

Chief Executive Officer's Statement



Dear Shareholders,

I have great pleasure in presenting our operating results for 2005, which represent an outstanding performance. Efforts we made in streamlining our management have produced remarkable results. In 2005, the Company has experienced a second straight year of substantial improvements in operational efficiency, coupled with solid growth in both net profits and free cash flow. While the traditional fixed-line business remained healthy, our growth businesses including broadband and value-added services grew rapidly, and contributed a fast increasing share of total revenues. "CNC Connected", a service targeted to business customers, has helped to build market share and strengthen our competitive edge in the segment for business customers and key accounts. We have been able to demonstrate our knowledge of the needs of this segment, by integrating domestic and international resources and by offering customized solutions.

In 2005, our efforts at external growth also paid off with acquisitions of major telecom assets and businesses in the provinces and regions of Heilongjiang, Jilin, Neimenggu and Shanxi. These enhanced competitiveness as well as value to our shareholders.

1. Robust Financial Performance

In 2005, the Company experienced sustained growth in revenues and operational efficiency, due to vigorous business expansion as well as the imposition of strict cost controls. According to our financial statements prepared by the merger accounting under generally accepted accounting principles in Hong Kong and on the basis that all assets and businesses acquired in 2004 were under the Company's control, revenues in 2005 were RMB87,232 million, including amortization of upfront connection fees of RMB3,405 million. If we exclude upfront connection fees, revenue was RMB83,827 million, a year-on-year increase of 5.9%; EBITDA was RMB42,149 million, up 9.9% year-on-year; EBITDA margin improved from 48.5% last year to 50.3%; Net profits were RMB10,483 million, while profit margin was 12.5%. Operational efficiency was significantly improved.

In 2005, the Company continued to implement strict control over capital expenditures in order to achieve profitable growth. CAPEX was reduced by 2.5% in 2005, to RMB27,562 million. CAPEX as a percentage of total revenue (excluding upfront connection fees) was also lower than the previous year, falling by 2.8 percentage points to 32.9% in 2005. In 2005, we maintained growth in free cash flow, which amounted to RMB5,995 million, up 11.1% from last year.

As of the end of 2005, total interest-bearing debts declined modestly by 0.6% to RMB82,130 million. However, the interest coverage ratio rose from 8.9 times of the last year to 10.9 times, reflecting an improved ability to repay debts and interests.



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2. Traditional Fixed-line Business: Stable Growth

In 2005, we effectively mitigated the impact of mobile substitution on the traditional fixed-line business through service improvements, reform of marketing and sales channels, and the introduction of new services and service bundling. Each of these contributed to maintaining healthy growth in this business segment. By the end of 2005, the number of fixed-line telephone subscribers reached 115.33 million, representing growth of 6.7%. This included 27.34 million PHS subscribers, an increase of 23.6% over the end of 2004. Sustained high growth in the PHS business remained the key driver for the expansion of the fixed-line telephone subscriber base. In 2005, local voice services maintained stable revenue in contrast to revenue from long distance voice services, which continued to decline. Owing to substantial revenue growth in interconnection services during the year, overall revenues from the traditional fixed-line voice business were stable. Besides, average subscriber acquisition cost for PHS business significantly declined in 2005, down to RMB100 from RMB255 in 2004. Meanwhile, improvement in services and development of new products helped to control the downward trend in Average Revenue per Unit (ARPU) of local telephone services in the second half of 2005, establishing a solid foundation for healthy development in 2006.

3. High Growth Businesses: Sharp Expansion

Broadband services and value-added services are playing a pivotal role in our transformation into a “broadband communications and multi-media services provider.” Both experienced rapid growth in 2005. They have become the engine for sustainable and profitable growth of the Company. In 2005, the number of broadband subscribers increased by 35.1% to 11.48 million. Revenues from broadband and Internet businesses grew by 34.6% to RMB8,350 million contributing 10.0% of total revenue (excluding upfront connection fees).

In the second half of 2005, we invested heavily in broadband content and application services and undertook an integration of related resources in this sector and internal broadband resources in order to prepare for the development of “video-oriented” broadband content and application services in the future. During the year, the Company also launched trial IPTV services with our partners in Harbin, Heilongjiang Province. The growth of application-based businesses and intensified marketing efforts devoted to business customers in 2005 stabilized and even tilt upward ARPU in the broadband business from the second half of 2005. Subject to regulatory approval, we believe that growth in IPTV and other broadband application-based services will further promote expansion of our broadband businesses in the future.

In 2005, our value-added services recorded strong growth. Revenues from value-added services were RMB4,000 million, representing year-on-year growth of 33.6%. The increase was due in large part to the launch of value-added services for PHS subscribers. The volume of PHS short messages reached 6,780 million while the number of Personalized Ring subscribers reached 6.814 million, up 241% and 981% respectively from the previous year.

Thanks to strong revenue growth from broadband and value-added services, the Company was able to achieve a more balanced revenue structure. The category of “High Growth Business Revenues,” which includes revenue from broadband services, value-added services, and business and data communications services, increased 24.5% over the previous year, while its contribution to total revenue (excluding upfront connection fees) rose by 3.5 percentage points to 23.0%.

In relation to the business customers' market, the Company re-launched the “CNC Connected” brand in 2005, providing integrated solutions to business customers. Due to the competitive edge we have due to our geographical location in the capital city, as well as our rich international network resources, we were able to further consolidate our lead in the business market.



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4. Management Innovations Leading to Prominent Effect

We relentlessly pursued our objective of enhancing operational efficiency by closely monitoring the best practices in the sector and establishing first class operation management systems. In 2005, the Company built on the management advantages of our "Headquarters–Branches" structure. We continued to centralize management in terms of financial management, capital controls, human resources, procurement, information systems, and network operations, as well as maintenance and development. The centralization of operational procedures and resources management significantly enhanced operational efficiency. In 2005, operating expenses accounted for 79.6% of total revenue(excluding upfront connection fees), a decrease of 3.8 percentage points from 2004. The proportion of various costs to total revenues generally recorded decreases.

Management innovations helped to improve operational efficiency. At the same time, the Company's ERP and internal control projects are in progress as planned.

In 2005, the Company was ranked No. 1 in the "Integrated Satisfaction Index Survey on Telecommunication Customer Services," sponsored by The Ministry of Information Industry. The Company has maintained this ranking for four consecutive years.

5. Future Outlook

Looking ahead, we expect market competition to intensify across the telecommunications sector. However, we also see abundant opportunities arising from changes in the market environment and regulatory policies, which will help us achieve our strategic goal of transformation into a "broadband communications and multi-media services provider." In 2006, the Company will focus on the following key operating strategies:

- Traditional fixed-line business: Our strategy is to strengthen our leading position in the market by bundling PHS and other services;
- High-growth businesses: We will devote substantial efforts to the development of broadband and value-added services in order to further boost the segment's revenue contribution. While expanding the broadband subscriber base, we will promote development of "video-oriented" broadband contents and application services. We will maintain growth momentum in value-added services by introducing innovations in value-added services for fixed-line telephones;
- "CNC Connected": We will provide one-stop customized services for business customers integrating communications, networking and IT in order to satisfy their diversified and personalized needs. The objective is to foster a stable and loyal business customer base and to maintain market share in the market for business customers;
- Mobile business: We will actively prepare for entry into the mobile sector, so as to establish a solid foundation for the Company's transformation into a provider of broadband communications and multi-media services to all end users across all networks;



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- Cooperation with leading international operators: We will extend strategic cooperation with international telecom operators in order to adopt advanced management practices and benefit from their expertise, thereby enhancing our capability for business innovation and mitigating the entry risks of new businesses; and
- Operations management: We will maintain cost control efforts through prudent management of capital expenditures, and pursue higher free cash flow and improved gearing structure of the Company.

2006 is a year of challenges and opportunities. With the joint efforts of the Board, management and staff, I am confident that we will continue to achieve substantial gains for our shareholders. Last but not least, I would like to take this opportunity to express my deepest gratitude to all our customers, shareholders, Board, management and employees for their invaluable trust and support.

Tian Suning

Vice Chairman and Chief Executive Officer

Hong Kong, 21 March 2006