

Our objective in 2001 was to become a first class international telecommunications company by: providing superior service through a quality network; optimizing the allocation and integrated usage of telecommunications resources in the pursuit of technological leadership and operational innovation; proactively mobilizing the expansion of various businesses at low cost to enhance our ability to create revenue and improve operational efficiency; and consistently reinforcing our long term competitiveness. We also emphasized the improvement of key economic indicators, such as cash flows and return on investment, in order to achieve high efficiency on the basis of high growth. At the same time, we also employed prudent financial policies and cash management strategies to preserve a stable capital and financial structure in order to consistently improve efficiency and create value for our shareholders.

In 2001, we achieved sound financial results. Annual revenue reached RMB29.39 billion, an increase of 24.1% from the previous year. Total service revenue (which excluded proceeds generated by sales of telecommunications products) grew by 29.3% from the previous year. EBITDA¹ increased by 23.4% from the previous year to RMB13.53 billion, and EBITDA margin maintained at a relatively high level of 46.0%. Net income increased by 37.8% to RMB4.46 billion and net income margin increased by 1.5% to 15.2%. Net income per share climbed up 24.1% to RMB0.36.

Our Cellular Business revenue maintained a high growth rate of 65.5% in 2001, and continued to be our key driver of growth in revenue and earnings. Our Long distance, Data and Internet Business recorded even more robust growth as revenue from these businesses increased by more than twofold, reflecting our market advantage as an integrated telecommunications operator. As the share of our revenue from the Cellular Business in total revenue increased and as we further increased our economies of scale, we not only maintained a stable EBITDA margin, but also improved our net income as compared to the previous year.

¹ EBITDA represents income before financial income and expense, net other income, taxation, depreciation and amortization. For corresponding year of 2000, EBITDA represented income before the aforesaid items and loss arising from terminations of CCF Arrangements.

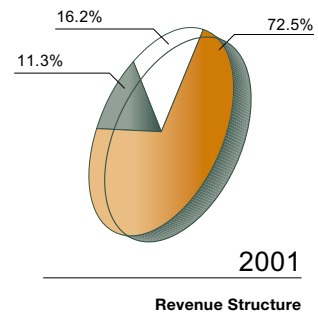
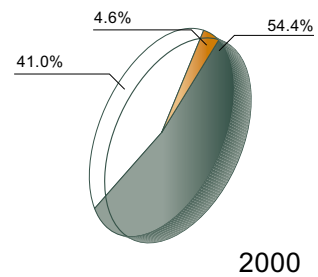
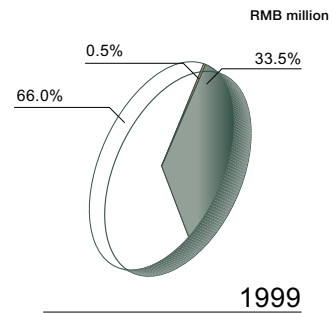
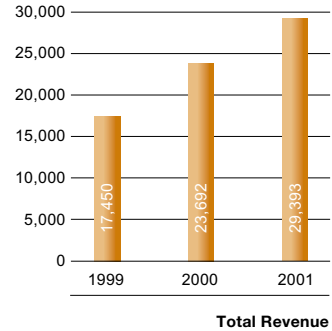
I. TOTAL REVENUE

Continuous rapid growth of total revenue

In 2001, the Company continued our strong revenue growth trend. Our annual revenue increased 24.1% to RMB29.39 billion from RMB23.69 billion in 2000. Of this amount, our service revenue increased 29.3% to RMB28.16 billion from RMB21.77 billion in 2000. As our Cellular Business continued its rapid growth and as our Long Distance, Data and Internet Business boomed, our overall competitiveness strengthened significantly.

Further rationalization of revenue structure

At the same time that our total revenue increased significantly, our revenue structure continued to change. We became more focused on network build-out and management, while reducing sales of telecommunications products, such as pagers. The share of service revenue in total revenue increased from 91.9% in 2000 to 95.8% in 2001. The Cellular Business, which increased its share of our total revenue from 54.4% in 2000 to 72.5% in 2001, continued its strong performance and boosted the rapid growth of our total revenue. Our Long Distance, Data and Internet Business have gradually become important sources of revenue for us, rapidly increasing their share of total revenue from 4.6% in 2000 to 11.3% in 2001. At the same time, the Paging Business's share of total revenue decreased from 41.0% in 2000 to 16.2% in 2001. These changes in the structure of our total revenue, while reflecting the decline of the paging market, demonstrate our strategy of focusing on high growth and high profit businesses to achieve more stable earnings growth.



Cellular
Long Distance, Data and Internet
Paging

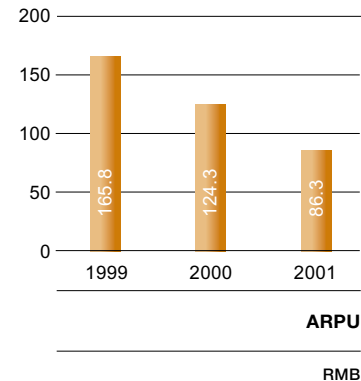
decrease of 15.6% from RMB75.1 in 2000. The drop in ARPU reflects the market wide trend of expansion of cellular service deeper into the mass market and allows our current subscriber load per channel to increase with decreasing average minutes of usage per subscriber per month (MOU), thus directly reducing the capital expenditure per user.

The following table illustrates the major revenue items from our Cellular Business in 1999, 2000 and 2001 and their respective percentage in Cellular Business revenue:

	1999		2000		2001	
	RMB in million	As percentage of Total	RMB in million	As percentage of Total	RMB in million	As percentage of Total
Revenue	5,841	100%	12,884	100%	21,326	100%
(1) Service Revenue	5,314	91.0%	12,188	94.6%	20,505	96.2%
include:						
Usage Fee	3,189	54.6%	8,212	63.7%	14,938	70.0%
Monthly Fee	1,116	19.1%	2,476	19.2%	3,660	17.2%
Connection Fee	674	11.5%	518	4.0%	205	1.0%
Interconnection						
Revenue	208	3.6%	754	5.9%	1,262	5.9%
Others	127	2.2%	228	1.8%	440	2.1%
(2) Sales of Cellular-Related						
Telecommunications						
Products	527	9.0%	696	5.4%	821	3.8%

Usage fee

The expansion of our cellular subscriber base and the improvement in our network service capabilities have boosted cellular usage fees, which grew 81.9% to RMB14.94 billion, from RMB8.21 billion in 2000. The rapid growth of pre-paid service, which has a higher airtime charge base, and the discontinuation of connection fees in 2001 caused the revenue from usage fees to increase its share of Cellular Business service revenue (not including the sale of cellular-related telecommunications products) from 67.4% to 72.8%. The revenue from the pre-paid cellular service in 2001 amounted to RMB4.10 billion, which increased by 5.3 times from RMB0.65 billion in 2000, accounting for 20.5% of the Cellular Business service revenue.



Sales of cellular-related telecommunications products

In 2001, sales of cellular-related telecommunications products were RMB0.82 billion, up 17.9% compared to RMB0.70 billion in 2000. The growth was principally due to increased SIM card sales caused by the sharp rise of cellular subscribers, although this was partially offset by the lowering of the unit price of SIM cards.

Strong growth in revenue from long distance, data and internet business

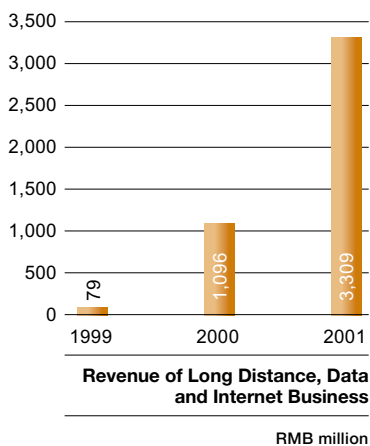
The coverage and capacity of our Long Distance, Data and Internet networks expanded significantly in 2001. Our network and subscriber resources were leveraged to further the integration of our business and realize consistent expansion in the competitive market environment through delivery of quality and comprehensive service and attractive product mix. Long Distance, Data and Internet business have been developing into important revenue generation sources. Total service revenue from these business amounted to RMB3.31 billion, an increase of 2.0 times from 2000. In addition, our Long Distance, Data and Internet business also provided transmission capacity for our Cellular Business and thus our inter-segment revenue reached RMB1.17 billion. The fast and strong revenue growth from the Long Distance, Data and Internet Business not only contributed to our overall revenue growth, but also demonstrated our positive long-term development outlook as an integrated telecommunications operator.

PSTN long distance revenue

As our nationwide long distance coverage expanded and interconnection improved, PSTN long distance revenue increased rapidly to RMB1.49 billion in 2001. We not only continued to satisfy domestic long distance demand, but also actively cooperated with overseas international telecommunications operators to effectively allocate resources to service incoming international, Hong Kong, Macau and Taiwan calls. We expect the international long distance call business to continue to enjoy positive growth, as the length of international incoming calls connected reached 1.16 billion minutes in 2001.

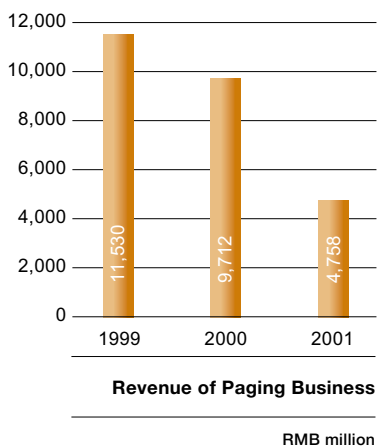
Revenue from data and IP telephony

We fully leveraged our competitive advantage as an integrated telecommunications operator and focused on the development of high value-added data services, such as FR, ATM, VPN, with our uniform and advanced integrated data communication platform. At the same time, we further improved the network coverage and communication quality of IP telephony and effectively expanded the usage of our IP telephony services (both domestic and international) through Direct Dial, PBX Preselection, Long Distance Registration and strengthening retail sales of telephone cards. The revenue from Data and IP Telephony business reached RMB1.55 billion in 2001.



Revenue from Internet business

In 2001, our Internet services expanded to mobile SMS download, IDC, VPN/VPDN, bank card, VISP, etc. The open platform was actively used to reinforce the cooperation with the ISP, ICP and SP businesses. The annual Internet revenue reached RMB0.27 billion.



Sharp decline in paging business revenue

The total paging revenue in 2001 was RMB4.76 billion. Paging service revenue (i.e., excluding sales of paging-related telecommunications products) was RMB4.34 billion, representing a decline of 48.8% from RMB8.48 billion in 2000. The principal factor for the decline was the replacement of paging services by cellular and other telecommunications services, which led to negative growth in the paging business and decreasing tariffs from intensifying competition. Therefore, we used considerable efforts to stabilize the incumbent traditional paging market and accelerate the development of bundled services and deployment of new technology. At the same time, we also sought to provide our former paging subscribers with our cellular and other telecommunications services.

As we have been reducing our share of pager sales, our revenue from the sales of paging-related telecommunications products dropped from RMB1.23 billion in 2000 to RMB0.42 billion in 2001, corresponding in a drop in its proportion in Paging Business revenue from 12.7% to 8.8%.

II. OPERATING EXPENSES

Total operating expenses

In 2001, in addition to boosting revenue, we also focused on tightening cost control through increasing operational efficiency from economies of scale and sharing of network, business, subscriber and sales resources. Nonetheless, total operating expenses increased to RMB24.13 billion in 2001 as compared to RMB18.47 billion in 2000, an increase of 30.6%, due to increases in fixed costs, such as depreciation and amortization, rising selling and marketing expenses in an increasingly competitive environment, and a provision for impairment of paging assets. Compared to the 24.1% increase in total revenue, the increase in expenses exceeded the increase in total revenue by 6.5%. We will continue to focus on cost control and optimization of our expense structure in order to ensure the continued growth in earnings.

The following table illustrates the major expenditure items from 1999 to 2001 and their respective share in the total revenue as a percentage.

	1999		2000		2001	
	RMB in million	% of Total Revenue	RMB in million	% of Total Revenue	RMB in million	% of Total Revenue
Total Revenue	17,450	100%	23,692	100%	29,393	100%
Total Operating Expenses	14,634	83.9%	18,470	78.0%	24,129	82.1%
Leased Lines	1,099	6.3%	1,158	4.9%	853	2.9%
Interconnection Charges	693	4.0%	1,380	5.8%	2,073	7.1%
Depreciation and Amortization	3,691	21.2%	5,734	24.2%	8,262	28.1%
Personnel	1,713	9.8%	1,770	7.5%	2,487	8.5%
Selling and Marketing	1,557	8.9%	2,492	10.5%	3,613	12.2%
General, Administrative and Other Expenses	2,586	14.8%	3,743	15.8%	5,499	18.7%
Cost of Telecommunications Products sold	3,294	18.9%	2,193	9.3%	1,342	4.6%

Personnel

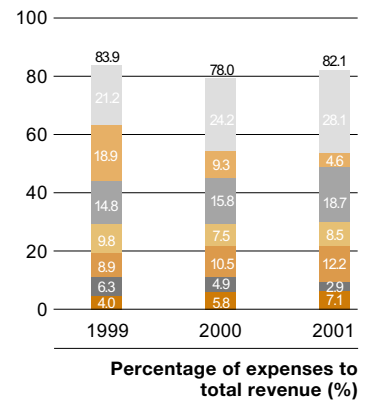
Despite the consistent and rapid growth of our various businesses, we emphasized reasonable allocation of human resources and were able to maintain strict control over personnel growth, thereby steadily raising our productivity.

As of the end of 2001, we employed 29,973 employees, 15.4% less than the 35,432 in 2000. In order to adapt to the changing competitive human resource market, to promote competition for positions at our company and to incentivize employees, we reformed our compensation structure in 2001. As a result, our personnel expenses rose from RMB1.77 billion in 2000 to RMB2.49 billion in 2001, accounting for 8.5% of total revenue as compared to 7.5% in 2000. Meanwhile, our compensation structure was tied to individual performance and company performance, resulting in reasonable personnel expenses. An attractive remuneration scheme is helpful in enhancing the long-term competitiveness of our company by retaining and attracting talented employees.

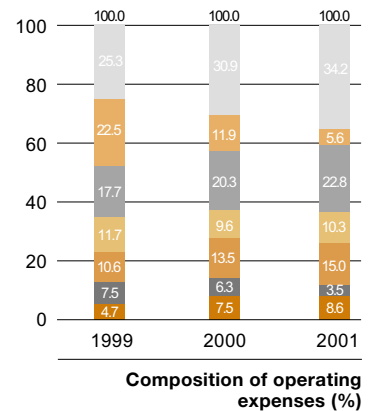
Selling and marketing

Our major selling and marketing expenses include commissions and promotion and advertising expenses. The rapid expansion of our various businesses and the substantial growth in new subscribers have resulted in an increase in commissions paid to agents. Increasing investment in market development and promotion of new products also resulted in increased promotion and advertising expenses. Our annual selling and marketing expenses were RMB3.61 billion in 2001, up 45.0% from RMB2.49 billion in 2000. Of this amount, RMB2.82 billion was commissions (an increase of 59.2% from 2000) and RMB0.79 billion was promotion and advertising expenses (an increase of 9.9% from 2000). Accordingly, the proportion of selling and marketing expenses in total revenue increased to 12.2% in 2001 from 10.5% in 2000. In order to exercise tighter control of our selling and marketing expenses, we implemented a variety of strategies including bundled sales and commission payments pegged to the usage fees of the new subscribers. We also increased efficiency in the allocation of selling and marketing expenses through a strategic partnership with China Post, which further enhanced the depth and breadth of our marketing initiatives.

Analysis of Operating Expenses



Percentage of expenses to total revenue (%)



Composition of operating expenses (%)

Interest income and expenses

Our total interest income in 2001 rose to RMB2.1 billion from RMB1.75 billion in 2000 mainly due to the interest income from the short-term bank deposits of our initial public offering proceeds in 2001.

Our interest expenses in 2001 were RMB1.91 billion, 40.9% higher than the RMB1.35 billion in 2000. The major reason for the rise was the interest on the bank loans obtained for our expanding network buildout. Our interest-bearing debts increased from RMB35.65 billion in 2000 to RMB44.27 billion in 2001.

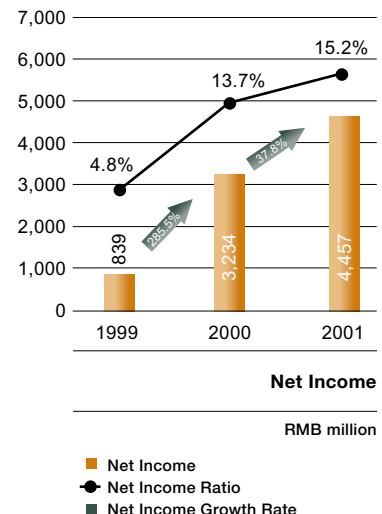
Our net interest income was RMB0.19 billion in 2001, RMB0.21 billion less than the RMB0.40 billion in 2000.

Income tax

Our income tax decreased from RMB1.10 billion in 2000 to RMB1.04 billion in 2001. Our effective tax rates in 2000 and 2001 were 24.7% and 19.1%, respectively. Our statutory tax rate under PRC enterprise income tax laws was 33%. The lower effective tax rate was due to the fact that the interest on the deposits of our initial public offering proceeds in Hong Kong was not subject to Hong Kong income tax.

Net income

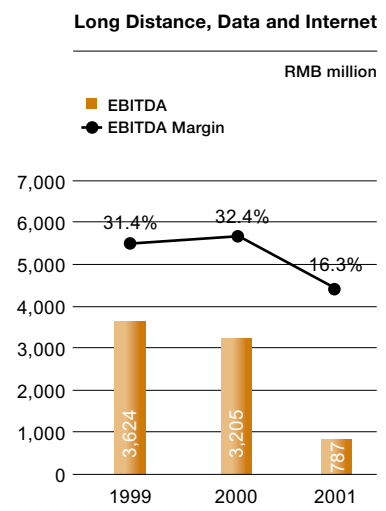
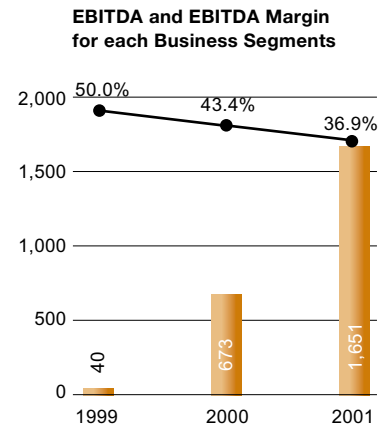
Our net income grew from RMB3.23 billion in 2000 to RMB4.46 billion in 2001, an increase of 37.8%. Net income per share was RMB0.36 in 2001, 24.1% higher than RMB0.29 in 2000. Our net income margin also increased from 13.7% in 2000 to 15.2% in 2001. The improvement of our profit level reflected our operational improvements from economies of scale. The loss from the terminations of China-China-Foreign Arrangements in 2000 was also a major factor in the increase of our net income in 2001.



EBITDA of the Long Distance, Data and Internet Business grew 145.2% to reach RMB1.65 billion in 2001. The EBITDA margin for these business declined from 43.4% in 2000 to 36.9% in 2001, due principally to rising interconnection charges, personnel expenses and general administrative expenses in these business as a percentage of its revenue.

EBITDA of the Paging Business was RMB0.79 billion in 2001, a decrease of 75.4% from RMB3.21 billion in 2000. The EBITDA margin for this business also decreased to 16.3% in 2001 from 32.4% in 2000. The decline was the result of negative growth in the Paging Business, sharp decline in revenue and profit, and a provision of RMB0.63 billion for impairment of paging assets. We will continue to impose tighter control over operating expenses and capital expenditures in the Paging Business, while working to cut losses in pager sales, so as to stabilize the EBITDA level in this business in the near future.

Even though the EBITDA margins of various business segments recorded different levels of decline, the increase in the share of Cellular Business revenue in our total revenue and the higher EBITDA margin of our Cellular Business as compared with our average EBITDA margin resulted in our ability to maintain a relatively stable overall EBITDA margin.



Using our debt management capabilities, we increased our leverage in 2001. Outstanding short-term and long-term bank loans, all of which are RMB-denominated, fixed-interest rate loans, rose from RMB35.65 billion at the end of 2000 to RMB44.27 billion at the end of 2001. The debt to assets ratio and the debt to equity ratio were 42.2% and 73.1%, respectively, at the end of 2001, compared with 39.0% and 63.9%, respectively, at the end of 2000.

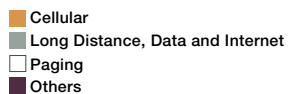
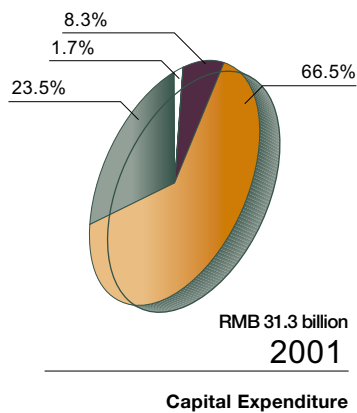
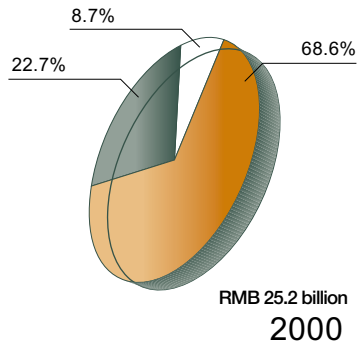
As of the end of 2001, we had RMB18.41 billion in cash and cash equivalents and RMB24.92 billion in short-term bank deposits. Our net liabilities, after cash and cash equivalents and short-term bank deposits, amounted to RMB1.76 billion.

Our working capital was RMB21.04 billion at the end of 2001, RMB9.25 billion less than the RMB30.29 billion at the end of 2000. The main factor for the decrease in working capital is the increase in capital expenditures for network expansion.

VI. CAPITAL EXPENDITURE

The following table sets forth the capital expenditure in each business segment for 1999, 2000 and 2001 and the anticipated capital expenditure for 2002.

	1999	2000	2001	2002
	RMB in billion	RMB in billion	RMB in billion	RMB in billion
Cellular Business	8.29	17.28	20.78	7.88
Paging Business	3.02	2.19	0.55	0.45
Long Distance, Data and Internet Business	1.39	5.71	7.33	8.5
Others	—	—	2.59	4.89
TOTAL	12.70	25.18	31.25	21.72



Working from a system of shared network infrastructure in 2001, we tightened our comprehensive management and control of projected capital expenditures and projects with an increased emphasis on accountability for capital expenditures in order to lower unit construction cost. At the same time, we also effectively reduced capital expenditures by actively enhancing our spectrum utilization rates, for example through network optimization and traffic adjustment. Decreases in the telecommunications equipment prices have also provided additional room for cost saving in project investments.

The annual capital expenditure for our various businesses totaled RMB31.25 billion, of which the portion attributed to the Cellular Business amounted to RMB20.78 billion. Our cellular expenditure was used mainly for the build-out of a more rational structure with higher coverage GSM network. Capital expenditure for the Long Distance, Data and Internet Business totaled RMB7.33 billion, which was mainly for the establishment of long distance switch center in the provincial capitals and the coverage of 300 local networks. In the Data Business, our expenditures concentrated on the construction of the broadband, high speed and integrated carrier data backbone and local transmission and access facilities. As for the Internet Business, the construction of Internet access points, data centers and portals was the main focus. Capital expenditure for the Paging Business was RMB0.55 billion, which was mainly used to upgrade existing networks and develop new technology and services. RMB2.59 billion was used for other projects, such as billing, customer service and information systems, operation maintenance and research and development.

Projected capital expenditure for 2002 is RMB21.72 billion. We will further improve our investment structure. Focus will be placed on enhancing our existing network coverage, strengthening work on optimization and depth. At the same time, a certain level of investment will be maintained for network infrastructure improvements, such as trunk line transmission, local transmission and access network. Investment will also be made in the development and implementation of supporting systems, such as billing, customer service and information systems, and appropriate technology unique to us to better enable us to exploit our competitive advantages. We principally rely on cash generated by operations, capital market financings and appropriate bank loans for our capital expenditure needs.

Virtually all of our revenue and expenses are denominated in Renminbi; however, a small portion of our telecommunications equipment purchases is denominated in foreign exchange. In the future, if the Renminbi exchange rate fluctuates, our equipment purchase expenditures may also change, thus affecting our operating expenses and profitability.

VII. PRINCIPAL ACCOUNTING ESTIMATE AND ACCOUNTING POLICIES

Impairment of assets for paging business

As of each year end, we conduct a full review of our property, plant and equipment and intangible assets, and provide a reasonable and prudent estimate on the amount of impairment loss of each asset whenever events or circumstances indicate that the carrying amount of assets may not be recoverable. To the extent that the estimated recoverable amount of an asset is lower than its carrying amount, an impairment loss is recognized.

In 2001, our Paging Business in certain provinces experienced a decline in revenue, loss of customers and incurred an operating loss. As a result, the carrying amounts of assets (including telecommunications equipment and goodwill related to the business) of these Paging Business exceeded their values in use, and provision for impairment loss of these assets has been made accordingly to properly reflect their recoverable values. Value in use is determined by us based on the expected discounted future net cash flows generated from the continuing use of these paging assets, and recognize an impairment loss for the amount not recoverable. In estimating the discounted future net cash flows, we have made key assumptions and estimations on the appropriate discount rate adopted and the period covered by the cash flow forecast, the gradual slow-down in the future loss of customers, the expected stability in average revenue per subscriber, the effects of incremental cash flows arising from new paging businesses and the adoption of cost reduction plans. These assumptions and estimation are made after considering the historical trends, the current market changes and the physical condition of the related assets, reasonably reflecting the risks involved. Based on the above, we recorded

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 the income statement, except where it is considered probable that no liability will arise or no asset will crystallize in the foreseeable future. A deferred tax asset is not recognized unless the related benefits are expected to crystallize in the foreseeable future.

In the preparation of our financial statements, we are required to estimate our income taxes in accordance with the prevailing tax rules and regulations in each locations or jurisdictions in which the Company and its subsidiaries operate. 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. Major deferred tax components include interest on loans from CCF joint ventures, income tax on advances from subscribers and prepaid telephone cards, impairment provisions for plant, property and equipment and other long-lived assets, provision for doubtful debts and write-down for inventory to net realizable value, additional depreciation deductible for tax purpose. Owing to the effects of these temporary differences on income tax, we have recorded deferred tax assets amounting to RMB1.58 billion, RMB1.01 billion and RMB0.5 billion as of 31 December 2001, 2000 and 1999, respectively. Deferred tax assets are recognized based on management estimates, to the extent that they will be recovered from future taxable income from continuing operations in the foreseeable future.

We believe that the Group has recorded adequate current and deferred taxes based on prevailing tax rules and regulations and represents the best estimates for the present circumstance. In the event that future tax rules and regulations or circumstances change, additional adjustments on the current and deferred taxes may be necessary.