

從悉尼到維多利亞港，仍是我兩臂間的距離



Business Review

- High-growth businesses continued to grow at a rapid pace and accounted for 26% of total revenues, representing an increase of 5.8 percentage points over the same period of last year
- Broadband and other Internet-related services continued to grow quickly, and the number of broadband subscribers reached 15.081 million, representing an increase of 31.4% over the same period of last year
- Value-added businesses continued to enjoy robust growth with the number of “Personalised Ring” subscribers reaching 15.766 million, translating into a penetration rate 13.7%; the number of caller identification subscribers reached 78.78 million, representing a penetration rate of 68.5%; and the volume of PHS short messages reached 7,815 million, representing an increase of 15.3% over the same period of last year
- “CNC Connected” and ICT services provide business subscribers with integrated telecommunications, IT and IT-related applications, allowing us to secure our cooperative relationships with existing customers further and to explore a new source for revenue growth
- CAPEX kept declining, and the CAPEX guidance for 2007 will represent 20.7% decrease from 2006.

Summary of Key Product Lines

Fixed-line Telephone Services	Broadband and Other Internet-related Services	Business and Data Communication Services	ICT services
■ 114.934 million subscribers (including PHS)	■ 15.081 million subscribers	■ Premium customer base	■ Targeting corporate customers
■ 91.5% market share ⁽¹⁾⁽²⁾	■ 87.5% broadband market share ⁽¹⁾⁽²⁾	■ Leading provider	■ Unique competitive strengths
■ 80.5% of revenue ⁽³⁾	■ 13.3% of revenue ⁽³⁾	■ 5.3% of revenue ⁽³⁾	■ 0.9% of revenue ⁽³⁾
■ Decrease of 2.6% ⁽³⁾	■ 33.7% growth ⁽³⁾	■ 5.3% growth ⁽³⁾	■ —

(1) As of December 31, 2006

(2) In our northern service region

(3) Excluding upfront connection fees

In 2006, amid extremely imbalanced market competition, we accelerated our strategic transformation towards becoming a “broadband communications and multi-media services provider” under the theme of “innovations and transformation”. On one hand, we fully leveraged our advantages of fixed-line multi-operations and ample network resources to provide bundled services to maintain our existing customer base; and on the other hand, we fully leveraged our abundant customer resources and the opportunities brought by the Government policy of promoting informatization to intensify development and promotion of our high-growth businesses. In

2006, the Company saw total revenue reached RMB85,495 million (excluding upfront connection fees and discontinuing operations.), of which continuing operations achieved revenues of RMB84,515 million (Unless otherwise specified, all data hereunder exclude upfront connection fees and discontinuing operations.), representing an increase of 2.5% over the same period of previous year. The high-growth businesses, including broadband, value-added services, ICT and business & data communication services are a major driver for revenue growth.

Business Review

The following table illustrates the key operating statistics for 2006 and 2005:

	2005	2006	Growth rate
Fixed-line subscribers ('000)	115,328	114,934	-0.3%
Including: PHS subscribers ('000)	27,337	27,334	-0.01%
Broadband subscribers ('000)	11,475	15,081	31.4%
Total usage (pulses in millions)	228,436	217,270	-4.9%
Excluding Internet dial-up usage (pulses in millions)	219,884	211,999	-3.6%
Internet dial-up usage (pulses in millions)	8,552	5,271	-38.4%
Domestic long distance calls (minutes in millions)	30,975	33,670	8.7%
International long distance calls (minutes in millions)	591	566	-4.2%
Number of ports for DDN (ports)	131,812	115,480	-12.4%
Number of ports for Frame Relay (ports)	43,519	41,448	-4.8%
Number of ports for ATM (ports)	4,212	6,441	52.9%
Digital circuits leased (x2Mbps)	129,989	171,249	31.7%
Volume of PHS short messages (in millions)	6,777	7,815	15.3%
"Personalised Ring" service subscribers ('000)	6,814	15,766	131.4%
Penetration rate for caller identification (%)	65.9%	68.5%	2.6%
Telephone information services (million minutes)	3,084	2,457	-20.3%

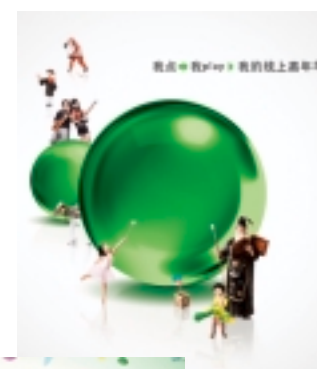
(1) International long distance call volume includes calls to Hong Kong, Macau and Taiwan

Broadband and other Internet-related Services

The PRC government's enthusiasm in promoting information technology across the country, coupled with gradual recognition by corporations of the value of informatization and surging demand from households and individuals for Internet content are driving rapid growth in broadband and Internet businesses in China. In 2006, the Company continued to advance its business model for broadband operation, with an "access + content" fee mechanism riding on a "PC + TV" multi-terminal platform. This model helped drive the development of our broadband businesses from various aspects, such as broadband access, broadband contents and applications as well as IPTV. Our broadband businesses thus maintained its rapid growth momentum and continued to be a major growth driver.

In order to enhance the penetration rate of our broadband operations, we adopted the following measures:

- selectively upgrading network speed;
- introducing more diversified product and price offerings to satisfy the customers in different niche markets;



Business Review

- making use of the first all-video website in China, “CNC MAX”, to implement our bundled “access + contents” marketing strategy; and
- promoting bundled broadband and traditional voice services and introducing bundled products such as “Family Affections Online” and “Affections Unlimited”

Through the above measures, we successfully maintained strong growth momentum in our broadband businesses. In 2006, we added a net of 3.61 million subscribers to broadband subscriber base, boosting the total to 15.081 million, representing a year-on-year increase of 31.4%. We still maintain a 87.5% market share in our northern service regions.

Unit: '000 subscribers	2004	2005	2006
Number of broadband subscribers	8,492.4	11,475.2	15,080.8
Including: DSL	5,956.2	8,568.4	11,378.9
LAN	2,533.2	2,904.2	3,698.2
Northern service region	8,146.4	11,036.2	14,428.6
Including: DSL	5,939.2	8,529.2	11,287.9
LAN	2,207.2	2,507.0	3,140.6
Southern service region	346	439	652.2
Including: DSL	17.0	39.2	91.0
LAN	326.0	397.2	557.6

We believe that the development in broadband contents and applications is crucial to maintain sustainable growth in our broadband business. In 2006, the Company established “China Netcom Group Broadband Online Limited Corporation”, a wholly-owned subsidiary specially designated for broadband content and applications. We officially launched the first all-video broadband website “CNC MAX”. “CNC MAX” blends into local content platforms run by our branches in each province, evolving into an “access + contents” combined fee mechanism. In 2006, “CNC MAX” and branch websites in each province hosted a high volume of live broadcast and featured activities, including the World Cup, NBA and “Starlight on spot”. These activities attracted patronage from a large number of web-surfers, consequently developed among them a habit of paid viewing. In addition, we established good strategic working relationships with mainstream content providers such as Sina, Google, Shanda, Jiuzhou and Youdu, thereby laying a solid basis for making “CNC MAX” a content-rich website.

In 2006, the Company leveraged its status as an official partner of the Olympic Games to develop the “2008 Broadband Hotels” services based on our commitment to deliver a “Broadband Olympics”. By the end of 2006, we had converted 1,267 hotels into “2008 Broadband Hotels”. We conducted a marketing campaign titled “Broadband Carnival, Where All the Funs Are” to promote our broadband businesses under the “Access + Contents + Olympic Elements” bundled sales mode.

In 2006, the Company spent more efforts in promoting its comprehensive information services for corporate customers, especially small and medium size enterprises. We provided them comprehensive communication and information services including information technology applications, basic communication products. In the course of delivering these services and value-added services, we satisfied their demand for “external communication + internal information technology applications” and at the same time achieved rapid growth in our broadband access and broadband contents and application businesses.

Our IPTV business also achieved a breakthrough in its development in 2006. In addition to Harbin, in July 2006 the Company was granted a right to provide IPTV services in five cities, including Heihe and Moudanjiang of Heilongjiang, Shenyang, Dalian and Panjin of Liaoning. In 2006, through joint efforts with the Government, the Company provided information technology services for the rural areas based on IPTV technology in Henan province. The model under which these services were being provided won the recognition of relevant government authorities and will be promoted in other regions in 2007. By the end of 2006, the number of IPTV subscribers reached 144.5 thousand, representing an increase of 201% over the same period of last year.

Business Review



Fixed-line Telephone Services

In 2006, as domestic mobile operators launched service packages at competitive prices, the migration from fixed line to mobile communications intensified, posing an acute challenge to monolithic fixed-line operators. In 2006, the number of our local fixed-line subscribers was 114.934 million, down by 0.3% over the same period of the previous year. This was the first time the Company experienced negative growth in its fixed line subscriber base. This was a result of a combination of intensifying mobile substitution and a change in our subscriber management strategy. The Company had put more effort in terminating services available to invalid subscribers. In 2006, our local voice traffic also declined. Stripping out dial-up internet access, the Company handled 211,999 pulses of million, down 3.6% over the same period of last year.

In order to maintain our leading position in local telephone operations, the Company exploited its advantage of multi-services fixed network and rich network resources and launched different bundled operations targeting different customer segments:

- For urban subscribers, we provided with bundled services labelled “Family 1+” and “Unified Number” with both fixed-line and mobile functionalities;
- For campus subscribers, we offered “New Sunshine” service to provide more SMS and family calls;
- For rural subscribers, we offered the “Economical Phone”, a bundled voice and value-added service, which does not charge monthly fees to encourage higher voice traffic and value-added-service usage.

These service offerings slowed down migration of customers away from the fixed line network and stimulated voice traffic to some extent. However, limited by the pace at which we upgraded our network to embrace intelligent functionalities and other supporting infrastructure, these bundled services were yet to be launched on a large scale in our service regions. Upon completion of the upgrading construction, these bundled services will be rolled out across our service regions, mitigating the declines in our local voice communications services.

Unit: '000 Subscribers	2004	2005	2006
Fixed-line subscribers	108,079	115,328	114,934
Northern service region	107,571	114,658	113,972
Including: Residential	70,638	70,273	68,803
Business	9,251	10,725	10,946
PHS	22,124	27,329	27,316
Public telephones	5,558	6,331	6,907
Southern service region	508	670	962

Business Review

As mobile operators launched aggressive tariff packages, the tariff advantage of PHS was diminishing. In 2006, our PHS business focused more on niche markets and was used as a core element in our bundled services. PHS was being marketed as an extension of our fixed-line telephone service in our sales programs. By the end of 2006, the number of PHS subscribers of the Company amounted to 27.334 million, roughly level to that of the same period of last year.

Value-added Services

In 2006, the strategy for our value-added services was to increase the penetration rate of our existing value-added services and to accelerate development of new services in our product mix. In 2006, our value-added services continued to enjoy rapid growth.



- The number of “Personalised Ring” subscribers was 15.766 million, up approximately 131.4% over the same period of last year, of which, the number of fixed-line “Personalised Ring” subscribers was 8.917 million, up 480.9% from the same period of last year.
- The volume of SMS sent through PHS was approximately 7,815 million pulses, representing an increase of 15.3% over the same period of last year.
- The penetration rate of caller identification service was 68.5%, 2.6 percentage points higher than the same period of last year.

In 2006, we introduced more varieties to our value-added services, including “Phone Navigation”, “Phonemate” and “Concealed Number”. New value-added services not only satisfied new demand from customers but also stimulated the usage of voice traffic through our fixed line network and significantly enhanced the revenue per line subscriber. Upon completion of upgrading our network to allow intelligent functionalities, new value-added services can be rolled out on a large scale in the service regions of the Company.

While fixed-line voice services were suffering from mobile substitution, value-added services became an important force in stabilizing voice traffic through the fixed-line network, as they brought about growth in revenue. They also constituted an effective means to enhance utilization of our customer resources. The growth in value-added services to some extent lessened effects of the decline in ARPU from the traditional local fixed-line telephone businesses.

Long Distance Services

Unit: million minutes	2004	2005	2006
Domestic long distance calls	29,366	30,975	33,670
Including: Traditional network	15,546	15,979	18,612
VOIP	13,820	14,996	15,058
Northern service region	27,047	27,775	28,809
Including: Traditional network	15,087	15,653	17,327
VOIP	11,960	12,122	11,482
Southern service region	2,319	3,200	4,861
VOIP	1,860	2,875	3,576

Business Review

In 2006, as we implemented aggressive sales and marketing programs to stimulate long distance voice traffic, the total usage volume of our long distance calls increased by 8.5% over last year. The increase in volume of long distance calls mainly came from the growth in volume of domestic long distance calls. In 2006, domestic

long distance voice traffic increased by 8.7% over the same period of the previous year. Since international long distance voice traffic was battered by substitution by Voice over Internet Protocol (VoIP), it decreased by 4.2% over the same period of the previous year.

Unit: million minutes	2004	2005	2006
International long distance calls	471	591	566
Including: Traditional network	158	173	187
VOIP	313	418	379
Northern service region	339	352	324
Including: Traditional network	148	156	144
VOIP	191	196	180
Southern service region	132	239	242
VOIP	122	221	199

Business and Data Communications Services

	2004	2005	2006
Number of ports			
DDN (ports)	150,630	131,812	115,480
Frame Relay (ports)	43,078	43,519	41,448
ATM (ports)	4,816	4,212	6,441
Leased line bandwidth			
DDN (x64kbps)	319,323	205,064	200,138
Frame Relay (x128kbps)	82,395	177,016	196,597
ATM (x2Mbps)	23,262	12,316	16,890
MPLSVPN (x2Mbps)	125	311	498
Leased circuit bandwidth (x2Mbps)	91,103	129,989	171,249
Corporate customers (x2Mbps)	56,363	100,387	147,459
Carrier customers (x2Mbps)	34,740	29,602	23,790

Data businesses enjoyed robust development from high demand for information services from government administration related needs, namely e-Government, city security and traffic monitoring system; centralized data processing for financial institutions, needs for IT-related services from logistics- and manufacturing-related industries. These had become the propelling forces for more demands for basic data communication services, broadband and data value-added services. Therefore, the Company has taken an initiative to explore the enterprise market with a view to fully leverage our location in the capital city, our network resources, our

innovative capability and our capability to provide one-stop solutions, securing our leading position in the enterprise market and pushing forward with our strategic transformation.

In 2006, under the "CNC Connected" label, we introduced comprehensive communication and IT services to enterprise customers. While we continued to develop our business, we also paid more attention to improving quality of services to our customers. This helped us to meet the demand for integrated information services from business customers. As we fostered closer

Business Review

relations with customers, we also stimulated the appetite of business customers for more communication and IT applications. This in turn contributed to strengthening our competitive advantage in the enterprise market.

In 2006, our leased circuit bandwidth was 171,249 X2M, representing a huge increase of 31.7% over last year.

ICT Services

In order to better leverage our existing customer relationships, to strengthen our advantage in communication technology and brand name, to secure our leading position in the business consumer market and to explore new sources of revenue growth, the Company started in 2006 to develop the business development model for ICT services.

Through ICT services, we provide integrated services of system integration, software development, management applications and fixed-line communication.

- We provide custodian service to small and medium size enterprises through our proprietary "IT Platform for Small and Medium Enterprises";
- We provide comprehensive system consulting and industry application system services to large enterprises;

- We provide LAN services and outsourcing services to governmental customers.

While ICT services allow us to meet the increasing demand of corporate customers for IT informatization services, they also help us foster closer business relations with our corporate customers, thereby retaining our customers more effectively and bringing about more growth potential for our business.

In 2006, revenue from our ICT services reached RMB788 million.

Branding

In 2006, in line with our strategy of "stabilizing traditional fixed-line services and making active efforts to explore high value-added services", the Company promoted and built our brand name in systematic fashion.

- Merging with the concept of Olympic sportsmanship, we promoted our core brand name concept of "A Broadband World" on a full scale;
- Targeting at stabilizing our traditional fixed-line services, we launched several bundling brands, such as "Family 1+", "Economical Phone" and "New Sunshine";
- Tapping the demand for IT services from public and corporate customers, we launched "CNC MAX", "CNC Connected" and "2008 Broadband Hotels".



Business Review

By making use of the opportunities brought about by the Olympic Games, we launched full-scaled promotion campaigns for these brand names via advertising and featured activities. These promotion campaigns effectively raised the brand awareness and reputation of the Company, thereby laying a solid basis for the sales and marketing of the Company's products and business development.

Marketing and Customer Service

In 2006, our sales and marketing systems, which comprise major account managers, community managers, sales outlets, 10060 telephone marketing and online marketing and other channels underwent important improvements.

- The sales and marketing system headed by community managers underwent further improvements. Six types of professional sales and marketing teams comprising public customer managers, business managers and network development managers were set up. By the end of 2006, thanks to the efforts of regional network development managers, the accumulated rate of newly subscribed customers by the newly established networks reached 96.2%, greatly secured our share in new markets.
- In line with the promotion of ICT services among business customers, we highly emphasized the "Structural Sales and Marketing Model", which organically combined frontline sales, back office support, branding and experience presentation and implemented the "Complete process, All Directions" model of sales and marketing, thus revolutionizing the previous simple model of sales and

marketing. The new model of sales and marketing achieved remarkable results in the promotion of products such as "CNC Connected".

- 10060 customer service, acceptance for handling and proactive sales and marketing underwent significant improvement. At present, the volume of acceptance for handling of the 10060 service accounted for 25% of the total volume of acceptance for handling.

Network Construction

In 2006, our network construction was carried out to ensure the smooth implementation of our Company strategic transformation, the improvement of capital investment efficiency, sustainable growth of high growth businesses and the retention of traditional fixed-line businesses.

In 2006, we continued to increase our capital expenditures for broadband and Internet services. The capital expenditures in broadband and internet service increased by 38.7% and its share in total capital expenditures increased to 18.6% up 5.5 percentage points from last year.

On the other hand, the Company fosters its control over investment in PHS business. The capital expenditures for the PHS network decreased from RMB4,784 million in 2005 to RMB2,748 million in 2006, representing a decrease of 42.6% and its share in total capital expenditures decreased by 7.2% from last year. The capital expenditures for the PHS network was mainly for the optimization of networks and construction of the platform for value-added services, so as to enhance the loyalty of existing subscribers and ARPU.

Regarding our strategic transformation, we have been preparing for network transformation and implemented commercial tests for new technologies and services, these steps strengthened our network technologies and supporting capabilities and accelerate evolution of our networks. We carried out the construction of the double-plane long distance exchange network, the large-customer network and the telecommunication IP carrier network. Meanwhile, our IPv6 project has completed initial trials and our ASON project is currently under trial run.

