Notes to the Unaudited Condensed Consolidated Financial Statements

For the six months ended June 30, 2002

1. BASIS OF PREPARATION

The unaudited condensed consolidated financial statements have been prepared in accordance with the requirements of the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited (the "Listing Rules") including compliance with Statement of Standard Accounting Practice ("SSAP") 25 "Interim Financial Reporting" issued by the HKSA.

Except as described in Note 17, the accounting policies adopted in preparing these unaudited condensed consolidated financial statements are consistent with those followed in preparing the Group's annual financial statements for the year ended December 31, 2001.

2. MATERIAL TRANSACTIONS

(a) On January 24, 2002, the Company issued 175 million ordinary shares at their estimated market value totalling approximately US$48 million (approximately HK$375 million) to a wholly-owned subsidiary of Trans World International, Inc. ("TWI") for the acquisition of a licence to use its sports archive and programmes. The Group was granted a 10-year royalty free non-exclusive licence to use existing and future sports archive and programmes owned by TWI in connection with the Group's services in Hong Kong and elsewhere in Asia.

(b) On January 29, 2002, PCCW Capital No. 2 Limited, an indirect wholly-owned subsidiary of the Company, issued US$450 million 1 percent guaranteed convertible bonds due 2007, which are unconditionally and irrevocably guaranteed on a joint and several basis by the Company and PCCW-HKT Telephone Limited ("HKTC"), another indirect wholly-owned subsidiary of the Company. The net proceeds from the bonds were used to prepay a portion of the Group's outstanding balance of the US$4,700 million term loan established in February 2001 and for working capital purposes.

(c) In March and April 2002, HKTC entered into agreements with several banks for two HK$5,000 million term loan facilities respectively. The facilities were used to prepay a portion of the outstanding balance of the US$4,700 million term loan.

(d) On June 28, 2002, the Company and Telstra Corporation Limited ("Telstra") entered into, and completed, an agreement relating to the following:

   i. the sale by the Company of its entire 40 percent equity interest in RWC to Telstra for a consideration of approximately US$614.38 million (approximately HK$4,792 million);

   ii. the redemption by the Company of the outstanding principal amount of the US$750 million (approximately HK$5,850 million) variable coupon subordinated convertible bond due 2007 ("2007 Bond") together with accrued interest of approximately US$54.38 million (approximately HK$424 million); and

   iii. the issue by the Company of a US$190 million (approximately HK$1,482 million) 5 percent mandatory convertible note due 2005 ("2005 Note") to Telstra.

   Please refer to Note 4 for details of the loss on disposal of the 40 percent equity interest in RWC.

3. SEGMENT INFORMATION

An analysis of turnover and contribution to the Group's results by business and geographical segments is set out below:

	Turnover Six months ended		Profit/(loss) from operations Six months ended	
	June 30, 2002 (Unaudited) HK$'million	June 30, 2001# (Unaudited) HK$'million	**June 30, 2002 (Unaudited) HK$'million**	June 30, 2001# (Unaudited) HK$'million
(a) Business segments:				
Telecommunications Services ("TSS")[1]	**9,105**	9,983	**3,410**	3,659
Business eSolutions[3]	**1,142**	986	**76**	39
Infrastructure	**311**	721	**177**	219
Others[2]	**362**	263	**(1,063)**	(1,047)
Eliminations	**(717)**	(641)	**–**	–
	10,203	11,312	**2,600**	2,870
(b) Geographical segments:				
Hong Kong	**9,827**	10,855	**2,923**	3,598
Mainland China and Taiwan	**295**	414	**(4)**	(19)
Others	**81**	43	**(319)**	(709)
	10,203	11,312	**2,600**	2,870

On disposal of the Group's 40 percent equity interest in RWC in June 2002, the segment assets of TSS were reduced by approximately HK$2,770 million.

Notes:

\# *Comparative figures were restated to conform with the current period's classification as follows:*

1. *Retail consumer broadband and narrowband Internet access services and related multimedia services were transferred to TSS from Internet Services in 2002.*
2. *The remainder of Internet Services, which primarily comprises costs associated with the production of English and Chinese Internet and broadband content, is included under Others in 2002.*
3. *The operations of Internet Data Center were merged into and are reported under Business eSolutions in 2002.*

4. LOSS ON DISPOSAL OF THE INTEREST IN RWC

On June 28, 2002, the Company and Telstra entered into, and completed, an agreement relating to the following:

i. the sale by the Company of its entire 40 percent equity interest in RWC to Telstra for a consideration of approximately US$614.38 million (approximately HK$4,792 million);

ii. the redemption by the Company of the outstanding principal amount of the 2007 Bond together with accrued interest of approximately US$54.38 million (approximately HK$424 million); and

iii. the issue by the Company of the 2005 Note to Telstra.

4. LOSS ON DISPOSAL OF THE INTEREST IN RWC *(continued)*

A summary of the loss on disposal of the interest in RWC, an associate, is set out below:

	Six months ended June 30, 2002 (Unaudited) HK$'million
2007 Bond	**5,850**
2007 Bond accrued interest	**424**
Less: Fair value of 2005 Note	**(1,482)**
Proceeds on disposal of the interest in RWC	**4,792**
Less: Book carrying value of the interest in RWC at June 28, 2002	**(2,770)**
Surplus of proceeds on disposal of the interest in RWC over its book carrying value	**2,022**
Less: Realization of related goodwill previously charged against reserves	**(3,831)**
Accounting loss on disposal of the interest in RWC	**(1,809)**

The accounting treatment for the sale of RWC is not reflective of the Group's operations or cash flows.

5. PROFIT BEFORE TAXATION

Profit before taxation is stated after crediting and charging the following:

	Six months ended	
	June 30, 2002 (Unaudited) HK$'million	June 30, 2001 (Unaudited) HK$'million
Crediting:		
Other income	**–**	31
Profit on sales of properties	**–**	18
Charging:		
Cost of sales	**2,539**	3,582
Depreciation	**1,302**	1,246
Amortization of intangible assets	**101**	66
Loss on disposal of fixed assets	**4**	7
Interest expense on borrowings	**1,068**	1,807

No listed securities were transferred from investment securities to other investments for the current period. During the six months ended June 30, 2001, certain listed securities were transferred from investment securities to other investments at fair value. The aggregate unrealized holding losses at the dates of transfer of approximately HK$193 million were recognized in the unaudited condensed consolidated income statement for the six months ended June 30, 2001.

6. TAXATION

	Six months ended June 30, 2002 (Unaudited) HK$'million	June 30, 2001 (Unaudited) HK$'million
Hong Kong:		
Company and subsidiaries	**723**	646
Associates and jointly controlled companies	**111**	106
	834	752

Hong Kong profits tax has been provided at the rate of 16 percent (2001: 16 percent) on the estimated assessable profits for the period.

7. INTERIM DIVIDEND

The board of directors does not recommend the payment of an interim dividend for the six months ended June 30, 2002 (2001: Nil).

8. (LOSS)/EARNINGS PER SHARE

The calculations of basic and diluted (loss)/earnings per share are based on the following data:

	Six months ended June 30, 2002 (Unaudited)	June 30, 2001 (Unaudited)
(Loss)/Earnings (HK$million)		
(Loss)/Earnings for the purposes of basic and diluted (loss)/earnings per share	**(713)**	935
Number of shares		
Weighted average number of ordinary shares for the purposes of basic (loss)/earnings per share	**22,923,459,843**	22,177,404,602
Effect of dilutive potential ordinary shares		892,559,282
Weighted average number of ordinary shares for the purpose of diluted earnings per share		23,069,963,884

The exercise of share options granted by the Company and conversion of convertible bonds and convertible notes would have an anti-dilutive effect on the loss per share for the six months ended June 30, 2002.

9. EBITDA

EBITDA represents earnings before interest, taxation, depreciation, amortization, net losses/gains on investments, loss on disposal of fixed assets, loss on disposal of the interest in RWC, other income and the Group's share of results of associates, jointly controlled companies and unconsolidated subsidiaries. While EBITDA is commonly used in the telecommunications industry worldwide as an indicator of operating performance, leverage and liquidity, it is not presented as a measure of operating performance in accordance with generally accepted accounting principles in Hong Kong and should not be considered as representing net cash flows from operating activities. The computation of the Group's EBITDA may not be comparable to similarly titled measures of other companies.

10. ACCOUNTS RECEIVABLE

An aging analysis of accounts receivable is set out below:

	At June 30, 2002 (Unaudited) HK$'million	At December 31, 2001 (Audited) HK$'million
0 – 30 days	**1,195**	1,490
31 – 60 days	**171**	235
61 – 90 days	**69**	54
91 – 120 days	**112**	65
Over 120 days	**167**	99
	1,714	1,943

The normal credit period granted by the Group is on average 30 days from the date of the invoice.

11. ACCOUNTS PAYABLE

An aging analysis of accounts payable is set out below:

	At June 30, 2002 (Unaudited) HK$'million	At December 31, 2001 (Audited) HK$'million
0 – 30 days	**227**	317
31 – 60 days	**81**	93
61 – 90 days	**33**	16
91 – 120 days	**46**	21
Over 120 days	**299**	244
	686	691

12. SHARE CAPITAL

	Number of shares (Unaudited)	Nominal value (Unaudited) HK$'million
Authorized:		
Ordinary shares of HK$0.05 each	**32,000,000,000**	**1,600**
Issued and fully paid ordinary shares of HK$0.05 each:		
Balance at January 1, 2002	**22,693,349,346**	**1,135**
Issued for acquisition of a licence (a)	**175,000,000**	**8**
Exercise of options (b)	**200,000,000**	**10**
Balance at June 30, 2002	**23,068,349,346**	**1,153**

(a) In January 2002, 175,000,000 ordinary shares were issued at their estimated market value totalling approximately US$48 million (approximately HK$375 million) to a wholly-owned subsidiary of TWI as the consideration for the acquisition of a licence to use its sports archive and programmes (Note 2a).

(b) In April 2002, 200,000,000 ordinary shares were issued to the minority shareholder of PCC Holdings Ltd. ("PCCH"), as a result of its conversion of part of its interest in PCCH into ordinary shares of the Company pursuant to the options granted to the minority shareholder of PCCH in September 1999.

All new ordinary shares issued during the period rank pari passu in all respects with the existing shares of the Company.

13. CAPITAL COMMITMENTS

	At June 30, 2002 (Unaudited) HK$'million	At December 31, 2001 (Audited) HK$'million
Authorized and contracted for	**5,385**	4,045
Authorized but not contracted for	**9,033**	11,378
	14,418	15,423

14. CONTINGENT LIABILITIES

	At June 30, 2002 (Unaudited) HK$'million	At December 31, 2001 (Audited) HK$'million
Performance guarantee	**59**	48
Others	**22**	111
	81	159

15. CHARGE ON ASSETS

As at June 30, 2002, certain assets of the Group with an aggregate carrying value of HK$8,198 million (December 31, 2001: HK$7,517 million) were pledged to secure loan and borrowing facilities utilized by the Group.

16. RELATED PARTY TRANSACTIONS

	Six months ended June 30, 2002 (Unaudited) HK$'million	June 30, 2001 (Unaudited) HK$'million
Telecommunication services fees, rental charges and subcontracting charges received and receivable from an associate and a jointly controlled company	**443**	91
Purchases of telecommunication services from an associate and a jointly controlled company	**899**	950
Convertible bond interest payable to the ultimate holding company	**147**	147

The above transactions were carried out after negotiations between the Group and the related parties in the ordinary course of business and on the basis of estimated market value as determined by the directors. In respect of transactions for which the price or volume has not yet been agreed with the relevant related parties, the directors have determined the relevant amounts based on their best estimation.

A wholly-owned subsidiary of the Company and a jointly controlled company ("JV") have entered into a Hong Kong Domestic Connectivity Agreement and an International Services Agreement for providing domestic and international connectivity services in Hong Kong and between Hong Kong and other countries. Pursuant to the International Services Agreement, for the first five years of operations subsequent to the formation of the JV, the Group is required to acquire 90%, 90%, 80%, 70% and 60% per annum, respectively, of its total annual purchases of "Committed Services" (being international public switched telephone network terminating access, international transmission capacity and Internet gateway access services) from the JV. The Hong Kong Domestic Connectivity Agreement contemplates a reciprocal arrangement, whereby the Group will provide local connectivity services to the JV under similar terms and conditions. Both agreements are subject to renegotiation when the agreements expire in 2006.

In addition, the Group entered into one year purchase arrangements for international connectivity services in 2002. The Group's commitments under these arrangements have regard to its future capacity needs and opportunities for growth as well as the JV's minimum earnings requirements under its financing arrangements. Regulated services in Hong Kong will be acquired in accordance with tariffs approved by the relevant regulatory authority and unregulated services will be acquired in accordance with market prices. Purchases made by the Group for the six months ended June 30, 2002 were HK$812 million (2001: HK$950 million). The remaining commitment for the year is approximately HK$1,200 million.

17. ADJUSTMENTS RETROSPECTIVELY APPLIED UPON ADOPTION OF NEW ACCOUNTING STANDARDS IN HONG KONG

A new SSAP issued by the HKSA, SSAP 34 "Employee benefits", became effective for accounting periods beginning on or after January 1, 2002. SSAP 34 prescribes the accounting and disclosure for all forms of consideration given by an enterprise in exchange for services rendered by employees. The underlying principle is that the cost of providing employee benefits should be recognized in the period in which the benefits are earned by the employees, rather than when they are paid or payable.

The Group has been providing defined benefit retirement plans to certain of its employees. Prior to the adoption of SSAP 34, contributions to the defined benefit schemes were made in accordance with the advice of qualified independent actuaries and were recognized as costs of retirement benefits to the income statement in the relevant accounting period. Special contributions were made to the retirement plans as recommended by the actuaries and were deferred and amortized to the income statement on a systematic basis over the employees' average expected service lives.

Upon the first adoption of SSAP 34, the Group has chosen to recognize the entire transitional liability immediately under the transitional provisions of SSAP 34. As at January 1, 2002, the transitional liability of the Group's defined benefit retirement plans, which represented the excess of the defined benefit obligation over the fair value of the plan assets, was HK$521 million. The amount was recognized retrospectively against the opening balance of the accumulated deficit as at January 1, 2002 and the liability has been carried in the unaudited condensed consolidated balance sheet as other long-term liabilities. In addition, the Group also wrote off the unamortized balance of special contribution of HK$298 million that was made to the defined benefit retirement plans in 1998. A resultant adjustment of HK$723 million after netting of deferred tax impact of HK$96 million was made to the opening balance of the accumulated deficit of the Group as at January 1, 2002. Comparative financial statements have not been restated.