

# Report of the Directors

The directors (the "Directors") of China Unicom Limited (the "Company") are pleased to present their report together with the audited financial statements of the Company and its subsidiaries (the "Group") for the year ended 31 December 2003.

## Principal activities

The principal activities of the Company are investment holding and its subsidiaries are principally engaged in the provision of cellular, long distance, data, Internet and paging services in China.

## Results and appropriation

The results of the Group for the year ended 31 December 2003 are set out on page 70 of the financial statements.

In view of the rapid growth in the Group's business and strong operating performance during 2003, the Board of Directors recommends the payment of a final dividend of RMB0.10 per ordinary share, totaling RMB1,255,317,207 for the year ended 31 December 2003.

## Summary of financial information

Please refer to the Financial Summary on pages 161 and 162 for the summary of the operating results, assets and liabilities of the Group for the five years ended 31 December 2003.

## Loans

Please refer to Notes 27 and 28 to the financial statements for details of the bank loans of the Group as at 31 December 2003.

## Capitalised Interest

Please refer to Note 9 to the financial statements for details of the Group's capitalised interest for the year ended 31 December 2003.

## Property, plant and equipment

Please refer to Note 21 to the financial statements for changes in the property, plant and equipment of the Group and the Company for the year ended 31 December 2003.

## Charge on assets

As of 31 December 2003, no property, plant and equipment was pledged to banks as loan security.

## Reserves

Please refer to page 74 of the financial statements for the movements in the reserves of the Group and the Company for the year ended 31 December 2003.

## Donations

For the year ended 31 December 2003, the Group made charitable and other donations totaling RMB30,084,000.

## Subsidiaries

Please refer to Note 25 to the financial statements for details of the Company's subsidiaries as at 31 December 2003.

## Changes in shareholders' equity

Please refer to page 74 of the financial statements on the Statement of Changes in Shareholders' Equity.

## Housing Benefits

Please refer to Note 13 to the financial statements for details of the housing benefits provided to employees of the Group.

## Retirement Benefits

Please refer to Note 12 to the financial statements for details of the retirement benefits provided to employees of the Group.

## Pre-emptive Rights

There are no provisions for pre-emptive rights in the articles of association of the Company (the "Articles of Association") requiring the Company to offer new shares to the existing shareholders in proportion to their shareholdings.

## Major Suppliers and Customers

The Group's sales to its five largest customers did not exceed 30% of the Group's total turnover for the year ended 31 December 2003.

Purchases from the largest supplier for the year ended 31 December 2003 represented approximately 6% of the Group's total purchases. The total purchases attributable to the five largest suppliers of the Group for the year ended 31 December 2003 accounted for approximately 24% of the total purchases of the Group for the year 2003.

None of the Directors nor their respective associates (as defined in the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited (the "Listing Rules") nor any shareholder of the Company (which to the knowledge of the Directors owns more than 5% of the Company's share capital) had any interests in the five largest suppliers of the Group for the year ended 31 December 2003.

## Connected Transactions

Please refer to Note 32(a) to the financial statements and the paragraph headed "Material Events" for a summary of the connected transactions entered into by members of the Group for the year ended 31 December 2003.

The independent non-executive Directors of the Company confirmed that all connected transactions referred to in Note 32(a), to which the Group was a party during 2003:

1. were entered into, and the agreements governing those transactions were entered into, by the Group in the ordinary and usual course of its business;
2. were entered into either (a) on normal commercial terms, or (b) if there are not sufficient comparable transactions to judge whether they are on normal commercial terms, on terms that are no less favourable than terms available to or from (as appropriate) independent third parties; and
3. were entered into in accordance with the relevant agreements governing such transactions on terms that are fair and reasonable and in the interests of our shareholders as a whole.

The independent non-executive Directors further confirm that:

1. the aggregate annual lease fee for the lease of CDMA capacity from Unicom New Horizon to CUCL ("CUCL CDMA Lease") did not exceed the maximum amount of RMB6.621 billion ("Cap A");
2. the aggregate annual lease fee for the lease of CDMA capacity from Unicom New Horizon to Unicom New Century ("UNC CDMA Lease") did not exceed the maximum amount of RMB1.500 billion ("Cap B");
3. the aggregate annual value of the rental charges for premises, equipment and facilities between CUCL and Unicom Group (the "Mutual Provision of Premises of CUCL") did not exceed the maximum amount of RMB100 million ("Cap C");
4. the aggregate annual value of the rental charges for premises leased from Unicom Group to Unicom New Century (the "Lease of Premises to UNC") did not exceed the maximum amount of RMB8 million ("Cap D"); and
5. the aggregate value of the CDMA mobile handset sales ("Sales of CDMA Mobile Handsets") from Unicom Guomai Communications Co. Ltd. to Unicom Group did not exceed the maximum amount of RMB240 million prescribed by agreement ("Cap E").

The auditors of the Group have reviewed the connected transactions and confirmed to the Directors that:

- (a) the transactions have received the approval from the Directors;
- (b) the transactions were entered into in accordance with the pricing policies as stipulated in the relevant agreements governing such transactions;
- (c) the transactions were entered into in accordance with the terms of the relevant agreements governing such transactions; and
- (d) the CUCL CDMA Lease, the UNC CDMA Lease, the Mutual Provision of Premises of CUCL, the Lease of Premises to UNC and the Sales of CDMA Mobile Handsets did not exceed Cap A, Cap B, Cap C, Cap D and Cap E respectively.

## Share Capital

Please refer to Note 30 to the financial statements for details of the share capital of the Company for the year ended 31 December 2003.

## Share option scheme

On 1 June 2000, the Company adopted a share option scheme (the "Share Option Scheme") for the purpose of providing incentives and rewards to employees who have made contributions to the development of the Company. The terms of the Share Option Scheme were amended on 13 May 2002 to comply with the requirements set out in the amended chapter 17 of the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited ("Listing Rules") which came into effect on 1 September 2001 and, following amendment, provides a more favourable scheme to attract and retain key personnel. Under the amended Share Option Scheme:

- (i) share options may be granted to employees including executive directors of the Group and any of the non-executive directors;
- (ii) any grant of share options to a Connected Person (as defined in the Listing Rules) of the Company must be approved by the independent non-executive directors of the Company (excluding any independent non-executive director of the Company who is the grantee of the options);
- (iii) the maximum number of shares in respect of which options may be granted must not exceed 10% of the issued share capital of the Company as at 13 May 2002;
- (iv) the option period commences on any day after the date on which an option is offered, but may not exceed 10 years from the offer date; and

- (v) the subscription price shall not be less than the higher of:
  - (a) the nominal value of the shares;
  - (b) the closing price of the shares on The Stock Exchange of Hong Kong Limited (“Stock Exchange”) as stated in the Stock Exchange’s quotation sheets on the offer date in respect of the options; and
  - (c) the average closing price of the shares on the Stock Exchange’s quotation sheets for the five trading days immediately preceding the offer date.

Up to 31 December 2003, 146,930,800 share options had been granted and remain valid under the Share Option Scheme of the Company, of which 5,024,000 share options are being held by the directors. Please refer to the paragraph “Directors’ Interests in and Rights to Acquire Shares” herein below for details.

All of the options granted and outstanding as at 31 December 2003 are governed by the amended terms of the Share Option Scheme as stated herein.

As of 31 December 2003, 176,000 options granted under the Share Option Scheme have been exercised.

### **Pre-global offering share option scheme**

On 1 June 2000, the Company also adopted a pre-global offering share option scheme (the “Pre-Global Offering Share Option Scheme”). In order to synchronise the administration of the options granted under the Pre-Global Offering Share Option Scheme with the Share Option Scheme, the Pre-Global Offering Share Option Scheme was also amended on 13 May 2002. The amended terms of the Pre-Global Offering Share Option Scheme are substantially the same as the Share Option Scheme stated above except that:

- (i) The price of a share payable upon the exercise of an option shall be HK\$15.42 (excluding the brokerage fee and Stock Exchange transaction levy);
- (ii) The period during which an option may be exercised commenced two years from the date of grant of the options and ends 10 years from 22 June 2000; and
- (iii) No further options can be granted under the scheme.

Up to 31 December 2003, 25,436,600 share options had been granted and remain valid under the Pre-Global Offering Share Option Scheme of the Company, of which 1,085,000 options are being held by the directors. Please refer to the paragraph “Directors’ Rights to Acquire Shares” herein below for details.

All of the options granted and outstanding as at 31 December 2003 are governed by the amended terms of the Pre-Global Offering Share Option Scheme as stated herein.

Up to 31 December 2003, no options granted under the Pre-Global Offering Share Option Scheme have been exercised.

### Financial impact and valuation of share options granted

The financial impact of share options granted is not recorded in the Company's or the Group's balance sheet until such time as the options are exercised, and no charge is recorded in the income statement account or balance sheet for their cost. Upon the exercise of the share options, the resulting shares issued are recorded by the Company as additional share capital at the nominal value of the shares, and the excess of the exercise price per share over the nominal value of the shares is recorded by the Company in the share premium account. Options which are cancelled prior to their exercise date are deleted from the register of outstanding options.

In respect of the disclosure of the value of options granted, please refer to the section headed "Supplemental Financial Information for North American Shareholders" on page 160.

Please also refer to Note 31 to the financial statements for an additional description of the respective share option schemes.

### Purchase, Sale or redemption of Shares

For the year ended 31 December 2003, neither the Company nor its subsidiaries has purchased, sold or redeemed any of the Company's listed shares.

### Substantial Interests and Short Positions in the Share Capital of the Company

The following table sets out the interests and short positions of every person, other than a Director or chief executive of the Company, in the shares or underlying shares of the Company as recorded in the register required to be kept under section 336 of the Securities and Futures Ordinance (the "Ordinance") as at 31 December 2003:

	Ordinary shares		Percentage of Total issued Shares
	Held directly	Held Indirectly	
(i) China United Telecommunications Corporation ("Unicom Group")	—	9,725,000,020	77.47%
(ii) China United Telecommunications Corporation Limited ("A Share Company")	—	9,725,000,020	77.47%
(iii) China Unicom (BVI) Limited ("China Unicom (BVI)")	9,725,000,020	—	77.47%

*Note: Because of the fact that Unicom Group and A Share Company directly or indirectly control one-third or more of the voting rights in the shareholders' meetings of China Unicom (BVI), in accordance with the Ordinance, the interests of China Unicom (BVI) are deemed to be, and have therefore been included in, the interests of Unicom Group and A Share Company.*

Apart from the foregoing, as at 31 December 2003 no person or corporation had any interest or short position in the shares or underlying shares in the Company as recorded in the register required to be kept under section 336 of the Ordinance.

Please also refer to Note 30 to the financial statements for the shareholding position of the Company's shares as at 31 December 2003.

## Directors and Senior Management of the Company

The following table sets forth certain information concerning the Directors and senior management of the Company.

Name	Position in the Company	Appointment Date	Re-appointment Date
Yang Xian Zu *	Executive Director	20 April 2000	
	Chairman, Chief Executive Director	28 May 2000	
Wang Jianzhou	Executive Director	20 April 2000	13 May 2002
	President	28 May 2000	
	Chairman, Chief Executive Director	28 August 2003	
Shi Cuiming *	Executive Director	20 April 2000	21 June 2001 &
	Executive Vice President	28 May 2000	12 May 2003
Tong Jilu	Executive Director & Chief Executive Officer	1 February 2004	
Zhao Le	Executive Director & Vice President	1 February 2004	
Lo Wing Yan, William	Executive Director & Vice President	8 July 2002	12 May 2003
Ye Fengping	Executive Director & Vice President	2 January 2003	12 May 2003
Ge Lei *	Non-Executive Director	20 April 2000	21 June 2001 &
			12 May 2003
Lee Hon Chiu	Independent Non-Executive Director	20 April 2000	13 May 2002
Wu Jinglian	Independent Non-Executive Director	20 April 2000	13 May 2002
Craig O. McCaw	Independent Non-Executive Director	24 May 2000	12 May 2003
C. James Judson	Alternate Director to Craig O. McCaw	14 March 2001	
Shan Weijian	Independent Non-Executive Director	12 May 2003	
Liu Yunjie *	Non-Executive Director	1 February 2004	

\* Mr. Yang Xian Zu resigned as Executive Director, Chairman and Chief Executive Officer on 28 August 2003, Mr. Shi Cuiming resigned as Executive Director and Executive Vice President on 1 February 2004, Mr. Ge Lei resigned as Non-Executive Directors on 1 February 2004, and Mr. Liu Yunjie resigned as Vice President on 1 February 2004 and he had been appointed as Non-Executive Director with effect from the same date.

In accordance with Article 101 of the Articles of Association, newly appointed directors, Messrs Tong Jilu, Zhao Le and Liu Yunjie are due to retire at the forthcoming annual general meeting of the Company and all retiring directors being eligible will offer themselves for re-election.

In accordance with Article 97 of the Articles of Association, Messrs Lee Hon Chiu, Wu Jinglian, Lo Wing Yan, William and Ye Fengping (decided after a lot), are due to retire at the forthcoming annual general meeting of the Company and, except Mr. Lee Hon Chiu, all retiring directors being eligible will offer themselves for re-election.

In addition, a resolution will be submitted by the Board of Directors at the forthcoming annual general meeting of the Company to elect Mr. Cheung Wing Lam, Linus as a new independent non-executive director of the Company, who shall serve as a member of the Audit Committee and the Remuneration Committee of the Board of Directors upon his appointment as a director of the Company.

## Directors' Interests and Short Positions in Shares

As at 31 December 2003, the interests and short positions of the Directors and the chief executive of the Company in any shares, underlying shares or debentures of the Company or any of its associated corporations (as defined in the Securities and Futures Ordinance (the "Ordinance")) as recorded in the register required to be kept under section 352 of the Ordinance or as otherwise notified to the Company and the Hong Kong Stock Exchange pursuant to the Model Code for Securities Transactions by Directors of Listed Companies were as follows:

As at 31 December 2003, the following Director held the following number of shares in the Company:

Name of Director	Personal Interest
Shi Cuiming*	30,000 Ordinary Shares

\* Mr. Shi Cuiming resigned as Executive Director and Executive Vice President on 1 February 2004.

As at 31 December 2003, the following Directors and chief executive of the Company held the following share options under the Pre-Global Offering Share Option Scheme and the Share Option Scheme:

Name of Director	No. of Options		No. of Options Exercised During the period	Outstanding at the end of the period
	No. of Options Granted Before the period <sup>1</sup>	No. of Options Granted During the period <sup>1</sup>		
Wang Jianzhou	816,200	420,000	—	1,236,200
Shi Cuiming <sup>2</sup>	792,200	396,000	—	1,188,200
Lo Wing Yan William	—	292,000	—	292,000
Ye Fengping	268,000	204,000	—	472,000
Ge Lei <sup>2</sup>	584,600	292,000	—	876,600
Lee Hon Chiu	292,000	292,000	—	584,000
Wu Jinglian	292,000	292,000	—	584,000
Craig O. McCaw	292,000	292,000	—	584,000
Shan Weijian	—	292,000	—	292,000

<sup>1</sup> Each option gives the holder the right to subscribe for one share.

<sup>2</sup> Mr. Shi Cuiming resigned as Executive Director and Executive Vice President on 1 February 2004, and Mr. Ge Lei resigned as Non-Executive Directors on 1 February 2004.

Apart from the foregoing, at no time during the year was the Company, or any of its holding companies or subsidiaries, a party to any arrangement to enable the Directors or any of their spouses or children under eighteen years of age to acquire benefits by means of the acquisition of shares in or debentures of the Company or any other body corporate.

Furthermore, apart from the foregoing, as at 31 December 2003, none of the Directors or chief executive of the Company had any personal, family, corporate or other interests or short positions in any shares, underlying shares or debentures in the Company or any of its associated corporations as defined in the Ordinance.

### **Directors' Interests in Contracts and Service Contracts**

Each of the existing executive Directors has entered into a service contract with the Company for a term of three years.

Save for the service contracts mentioned above, as at 31 December 2003, the Directors did not have any material interests, whether directly or indirectly, in any contracts of significance entered into by the Company.

None of those Directors proposed for re-election at the forthcoming annual general meeting has an unexpired service contract which is not terminable by the Company within one year without payment of compensation (other than statutory compensation).

### **Emoluments of the Directors and Senior Management**

Please refer to Note 11 to the financial statements for details of the emoluments of the Directors and senior management of the Company.

### **Material Events (Acquisition and Sale)**

On 20 November 2003, the Company entered into a conditional agreement for sale and purchase with China Unicom (BVI) Limited in relation to the acquisition of the businesses, assets and liabilities (including the GSM assets and business and the CDMA business) relating to telecommunications services in Shanxi, Hunan, Hainan, Yunnan, Gansu and Qinghai provinces and the Inner Mongolia, Ningxia Hui and Xizang autonomous regions in the PRC from Unicom Group indirectly through the acquisition of the entire issued capital of Unicom New World (BVI) Limited (the "Acquisition").

On the same day, the Company entered into a conditional agreement for sale and purchase with Unicom A Share Company in relation to the sale of entire equity interests of Guoxin Paging Corporation Limited to Unicom Group (the "Sale") (via intermediary holding company, China Unicom Corporation Limited).

The Acquisition and the Sale constitute connected transactions for the Company under the Listing Rules, pursuant to which an independent board committee consisting of all independent directors formed by the Board together with the appointed independent financial advisers had reviewed the Acquisition and Sale and confirmed the terms of the transaction to be fair and reasonable and recommended to shareholders to vote for the approval of the Acquisition and Sale at the extraordinary general meeting held on 22 December 2003 whereby such shareholders' approval was obtained. The Acquisition and the Sale were effective on 31 December 2003.

### **Compliance with Code of Best Practice**

The Company has complied throughout the year of 2003 with the Code of Best Practice as set out by the Stock Exchange in Appendix 14 to the Listing Rules except that the non-executive Directors were not appointed for a specific term but are subject to retirement by rotation and re-election at the Company's annual general meeting in accordance with the Articles of Association.

### **Material Legal Proceedings**

For the year ended 31 December 2003, the Company was not involved in any material litigation or arbitration and no material litigation or claims was pending or threatened or made against the Company as far as the Company is aware.

### **Auditors**

PricewaterhouseCoopers were appointed as the auditors of the Company for the year ended 31 December 2003 and have audited the accompanying financial statements. A resolution will be submitted by the Board of Directors at the forthcoming annual general meeting of the Company to re-appoint PricewaterhouseCoopers as the Company's auditors for the year ending 31 December 2004.

By Order of the Board

### **Wang Jianzhou**

*Chairman and Chief Executive Officer*

Hong Kong, 25 March 2004