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

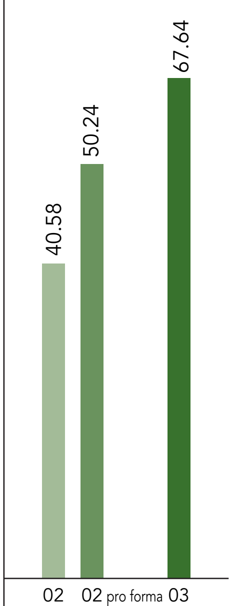
I. Overview

The operating revenue and EBITDA(Note 1) of the Company in 2003 sustained their rapid growth. CDMA Cellular Business became profitable since the third quarter. Free cash flow (i.e. net cash inflow from operating activities minus capital expenditures) for the year turned positive. Our financial operating results for 2003 are encouraging.

Operating revenue in 2003 increased by 66.7% from 2002 to RMB67.64 billion. EBITDA increased by 34.0% from 2002 to RMB24.90 billion. Operating profit increased by 16.3% from 2002 to RMB8.51 billion. Net profit fell by 8.3% from 2002 to RMB4.22 billion. Without taking account of the RMB0.56 billion impairment loss and assets write-off of the Paging Business and the RMB0.66 billion loss on sale of Guoxin Paging, net profit was RMB5.08 billion, up 10.5% from that in 2002. Basic earnings per share was RMB0.336, down by RMB0.03 per share from RMB0.366 in 2002. Capital expenditures were RMB19.76 billion. Free cash flow improved significantly from an outflow of RMB5.89 billion in 2002 to an inflow of RMB2.81 billion.

On 31 December 2002, the Company completed the acquisition of the GSM cellular assets and businesses and the CDMA businesses of Unicom New Century in 9 provinces, municipalities and autonomous regions including Jilin (the "2002 Acquired Cellular Business"). For the ease of comparison, the unaudited pro forma information in 2002 ("pro forma") referred to in this report were prepared on the assumption that the acquisition had been completed on 1 January 2002 and the operating results of the 2002 Acquired Cellular Business were always part of the Company since 1 January 2002 (unless otherwise stated, same as below).

Total operating revenue



(RMB in billion)

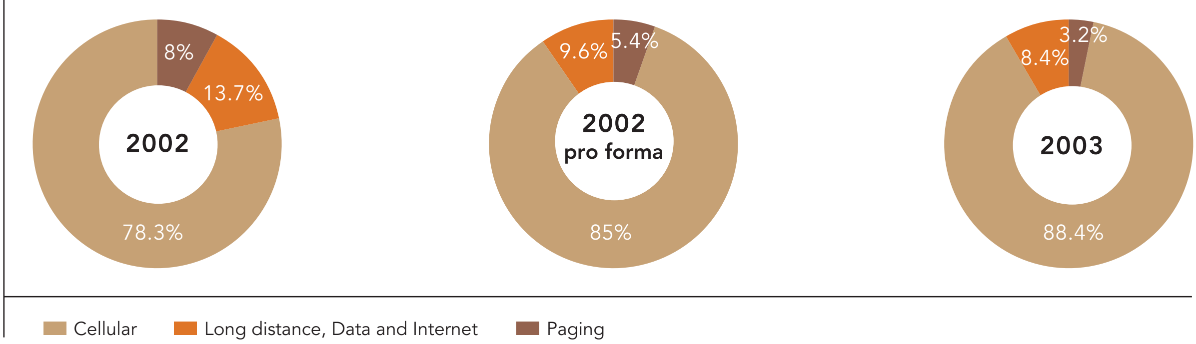
On a pro forma basis, in 2003, operating revenue increased by 34.6%, EBITDA increased by 7.8%, operating profit decreased by 2.6%, and net profit decreased by 16.3%. Without taking account of the RMB0.56 billion impairment loss and assets write-off of the Paging Business and the RMB0.66 billion loss on sale of Guoxin Paging, net profit increased 0.8% from 2002.

II. Operating revenue

Operating revenue in 2003 was RMB67.64 billion, up by 66.7% from 2002, an increase of 34.6% on a pro forma basis. Growth in operating revenue remained fast as the Company further strengthened its integrated capabilities.

Note (1) : In this annual report, EBITDA for 2003 represents net profit before interest income, finance costs, net other (expense) income, loss on sale of Guoxin Paging, taxation, depreciation and amortisation, and minority interests.

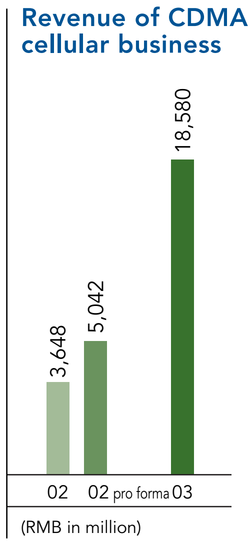
Revenue composition



Our operating revenue is mainly generated by the GSM and CDMA Cellular Businesses, 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 2002, 2002 pro forma and 2003.

	2002		2002 pro forma		2003	
	RMB in million	As percentage of total	RMB in million	As percentage of total	RMB in million	As percentage of total
Operating revenue:						
Cellular, include:	31,757	78.3%	42,725	85.0%	59,746	88.4%
GSM	28,109	69.3%	37,683	75.0%	41,166	60.9%
CDMA	3,648	9.0%	5,042	10.0%	18,580	27.5%
Long Distance, Data and Internet, include:	5,578	13.7%	4,796	9.6%	5,733	8.4%
Long Distance	2,779	6.8%	2,170	4.4%	2,288	3.3%
Data and Internet	2,799	6.9%	2,626	5.2%	3,445	5.1%
Paging	3,241	8.0%	2,723	5.4%	2,157	3.2%
Total operating revenue	40,576	100.0%	50,244	100.0%	67,636	100.0%

Revenue from Cellular Business increased rapidly, with its share of operating revenue increasing from 78.3% in 2002 to 88.4% in 2003, and accounting for 103.4% of the increase in total operating revenue. Operating revenue from our Long Distance, Data and Internet Business increased steadily, accounting for 8.4% of the total operating revenue in 2003. Operating revenue from the Paging Business as a percentage of total operating revenue decreased from 8.0% in 2002 to 3.2% in 2003. The changes in our total operating revenue composition fully reflected the Company's strategy of focusing on the development of Cellular Business.

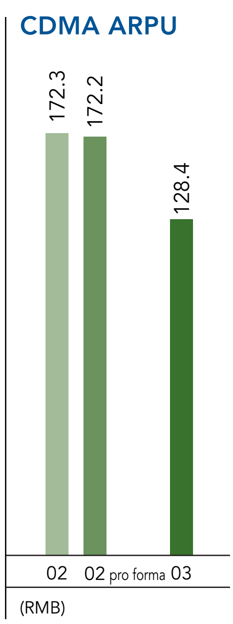


1. Sustained and rapid growth in CDMA Cellular Business

Rapid growth in the revenue from the CDMA Cellular Business was fostered by the fast growth in our CDMA subscribers base. Operating revenue from our CDMA Cellular Business reached RMB18.58 billion in 2003, an increase of 409.3% from 2002, an increase of 268.5% from pro forma. Average revenue per user ("ARPU") for our CDMA Cellular Business reached RMB128.4.

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 2002, 2002 pro forma and 2003.

	2002		2002 pro forma		2003	
	RMB in million	As percentage of total	RMB in million	As percentage of total	RMB in million	As percentage of total
Operating revenue:	3,648	100.0%	5,042	100.0%	18,580	100.0%
(1) Service Revenue	3,225	88.4%	4,346	86.2%	16,624	89.5%
Include: Usage Fee	2,231	61.2%	3,142	62.3%	11,672	62.8%
Monthly Fee	713	19.5%	964	19.1%	3,488	18.8%
Interconnection Revenue	184	5.0%	120	2.4%	608	3.3%
Others	97	2.7%	120	2.4%	856	4.6%
(2) Sales of Telecommunication Products	423	11.6%	696	13.8%	1,956	10.5%

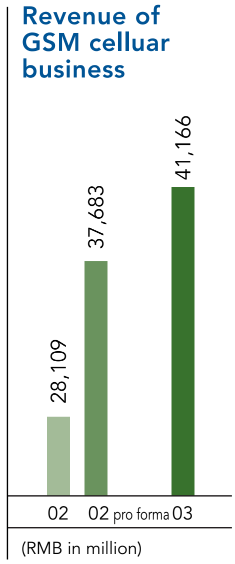


Service revenue from CDMA Cellular Business as a percentage of the total operating revenue from CDMA Cellular Business increased from 88.4% in 2002 to 89.5% in 2003. CDMA usage fees rose to RMB11.67 billion in 2003, representing 62.8% of its total operating revenue from CDMA Cellular Business, while monthly fee reached RMB3.49 billion in 2003, representing 18.8% of its total operating revenue from CDMA Cellular Business. CDMA interconnection revenue reached RMB0.61 billion, accounting for 3.3% of the total operating revenue from CDMA Cellular Business. Revenue from the sales of telecommunication products as a percentage of the total operating revenue from CDMA Cellular Business reduced from 11.6% in 2002 to 10.5% in 2003.

The Company is actively developing its CDMA wireless data business. Efforts have been devoted to converting the competitive edge in CDMA technology to a competitive edge in operations in order to enhance competitiveness in the market and our appeal to subscribers. Revenue from the value-added business of CDMA Cellular Business reached RMB0.78 billion, and accounted for 4.5% of total service revenue from CDMA Cellular Business.

2. Steady growth in GSM Cellular Business

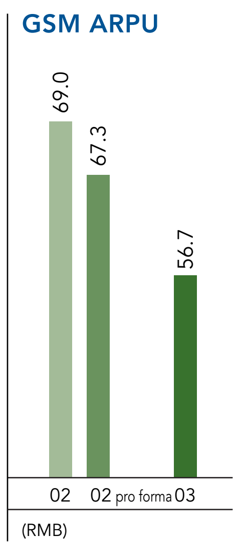
Revenue from the GSM Cellular Business increased by 46.5% from 2002 and reached RMB41.17 billion in 2003, representing an increase of 9.2% on a pro forma basis. ARPU from this business segment decreased from RMB67.3 on a pro forma basis to RMB56.7 in 2003. Of this amount, post-paid ARPU decreased by RMB11.1 from RMB77.3 in 2002 to RMB66.2 in 2003, and pre-paid ARPU decreased by RMB6.8 from RMB52.8 in 2002 to RMB46.0 in 2003.



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 2002, 2002 pro forma and 2003.

	2002		2002 pro forma		2003	
	RMB in million	As percentage of total	RMB in million	As percentage of total	RMB in million	As percentage of total
Operating revenue:	28,109	100.0%	37,683	100.0%	41,166	100.0%
(1) Service Revenue	27,388	97.4%	36,690	97.4%	40,303	97.9%
Include: Usage Fee	20,275	72.1%	27,595	73.3%	29,072	70.6%
Monthly Fee	4,169	14.8%	6,143	16.3%	7,042	17.1%
Interconnection Revenue	1,710	6.1%	1,471	3.9%	1,927	4.7%
Others	1,234	4.4%	1,481	3.9%	2,262	5.5%
(2) Sales of Telecommunication Products	721	2.6%	993	2.6%	863	2.1%

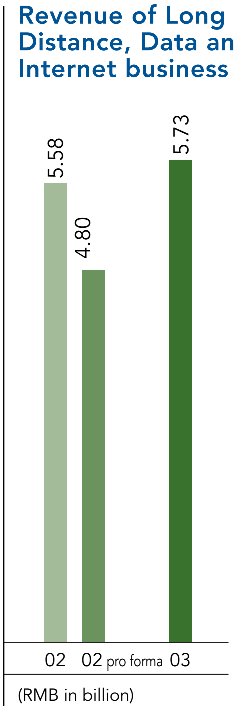
Service revenue from GSM Cellular Business as a percentage of the total operating revenue from GSM Cellular Business increased from 97.4% in 2002 to 97.9% in 2003. GSM usage fees reached RMB29.07 billion in 2003, representing 70.6% of the total operating revenue from GSM Cellular Business, while monthly fee reached RMB7.04 billion in 2003, representing 17.1% of the total operating revenue from GSM Cellular Business. GSM interconnection revenue was RMB1.93 billion, accounting for 4.7% of the total operating revenue from GSM Cellular Business.



GSM value-added service of the Company mainly provides the short message service, i.e. SMS. Revenue from GSM value-added services reached RMB2.07 billion in 2003, representing a 5.0% share in the service revenue from GSM Cellular Business.

3. Steady development in revenue from Long Distance, Data and Internet Business

Revenue from our Long Distance, Data and Internet Business increased by 2.8% from 2002 and reached RMB5.73 billion in 2003, an increase of 19.5% on a pro forma basis.



Revenue from PSTN Long Distance Business

Revenue from our PSTN Long Distance Business decreased by 17.7% from 2002 to RMB2.29 billion in 2003, an increase of 5.4% on a pro forma basis.

Revenue from Data and Internet Businesses

We have fully leveraged the technological advantage of our multi-businesses integrated network platform. Along with effectively expanding international and domestic call volume for IP telephony, we have been targeting business subscribers and corporate subscribers in promoting services with distinctive features such as "UNI-VIDEO", and also we have been targeting the mass market in promoting new services, such as "Ruyi mailbox". Revenue from our Data and Internet Businesses rose by 23.1% from 2002 to RMB3.44 billion in 2003, an increase of 31.2% on a pro forma basis.

4. Continuing decline in revenue of Paging Business

In 2003, revenue from our Paging Business was RMB2.16 billion. Paging service revenue (i.e. excluding sales of paging-related telecommunications products) fell by 35.1% to RMB1.40 billion in 2003, a decrease of 31.3% on a pro forma basis. Revenue from value-added and other services of the Paging Business reached RMB0.79 billion and accounted for 56.2% of the service revenue from the Paging Business.

III. Operating expenses

The Company continued to exercise strict controls over costs. Operating expenses in 2003 were RMB59.12 billion, representing an increase of 77.8%, which was greater than the 66.7% growth in operating revenue for the same period. On a pro forma basis, the increase would be 42.5%.

The table below illustrates the major expense items from 2002, 2002 pro forma and 2003 and their respective share of total operating revenue.

	2002		2002 pro forma		2003	
	RMB in million	As percentage of total revenue	RMB in million	As percentage of total revenue	RMB in million	As percentage of total revenue
Total operating expenses:	33,253	82.0%	41,501	82.6%	59,122	87.4%
Leased lines and network capacities	1,583	3.9%	2,021	4.0%	4,320	6.4%
Interconnection charges	3,230	8.0%	3,755	7.5%	5,921	8.7%
Depreciation and amortization	11,256	27.7%	14,348	28.6%	16,385	24.2%
Personnel	3,335	8.2%	4,006	8.0%	4,575	6.8%
Selling and marketing	5,981	14.8%	7,851	15.6%	15,157	22.4%
General, administrative and other expenses	5,632	13.9%	7,087	14.1%	9,112	13.5%
Include: Impairment loss and assets write-off of the Paging Business	–	–	–	–	557	0.8%
Cost of telecommunications products sold	2,236	5.5%	2,433	4.8%	3,652	5.4%

1. Leased lines and network capacities

As the lease expense for CDMA network capacities in 2003 increased to RMB3.52 billion, the aggregate amount of our leased line expenses and network capacity lease expenses increased to RMB4.32 billion, with their proportion to total operating revenue rose from 4.0% on a pro forma basis to 6.4% in 2003, representing an increase of 113.8% on a pro forma basis.

2. Interconnection charges

Along with the increase in interconnection traffic, interconnection charges increased by 83.3% to RMB5.92 billion in 2003, an increase of 57.7% on a pro forma basis. Interconnection charges for CDMA and GSM Cellular Business increased by 418.8% and 22.3% on a pro forma basis, respectively. Interconnection charges for Long Distance, Data and Internet Business increased by 54.0% on a pro forma basis. As our various business segments continued to develop, interconnection charges as a percentage of total operating revenue also increased from 7.5% on a pro forma basis to 8.7%.

3. Depreciation and amortization

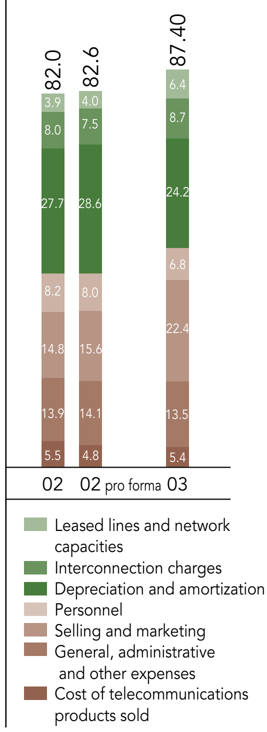
Due to increase of network capacity, the rapid development of the GSM Cellular Business and the expansion of assets scale, depreciation and amortization expenses increased by 45.6% to RMB16.39 billion in 2003, at a lower growth rate than the growth in operating revenue, and accounting for an increase of 14.2% on a pro forma basis. Depreciation and amortization expenses as a percentage of total operating revenue decreased from 28.6% on a pro forma basis to 24.2% in 2003.

4. Personnel

As of the end of 2003, we had 38,728 employees, an increase of 32.0% from 29,332 at the end of 2002, and an increase of 10.5% from 35,055 at the end of 2002 on a pro forma basis. Our personnel expenses were RMB4.57 billion in 2003, its share as a percentage of total operating revenue dropped to 6.8%, from 8.0% on a pro forma basis. In order to align the interest of our employees with that of our shareholders, we have set up an employee share option scheme and granted options to qualified employees. During 2003, total share options involving 105,956,000 shares in the Company were granted under the share option scheme. For more information regarding our share option scheme, please refer to Report from the Directors and Note 31 to the Financial Statements.

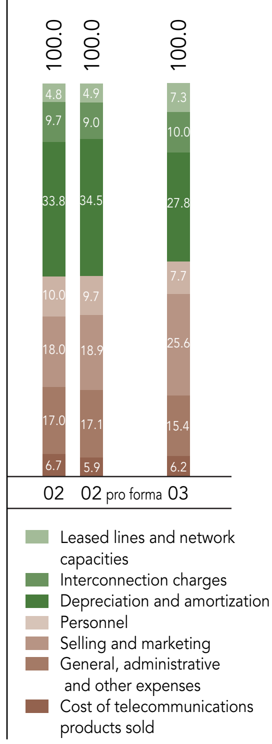
Analysis of operating expenses

Percentage of expenses to total revenue (%)



Analysis of operating expenses

Composition of operating expenses (%)



5. Selling and marketing

Our major selling and marketing expenses included commissions, promotion and advertising expenses and amortization of customer acquisition costs of contractual CDMA subscribers. Selling and marketing expenses totaled RMB15.16 billion in 2003, an increase of 153.4% from 2002, and an increase of 93.1% on a pro forma basis. Amortization of CDMA subscribers acquisition costs in 2003 were RMB5.84 billion, an increase of 174.2% on a pro forma basis. The balance of unamortised deferred CDMA subscribers acquisition costs fell from RMB5.99 billion as of the end of 2002 to RMB4.04 billion as of the end of 2003. Due to the continued growth in the subscriber base of our various business segments, the commissions to distributors and sales agents rose to RMB7.29 billion, an increase of 63.1% on a pro forma basis. Promotion and advertising expenses were RMB2.04 billion, an increase of 63.2% on a pro forma basis. Selling and marketing expenses as a percentage of operating revenue increased from 15.6% on a pro forma basis to 22.4% in 2003.

6. General, administrative and other expenses

Our general, administrative and other expenses were RMB9.11 billion in 2003. Without taking account of the impairment loss and assets write-off of the Paging Business amounting to RMB0.56 billion, total expenses for this category increased by 51.9% from RMB5.63 billion in 2002. General, administrative and other expenses as a percentage of total operating revenue decreased from 13.9% in 2002 to 13.5% in 2003. In 2003, the provision for doubtful debts was RMB1.75 billion, an increase of 39.1% on a pro forma basis. Provision for doubtful debts as a percentage of service revenue increased slightly from 2.6% on a pro forma basis to 2.7% in 2003. This has also given rise to an increase in our general, administrative and other expenses.

7. Cost of telecommunications products sold

The cost of telecommunication products sold increased to RMB3.65 billion in 2003, an increase of 50.1% on a pro forma basis. The share of cost of telecommunications products sold as a percentage of operating revenue increased from 4.8% on a pro forma basis to 5.4% in 2003.

IV. Earnings

1. Operating profit

In 2003, our operating profit reached RMB8.51 billion, an increase of 16.3% from 2002, a decrease of 2.6% on a pro forma basis.

Operating loss from our CDMA Cellular Business was RMB0.29 billion in 2003, while CDMA Cellular Business became profitable since the third quarter. Operating profit from our GSM Cellular Business increased to RMB8.72 billion, a decrease of 9.5% on a pro forma basis. Operating profit from our Long Distance, Data and Internet Business increased to RMB1.45 billion in 2003, an increase of 2.9% on a pro forma basis. While operating profit from our Long Distance Business fell to RMB0.70 billion due to a reduction in the inter-segment revenue, operating profit from our Data and Internet Business increased to RMB0.75 billion. Operating loss from our Paging Business was RMB1.20 billion.

2. Finance costs

In 2003, the Company further allocated the capital resources in an active and proper approach, whereas the objective was to enhance the centralized treasury function. The net finance costs were reduced from RMB1.92 billion in pro forma to RMB1.76 billion in 2003, a decline of 8.1%.

3. Loss on sale of Guoxin Paging

Disposal loss on the sale of Guoxin Paging amounted to RMB0.66 billion in 2003.

4. Income tax

Our income tax increased to RMB1.89 billion in 2003, an increase of 6.1% on a pro forma basis. The resulting effective tax rate was 31.0%, up by approximately 5 percent as compared to 26.2% on a pro forma basis. Nevertheless, this rate was lower than the standard tax rate of 33%.

5. Net profit

Our net profit reached RMB4.22 billion in 2003. Basic earnings per share was RMB0.336, a decrease of 8.3% from RMB0.366 in 2002. Without taking account of the RMB0.56 billion in impairment loss and assets write-off of the Paging Business and the RMB0.66 billion loss on sale of Guoxin Paging, net profit would have been RMB5.08 billion, representing an increase of 10.5% from 2002.

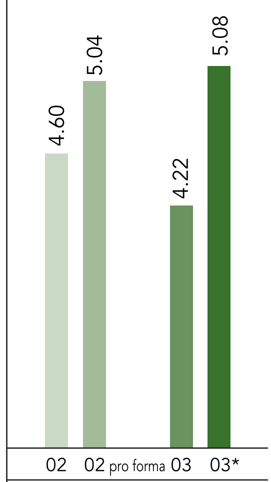
V. EBITDA

Our EBITDA increased by 34.0% from 2002 to RMB24.90 billion in 2003, an increase of 7.8% on a pro forma basis. EBITDA margin (EBITDA as a percentage of operating revenue) fell from 46.0% on a pro forma basis to 36.8%.

EBITDA for the GSM Cellular Business rose by 4.4% on a pro forma basis to RMB21.84 billion. EBITDA margin fell from 55.5% on a pro forma basis to 53.0%. EBITDA for the CDMA Cellular Business improved from –RMB1.34 billion on a pro forma basis to RMB20 million in 2003.

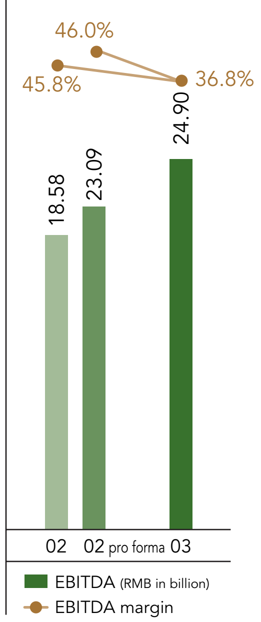
EBITDA for the Long Distance, Data and Internet Business grew by 13.6% to RMB3.17 billion in 2003, an increase of 13.6% on a pro forma basis. EBITDA margin for this business fell from 40.9% on a pro forma basis to 37.6%. While EBITDA margin for the Long Distance Business fell from 49.4% on a pro forma basis to 35.5% as a result of the decrease in interconnection revenue, EBITDA margin for the Data and Internet Business grew from 32.1% on a pro forma basis to 38.9%. After accounting for the RMB0.56 billion in impairment loss and assets write-off of the Paging Business, EBITDA for the Paging Business turned from RMB0.82 billion in 2002 to –RMB60 million in 2003.

Net profit

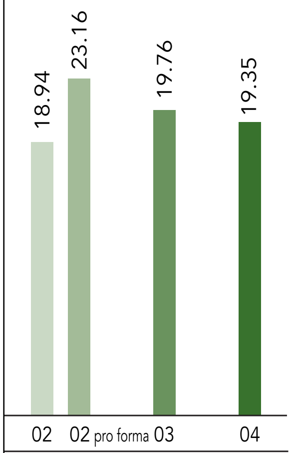


* Without taking account of the impairment loss and assets write-off of the Paging Business and the loss on sales of Guoxin Paging
(RMB in billion)

EBITDA and EBITDA margin



Capital expenditure & Projected capital expenditure



(RMB in billion)

VI. Capital expenditure and free cash flow

During 2003, the Company implemented strict controls over the capital expenditures and endeavoured to lower the unit construction cost. The Company was able to effectively control its capital expenditures, notwithstanding that adequate investments were made as appropriate in regions with high market demand. Capital expenditures for our various businesses totaled RMB19.76 billion in 2003. 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 RMB8.91 billion, RMB2.13 billion, RMB40 million, RMB4.55 billion and RMB4.13 billion respectively.

The following table sets forth the capital expenditures in each business segment for 2003 and our planned capital expenditures in 2004.

	2003 (RMB in billion)	2004 (RMB in billion)		
	21 provinces Total	30 provinces Total	Include: 21 provinces	Include: 9 provinces
Total	19.76	19.35	17.87	1.48
Cellular	8.91	6.53	5.05	1.48
Long Distance, Data and Internet	2.13	1.50	1.50	–
Paging	0.04	–	–	–
Transmission network	4.55	3.43	3.43	–
Others	4.13	7.89	7.89	–

Note: Capital expenditure for Cellular Business in 2003 is the total expenditures for businesses operating in 21 provinces, municipalities and autonomous regions. Capital expenditure for Cellular Business in 2004 is the total capital expenditures for businesses operating in 30 provinces, municipalities and autonomous regions, including the 9 provinces and autonomous regions acquired by the Company on 31 December 2003.

Free cash flow in 2003 improved significantly from an outflow of RMB5.89 billion in 2002 to an inflow of RMB2.81 billion.

Projected capital expenditures for 2004 with respect to all 30 provinces, municipalities and autonomous regions in which we operate is RMB19.35 billion (which includes RMB17.87 billion for the 21 provinces, municipalities and autonomous regions and RMB1.48 billion for newly acquired businesses in 9 provinces and autonomous regions), which will be used mostly to improve the GSM network and network transmission infrastructure. The Company will rely principally on cash generated by operations for satisfying its capital expenditures needs.

VII. Acquisition of Unicom New World and the sale of Guoxin Paging

In December 2003, we acquired the GSM cellular assets and businesses and CDMA businesses of Unicom New World in the following nine provinces and autonomous regions, namely: Shanxi, Inner Mongolia, Hunan, Hainan, Yunnan, Xizang, Gansu, Qinghai and Ningxia and the total acquisition price is RMB3.2 billion. On the same date, we sold the entire equity interests in Guoxin Paging for a total sale price of RMB2.75 billion.

We are pleased with the operating results of the Cellular Business of Unicom New World in 2003. Operating revenue from the Cellular Business of Unicom New World was RMB8.14 billion, 53.0% higher than RMB5.32 billion in 2002. Net profit for these businesses improved from a loss of RMB0.12 billion in 2002 to a profit of RMB0.35 billion.

Assuming the acquisition of Unicom New World and the sale of Guoxin Paging have been undertaken before 1 January 2002, the Unaudited Pro Forma operating revenue of the Group and Unicom New World ("the Combined Group") was RMB72.33 billion in 2003, representing an increase of 40.3% from 2002, the Unaudited Pro Forma EBITDA was RMB27.20 billion in 2003, representing an increase of 13.5% from 2002 and the Unaudited Pro Forma net profit was RMB5.77 billion in 2003, representing an increase of 6.0% from 2002.

The following table sets forth the Unaudited Pro Forma information of the Combined Group for the years ended 31 December 2003 and 2002, as if the acquisition of Unicom New World and the sale of Guoxin Paging have been undertaken before 1 January 2002.

	Unaudited Pro Forma information of the Combined Group			
	2003		2002	
	RMB in million	As percentage of total revenue	RMB in million	As percentage of total revenue
Operating Revenue (Turnover):				
GSM Business	45,409	62.7%	40,869	79.2%
CDMA Business	18,336	25.4%	4,733	9.2%
Data and Internet Business	3,168	4.4%	2,504	4.9%
Long Distance Business	2,017	2.8%	1,747	3.4%
Total service revenue	68,930	95.3%	49,853	96.7%
Sales of telecommunications products	3,397	4.7%	1,684	3.3%
Total operating revenue	72,327	100%	51,537	100%
Operating expenses:				
Leased line and network capacities	(4,727)	6.5%	(2,107)	4.1%
Interconnection charges	(6,119)	8.5%	(3,953)	7.7%
Depreciation and amortization	(16,766)	23.2%	(14,165)	27.5%
Personnel	(4,355)	6.0%	(3,657)	7.1%
Selling and marketing	(17,200)	23.8%	(8,680)	16.8%
General, administrative and other expenses	(9,070)	12.5%	(7,123)	13.8%
Cost of telecommunication products sold	(3,659)	5.1%	(2,060)	4.0%
Total operating expenses	(61,896)	85.6%	(41,745)	81.0%
Operating profit	10,431	14.4%	9,792	19.0%
Finance costs	(2,156)	3.0%	(2,375)	4.6%
Other expenses, net	(30)	0.0%	(46)	0.1%
Taxation	(2,473)	3.4%	(1,923)	3.7%
Profit attributable to shareholders	5,772	8.0%	5,448	10.6%

Notes:

1. *The Unaudited Pro Forma information presented above is prepared on the assumption that the acquisition of Unicom New Century and Unicom New World and the sale of Guoxin Paging had all been undertaken before 1 January 2002.*
2. *Basis and assumption used for presentation and adjustment for the Unaudited Pro Forma information of the Combined Group should be referred to Appendix VI "Pro forma information of the Combined Group" as set forth in the shareholders' circular "Connected Transactions" of the Company issued on 26 November 2003.*

The following table sets forth our asset-debt structure as of 31 December 2003 before and after the acquisition of Unicom New World and the sale of Guoxin Paging.

	As of December 31		
	2002	2003	
		Before the Acquisition and the Sale	After the Acquisition and the Sale
(RMB in million)			
Cash	19,529	11,279	10,133
Total assets	149,628	140,964	149,838
Total debts	82,409	70,307	80,222
Include: Short-term interest-bearing debt	15,330	14,754	18,173
Long-term interest-bearing debt	37,686	30,739	36,213
Minority interests	566	552	—
Owners' equity	66,653	70,105	69,615
Debt-to-asset ratio	55.1%	49.9%	53.5%

As of 31 December 2003, Unicom New World acquired by the Company accounted for RMB15.13 billion in assets, RMB12.88 billion in liabilities and the debt-to-asset ratio was 85.1%.

The Company places heavy emphasis on balancing the debt structure, pays particular attention to operation risks and endeavors to decrease the liability level. Upon the completion of the Acquisition and the Sale, our total assets increased from RMB149.63 billion as of 31 December 2002 to RMB149.84 billion as of 31 December 2003. Our total debts decreased from RMB82.41 billion as of 31 December 2002 to RMB80.22 billion as of 31 December 2003. Our debt-to-asset ratio after the Acquisition and the Sale decreased from 55.1% at the end of 2002 to 53.5% at the end of 2003.

Our debt to capitalization 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 31 December 2003 was 43.9%, 0.7% less than 44.6% in 2002, due to our efforts to control the debts structure and liability level. As of 31 December 2003, we had RMB10.13 billion in cash, of which 84.1% was in RMB, 15.7% was in US dollars and 0.2% was in Hong Kong dollars. As of 31 December 2003, our short-term and long-term bank loans were RMB54.39 billion in total, 2.6% higher than that of 2002. The majority of bank loans are denominated in RMB with fixed interest rates, with annual interest rates ranging from 4.44% to 5.76%.

Upon the completion of the Acquisition of the Unicom New World and the Sale of Guoxin Paging, the competitiveness of the Company has been further strengthened.

VIII. Cash flow analysis

As of 31 December 2003, we had net current liabilities (i.e. current assets minus current liabilities) of RMB21.66 billion, compared to net current liabilities of RMB12.71 billion as of 31 December 2002. The decrease in working capital mainly resulted from (i) the increase in short-term bank loans to replace long-term bank loans; (ii) cash used for the acquisition of Unicom New World at year-end; and (iii) higher indebtedness brought from the newly acquired Unicom New World. Taking into account available financing and continuous net cash inflows from our operating results, we believe that the Company has sufficient working capital for its present requirements.

IX. Critical accounting policies and significant accounting estimates

The preparation of our financial statements and this annual report requires us to make estimates and assumptions that affect the reported and disclosed amounts of assets and liabilities, including contingent assets and liabilities as at the relevant dates, and revenue and expenses for the relevant periods. We have identified the accounting policies and estimates below as considered critical to our operating activities and to the understanding of our operating results and financial positions. For a discussion of the application of these and other accounting policies, see Notes 2 and 3 to the financial statements included in this annual report. There can be no assurance that actual results will not differ from those estimates and assumptions.

1. Deferral of CDMA Customer Acquisition Costs

We have been operating 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 2002. As part of the contractual arrangements with certain CDMA contractual subscribers under these special promotional packages, CDMA handsets were provided to the subscribers for their use at no additional charge during the specified contract periods, which range 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 contractual performance, these subscribers are required under their contracts to (i) prepay certain non-refundable amounts of service fees or deposits, (ii) maintain a bank deposit in one of the designated commercial banks to secure their minimum contract amounts, or (iii) provide a guarantor who will compensate us for any loss in the event of the subscriber's non-performance of related contractual obligations.

We consider the costs of the CDMA handsets provided to contractual subscribers under these promotional packages as part of the 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 actual or minimum contract spending amounts, whichever is the higher.

We determined our accounting policy of deferred customer acquisition costs of contractual CDMA 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 rates of these subscribers; (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 bank deposits, and guarantees received, as well as penalty clauses imposed on subscribers.

Therefore, we believe that the above deferred customer acquisition costs are recoverable from future revenue to be derived from these promotional packages, and the capitalisation and amortization of these customer acquisition costs to match with future revenue is an appropriate accounting policy. Furthermore, we continuously assess and evaluate the recoverability of these deferred customer acquisition costs, based on the detailed review of historical subscriber churn rates and the estimated default rate. Based on our current assessment and evaluation, we believe that there is no significant problem in recovering the carrying amounts of the deferred customer acquisition costs as at 31 December 2003.

We have made the above recoverability assessments based on the current legal and operating environment relating to the subscribers' contract performance and other information currently available to us. Actual results may differ significantly from current situation and our current estimates. If the situation changes significantly in the future, we may need to expensed off additional non-recoverable deferred customer acquisition costs based on conditions at that time.

2. Lease of CDMA Network Capacity

We have entered into a CDMA network capacity lease agreement with Unicom Group and Unicom New Horizon. Pursuant to this 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, on 31 December 2002 and 2003, we acquired all the equity interests in Unicom New Century and Unicom New World respectively, which together operate GSM and CDMA cellular businesses in another 12 provinces, 1 municipality and 5 autonomous regions in the PRC. Unicom New Century and Unicom New World have also respectively entered into a CDMA lease agreement with Unicom Group and Unicom New Horizon on similar terms and conditions. These lease agreements and our existing lease agreement will be referred to as the CDMA Lease Agreements.

According to the terms of the CDMA Lease Agreements, the initial lease period is for one year, renewable for additional one-year terms at our own option. In January 2003, we renewed the CDMA network capacity for an additional one-year term.

We have assessed the appropriate lease classification at the inception of the CDMA Lease Agreements. Factors and related implications we have considered include whether we have taken the risks and rewards of ownership of the CDMA assets. Furthermore, we have considered whether the existence of the purchase option and the annual renewal options, combined with the related economic penalties, risks and benefits, have caused us to take on 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 believe we only bear the risks associated with the operation of our CDMA business during the relevant leasing periods and are free from any ownership risks of CDMA network. According to the terms of the CDMA Lease Agreements, our initial lease period is only one year, with renewal for additional one-year terms at our own option. Accordingly, there is no pre-determined lease period and minimum network capacity to be leased in future periods. We have the option to determine whether we will renew and continue the leases and how much capacity to lease. We also have the option to decide whether we will exercise the purchase option of CDMA network based on market environment and the future operating performance of the CDMA business subject to approvals obtained from our independent minority shareholders.

Accordingly, if the CDMA business turns out to be unsuccessful, we do not have the obligation to continue this CDMA lease arrangement or to exercise the purchase option. Or, we could continue to lease nominal capacity in order to ensure that no other operators takes possession of the assets to compete with us in our service areas.

In general, the classification of leases is dependent on whether the risks and rewards of ownership of the leased assets rest substantially with the lessor or the lessee. Leases that substantially transfer to the lessee all the risks and rewards of ownership of the leased assets are accounted for as finance leases; and leases where substantially all the risks and rewards of ownership of the leased assets remain with the lessor are accounted for as operating leases. When performing this assessment, we have considered a number of factors above that required significant judgments.

At the inception of the CDMA Lease Agreements, there has been a high degree of uncertainty related to the market condition and existing operating results of CDMA business. It remains highly uncertain whether we will continue to lease the network in the future or to estimate the future network capacity to be leased. We are also unable to determine whether or not we will exercise the purchase option. Given these uncertainties and due to the fact that the risks associated with the ownership of the CDMA assets substantially remain with Unicom Group and Unicom New Horizon, we account for the leasing of the CDMA network as operating leases, so as to reflect the respective rights and obligations of the relevant parties to the CDMA Lease Agreements. At the end of the effective lease term, we will reassess the appropriate classification based on the relevant factors and circumstances available at that time.

Under the above accounting estimates, only the operating lease expense has been recorded in our income statement since the commencement of the CDMA Lease Agreements, whereas the carrying value of the CDMA assets and the related liabilities are not reflected in our balance sheet. For the year ended 31 December 2003, we recorded lease expense of approximately RMB3.52 billion under the CDMA Lease Agreements.

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 and other long-term assets 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. 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 our estimate of any impairment provision considered necessary as at any given balance sheet date. To the extent our assumptions and estimations differ significantly from actual events and circumstances, we may need to make additional impairment provisions in future.

In 2002, despite the fact that the revenue and subscriber number of the paging business continued to decline, it managed to maintain net cash inflows from operations. Our paging business did not improve significantly because the traditional paging business was still declining, whereas the new value-added paging businesses were at their initial development stage, and thus, the real value of the paging business was not yet fully realised. At that time, we were confident about the future prospects of these new value-added paging businesses, and we believed that they could generate sufficient future economic benefits to recover the carrying values of the existing paging assets. Consequently, we believed that it was not necessary to make additional impairment provision for 2002.

Later on, in the first half of 2003, the Company conducted a re-assessment of the recoverable amount of the paging assets based on the best estimates of the discounted net future cash flows expected to be generated from the paging business in the foreseeable future years. Management made key assumptions and estimations on the appropriate discount rate adopted (8% per annum), the period covered by the cash flow forecast, the impact of the continuous decline of traditional paging business, the future loss of subscribers, the expected trend in average revenue per subscriber, as well as incremental cash flows arising from new paging businesses and the effects of the adoption of cost reduction plans. All these assumptions and estimations were made based on historical trends adjusted for the current market situation (including the physical condition of these assets) and the forecast of the future development of the new value-added paging businesses.

In the first half of 2003, based on our updated analysis and the worsening decline of the traditional paging business, we expected that the related incremental future cash inflows to be generated from the new value-added paging services, despite their continuous growth, were unlikely to offset the effects of the rapid decline of the traditional paging business in future. Consequently, based on the latest estimate of the discounted future net cash flows expected to arise from the continuing operations of the Paging Business, after considering the unexpected rapid decline of the traditional paging business in the first half of 2003, we concluded that the carrying amount of paging assets as at 30 June 2003 had exceeded their expected recoverable amounts. Accordingly, the Group recorded an additional impairment loss for property, plant and equipment of the Paging Business amounted to approximately RMB528 million in the first half of 2003. Subsequently, we sold the Paging Business to our ultimate parent company, Unicom Group, which was effective on 31 December 2003. The disposal loss of this discontinued operation, representing the difference between the sales proceeds and the carrying amount of the net assets of the Paging Business as of the effective date of the disposal amounted to approximately RMB663 million, which was recognised and charged to the income statement in 2003.

4. Provision for Doubtful Debts

Accounts receivables are stated at costs, less provision for doubtful debts. We evaluate specific accounts receivable where there are indications that the receivable may be doubtful or is not collectible. We record a provision based on our 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, historical collection patterns, subscribers' credit worthiness and collection trends. For the general subscribers of Cellular, Long Distance, Data and Internet services, we make a full provision for receivables aged over 3 months, which is consistent with our credit policy with respect to relevant subscribers.

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

5. Income Tax and Deferred Taxation

Income tax is provided for 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 in full, using the liability method, on temporary differences arising between the tax basis of assets and liabilities and their carrying amounts in the financial statements. Deferred tax assets are recognized to the extent that it is probable that future taxable profit will be available against which the temporary differences can be utilized.

In the preparation of our financial statements, we estimated our income tax provision and deferred taxation in accordance with the prevailing tax rules and regulations, taking into account any special approvals obtained from relevant tax authorities and any preferential tax treatment to which we are entitled in each location or jurisdiction in which we operate. This process involves estimation made by us about our current tax exposure together with an 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. We believe that we have recorded adequate tax provisions based on our best estimates and assumptions. 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, provisions for doubtful debts and write-down of inventory to net realizable value and additional depreciation deductible for tax purpose. Due to the effects of these temporary differences on income tax, we have recorded deferred tax assets amounting to RMB1.20 billion as of 31 December 2003. Deferred tax assets are recognized based on our estimates and assumptions 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 taxed based on prevailing tax rules and regulations and our current best estimates and assumptions. In the event that future tax rules and regulations or related circumstances change, adjustments to current and deferred taxes may be necessary.