	15,940
Taxation	(1,828,064)	(1,242,338)
Minority interests	15,252	35,310
Profit attributable to shareholders	4,990,209	4,516,485

Notes:

- The Unaudited Pro Forma information presented above is prepared on the assumptions that the acquisition of Unicom New Century had been completed since 1 January 2001 and 1 January 2002, respectively, as if Unicom New Century was always part of the Group.

2. Basis and assumptions used for presentation and adjustments for the Unaudited Pro Forma information of the Combined Group should be read in conjunction with Appendix IV “Financial Information of the Group” as set forth in the Circular “Connected transactions and renewal of waiver for existing connected transactions” of the Company issued on 29 November 2002.

The following table sets forth our asset-debt structure as of 31 December 2001 and as of 31 December 2002, before and after the acquisition of the cellular businesses in the nine provinces, municipalities and autonomous regions.

	As of December 31		
	2001	2002 Before acquisition (RMB in million)	2002 After acquisition
Cash	43,335	18,151	19,259
Total assets	127,905	122,583	149,223
Total debts	65,394	55,770	82,409
Include: Short-term interest-bearing debt	7,933	11,574	15,330
Long-term interest-bearing debt	36,337	22,221	37,686
Minority interests	829	566	566
Shareholders' equity	61,681	66,247	66,247
Asset-to-debt ratio	51.1%	45.5%	55.2%

As of December 31, 2002, the Cellular Businesses of the nine provinces, municipalities and autonomous regions acquired by our company accounted for RMB30.01 billion in assets and RMB27.46 billion in liabilities. The asset-to-debt ratio for these businesses was 91.5%. After the acquisition, our consolidated assets increased from RMB127.90 billion as of December 31, 2001 to RMB149.22 billion as of December 31, 2002 and our consolidated liabilities increased from RMB65.39 billion as of December 31, 2001 to RMB82.41 billion as of December 31, 2002. Correspondingly, our asset-to-debt ratio after the acquisition rose from 51.1% as of the end of 2001 to 55.2% as of the end of 2002. Excluding the effects of this acquisition, our total assets as of the end of 2002 would have been RMB122.58 billion, total liabilities would have been RMB55.77 billion and the asset-to-debt ratio would have been 45.5%.

Our debt to capitalisation ratio, i.e. (long-term and short-term interest-bearing debts + minority shareholders' equity)/(long-term and short-term interest-bearing debts + minority shareholders' equity + shareholders' equity) as of December 31, 2002 was 44.7%, 2.5% higher than the 42.2% in 2001. The higher debt to capitalisation ratio results from the additional debt taken after the above-mentioned acquisition. As of December 31, 2002, we had RMB19.26 billion in cash, of which 35.3% was in RMB, 49.3% was in U.S. dollars and 15.4% was in Hong Kong dollars. As of December 31, 2002, our short-term and long-term bank loans totaled RMB53.02 billion, 19.8% higher than that of 2001. All bank loans are denominated in RMB with fixed interest rates, with annual interest rates ranging from 4.54% to 7.65%.

We anticipate that, with the addition of the Cellular Business of the nine provinces, municipalities and autonomous regions, our position and competitiveness in the domestic cellular telecommunications market in Mainland China will be further enhanced, which will in turn allow our company to realise greater efficiencies from the scale of our networks and increase investment returns to our shareholders.

Except for the acquisition of Unicom New Century described above, there were no significant investment held by the Company for the year end 31 December 2002.

VIII. Critical accounting policies

1. Deferral of CDMA customer acquisition costs

We have started to operate the CDMA business since the beginning of 2002. In order to accelerate the development of the CDMA business and subscriber growth, we have offered certain promotional packages since the second half of the year. As part of the contractual arrangements with certain CDMA contractual subscribers under these special promotional packages, CDMA mobile phone handsets were provided to these CDMA subscribers for their use at no additional cost during the specified contract periods, ranging from 6 months to 2 years. In return, 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 also required under the contract to (1) prepay certain non-refundable amounts of service fees or deposits, (2) maintain a restricted bank deposit in 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 subscribers' non-performance of related contract obligations.

We consider the costs of the handsets provided to subscribers under these promotional packages as part of the deferred customer acquisition costs for the development of these new CDMA contractual subscribers. Such customer acquisition costs are deferred, to the extent recoverable, and amortised over the contract periods to match with the minimum contract spending amount. The details of the amortisation charges for the year and carrying amounts of such deferred customer acquisition costs as at year-end under different types of promotional packages, separately shown for CUCL and Unicom New Century, are set out below:

(Expressed in millions of Renminbi)

Details of promotion packages launched by CUCL

	Promotion Packages							Total
	Service fee received in advance	Deposit received	Bank deposit (Restricted)	Bank deposit (Non-Restricted)	Guaranteed by government	Guaranteed by corporations	Guaranteed by individuals	
Deferred customer acquisition costs of CDMA contractual subscribers amortised in 2002	490	50	40	20	30	420	340	1,390
Balance of deferred customer acquisition costs of CDMA contractual subscribers amortised in 2002 as of 31 December 2002	1,870	90	130	90	150	1,320	520	4,170

(As of 31 December 2002, there were approximately RMB1,985 million of service fee received in advance, RMB102 million of deposit received and RMB443 million of restricted bank deposit for purposes of ensuring subscriber usage commitments, and thus recovery of handset costs under the above promotional packages.)

Details of promotion packages launched by Unicom New Century

	Promotion Packages							Total
	Service fee received in advance	Deposit received	Bank deposit (Restricted)	Bank deposit (Non-Restricted)	Guaranteed by government	Guaranteed by corporations	Guaranteed by individuals	
Deferred customer acquisition costs of CDMA contractual subscriber amortised in 2002	210	50	80	–	–	90	310	740
Balance of deferred customer acquisition costs of CDMA contractual subscriber as of December 31, 02	670	70	370	–	–	580	130	1,820

(As of December 31, 2002, there were approximately RMB640 million of service fee received in advance, RMB48 million of deposit received and RMB621 million of restricted bank deposit for purposes of ensuring subscriber usage commitments, and thus recovery of handset costs under the above promotional packages.)

We determined our accounting policy of deferring customer acquisition costs of certain CDMA contractual subscribers after a careful evaluation of our specific facts and circumstances, and believe that the capitalisation of such costs appropriately matches the future contractual revenues due to (1) the historically high ARPUs and low churn, default or bad debt rate of these subscribers in 2002; (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, restricted deposits, and guarantees received, as well as penalty clauses imposed on subscribers.

Therefore, we believe that the handset costs are recoverable from future revenue to be derived from these promotional packages, and the capitalisation and amortisation of these customer acquisition costs of certain CDMA contractual subscribers to match with future revenue are appropriate. Furthermore, we continuously assess and evaluate the recoverability of these deferred costs, based on the historical subscriber churn rate and the estimated default rate. Based on our current assessment and evaluation, we believe that no significant recoverability problem existed on the carrying amounts of deferred customer acquisition costs as of 31 December 2002.

Since we made the above recoverability assessments based on the current legal and operating environment in terms of the subscribers' contract performance and our best available information, the actual results may differ from the current trends or estimates. If the situation changes significantly in the future, we may need to write down certain non-recoverable deferred customer acquisition costs of certain CDMA contractual subscribers based on future conditions.

2. The leasing of CDMA network capacity

We have entered into a CDMA network capacity lease agreement ("CDMA Lease Agreement") with Unicom Group and Unicom New Horizon. Pursuant to the CDMA Lease Agreement, Unicom New Horizon has agreed to lease the capacity of the CDMA network to us covering the 9 provinces of Guangdong, Jiangsu, Zhejiang, Fujian, Liaoning, Shandong, Anhui, Hebei, Hubei and the 3 municipalities of Beijing, Shanghai and Tianjin. This lease became effective on 8 January 2002.

In addition, we have acquired all the equity interests of Unicom New Century (which operates cellular businesses in another 8 provinces and 1 municipality in the PRC) on 31 December 2002. Unicom New Century has also entered into a CDMA lease agreement with Unicom Group and Unicom New Horizon with similar terms and conditions.

We are required to assess the appropriate lease classification related to these CDMA network assets at the inception of the lease term in order to ascertain the proper accounting for each reporting period. Factors and related implications we have considered include whether we have the risks and rewards of ownership of these assets. Furthermore, we have considered whether the existence of the purchase option and the annual renewal options, combined with the related economic penalties, would have caused us to take on the risks and rewards similar to those that an owner of these assets would bear.

Unicom New 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 only bear the operation risks of CDMA business during any leasing periods and are free from any ownership risks of the CDMA network. According to the terms of the CDMA Lease Agreement, our initial lease period is only one year, which is renewable for one-year terms at our own option, and there are no required minimum lease period nor lease payments. In addition, we have the option to determine whether we will continue the lease, and if we decided to renew, how much capacity to lease. We also have the option to decide whether we would exercise the purchase option based on the future operating performance and market environment of the CDMA business. Accordingly, even if the CDMA business turns out to be unsuccessful, we will have no obligation to continue the lease of the CDMA network capacity or to exercise the purchase option.

Under Hong Kong Generally Accepted Accounting Principles, the classification of leases is dependent on whether the risks and rewards of ownership of assets rest substantially with the lessor or the lessee. Leases that substantially transfer to the lessee all the risks and rewards of ownership of assets are accounted for as finance leases; and leases where substantially all the risks and rewards of ownership of assets remain with the lessor are accounted for as operating leases.

At the inception of the CDMA Lease Agreement, there was a high degree of uncertainty related to the market condition and operating results of the CDMA business. It remains highly uncertain that we will continue to lease the network in the future. We are unable to estimate the future network capacity we will lease. We are also unable to determine whether we will eventually exercise the purchase option. Since the risks associated with the ownership of assets substantially remain with Unicom Group and Unicom New Horizon, we have accounted for this lease of CDMA network capacity as an operating lease, so as to reflect the respective rights and obligations of the parties to this lease arrangement. Upon renewal of a new lease term, we will reassess the appropriate classification based on the relevant facts and circumstances available at that time.

3. 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, goodwill, investment in securities and investments in associates 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 recognised in the income statement. 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 whether an impairment assessment is performed as at any given balance sheet date.

In 2001, our Paging Business in certain provinces has experienced a decline in revenue and an increase in loss of subscribers and thus leading to an operating loss. As a result, the carrying amounts of certain assets (including telecommunications equipment and goodwill related to the business) of other paging businesses exceeded their values in use, and provision for impairment loss of these assets has been made accordingly to properly reflect their recoverable amounts. Value in use is determined based on the expected discounted future net cash flows generated from the continuing use of the paging assets. In estimating the discounted future net cash flows, we have made certain key assumptions, including the appropriate discount rate adopted, the period covered by the cash flow forecast, the impacts of the continuous decline of traditional paging business, the incremental cash flows from new paging businesses and the adoption of cost reduction plans. All these assumptions and estimations are based on historical trends adjusted for current market situation (including the physical conditions of these assets) and our forecast of the future development of new paging businesses, commensurate with the risks involved. Consequently, based on these assumptions and our best estimates, the Group recorded impairment losses of assets for the year ended 31 December 2001 amounting to approximately RMB633 million.

In 2002, despite the fact that the revenue and subscriber number of the Paging Business continued to decline, it has managed to maintain net cash inflows from operations. Our Paging Business did not improve significantly since the traditional paging business was still declining, whereas the new value-added paging businesses were at their initial development stage, and therefore, the real value of the Paging Business has yet to be realised. Nevertheless, we are confident about the future prospects of these new value-added paging businesses, and we believe that they can generate sufficient future economic benefits to recover the carrying values of existing paging assets. Consequently, we believe that it is not necessary to make any impairment provision for 2002.

Since we made our estimates based on assumptions described above, our estimates may differ from actual developments in the future. As a result, to the extent our assumptions and estimations differ significantly from actual events and circumstances, we may need to make additional impairment provisions in future.

4. Provision for doubtful debts

Accounts receivables are stated at cost less provision for doubtful debts. We evaluate specific accounts where there are indications that the receivable may be doubtful or is not collectible. We record a specific provision based on 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 general 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, subscriber creditability and collection trends. For the Cellular, Data, Internet and Long Distance telecommunication services, we make a full provision for receivables aged over 3 months, which is consistent with our credit policy with respect to relevant subscribers. Since the Paging Business mainly receives fees in advance and only limited revenue is collected from sales agents, 100% provision is made for receivable from sales agents aged over 1 month.

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

5. Accounting for income taxes and deferred tax

Income tax is provided based on income before tax for statutory financial reporting purposes, adjusted for income and expense item 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 under the liability method, at the current tax rate, in respect of temporary differences between income as computed for taxation purposes and income as stated in our income statement, except where it is considered probable that no liability will arise or no asset will crystallise in the foreseeable future. A deferred tax asset is not recognised unless we expect related benefits are expected to crystallise in the foreseeable future.

In the preparation of our financial statements, we estimate our income tax provision in accordance with the prevailing tax rules and regulations in each location or jurisdiction in which our Group operates. This process involves an estimation made by us about our current tax exposure together with the 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. In determining the tax provisions, we have considered the prevailing tax rules, regulations and approvals obtained from relevant tax authorities. Accordingly, we record an adequate provision based on our best estimate. 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 CCF joint ventures, loss arising from terminations of CCF arrangements, income tax on advances from subscribers and prepaid telephone cards, impairment provisions for plant, property and equipment and other long-lived assets, provisions for doubtful debts and write-down of inventory to net realisable value, additional depreciation deductible for tax purpose, etc. Owing to the effects of these temporary differences on income tax, we have recorded deferred tax assets amounting to RMB1.33 billion and RMB1.58 billion as of 31 December 2002 and 2001, respectively. Deferred tax assets are recognised based on our estimates that they will be recovered from taxable income from the 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 best current best estimates. In the event that future tax rules and regulations or related circumstances change, adjustments to current and deferred taxes may be necessary.

IX. Others

1. Liquidity and capital resources

As of 31 December 2002, we had a net current liabilities (current assets minus current liabilities) of RMB13.19 billion, compared to a net current assets of RMB21.04 billion at the end of 2001. The decrease in working capital mainly resulted from (i) the repayment of long-term bank loans by utilising our short-term bank deposits, and (ii) cash paid out for the acquisition of Unicom New Century at year-end. Taking into account available financing and continuous net cash inflows from our operating results, we believe that we have sufficient working capital for our present requirements.

2. Charged on assets

As of 31 December 2002, no property, plant and equipment were pledged to banks as loan security.

3. Contingent liability

For the year ended 31 December 2002, Unicom Guomai Communications Corporation Limited provided guarantees for bank loans borrowed by Shanghai Telecommunications Company Limited amounted to approximately US\$23.48 million. All these bank loans were not yet due as of 31 December 2002.