

NOTES TO FINANCIAL STATEMENTS

(Prepared under Hong Kong accounting standards)

31 December 2004

1. CORPORATE INFORMATION

The registered office of ZTE Corporation (the "Company") is located at ZTE Plaza, Keji Road South, Hi-Tech Industrial Park, Nanshan District, Shenzhen 518057, the People's Republic of China (the "PRC").

During the year, the Company and its subsidiaries (the "Group") were principally involved in the design, development, manufacture and sale of telecommunications systems equipment and solutions.

In the opinion of the directors, the ultimate holding company is Shenzhen Zhongxingxin Telecommunications Equipment Company, Limited ("Zhongxingxin"), a limited liability company registered in the PRC.

2. IMPACT OF RECENTLY ISSUED HONG KONG FINANCIAL REPORTING STANDARDS ("HKFRSs")

The Hong Kong Institute of Certified Public Accountants has issued a number of new and revised Hong Kong Financial Reporting Standards and Hong Kong Accounting Standards, herein collectively referred to as the new HKFRSs, which are generally effective for accounting periods beginning on or after 1 January 2005. The Group has not early adopted these new HKFRSs in the financial statements for the year ended 31 December 2004. The Group has already commenced an assessment of the impact of these new HKFRSs but is not yet in a position to state whether these new HKFRSs would have a significant impact on its results of operations and financial position.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of preparation

These financial statements have been prepared in accordance with Hong Kong Financial Reporting Standards (which also include Statements of Standard Accounting Practice and Interpretations) issued by the Hong Kong Institute of Certified Public Accountants, accounting principles generally accepted in Hong Kong and the disclosure requirements of the Hong Kong Companies Ordinance. They have been prepared under the historical cost convention.

Basis of consolidation

The consolidated financial statements include the financial statements of the Company and its subsidiaries for the year ended 31 December 2004. The results of subsidiaries acquired or disposed of during the year are consolidated from or to their effective dates of acquisition or disposal, respectively. All significant intercompany transactions and balances within the Group are eliminated on consolidation.

Minority interests represent the interests of outside shareholders in the results and net assets of the Company's subsidiaries.

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3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Subsidiaries

A subsidiary is a company whose financial and operating policies the Company controls, directly or indirectly, so as to obtain benefits from its activities.

The results of subsidiaries are included in the Company's profit and loss account to the extent of dividends received and receivable. The Company's investments in subsidiaries are stated at cost less any impairment losses.

Joint venture companies

A joint venture company is a company set up by contractual arrangement, whereby the Group and other parties undertake an economic activity. The joint venture company operates as a separate entity in which the Group and the other parties have an interest.

The joint venture agreement between the venturers stipulates the capital contributions of the joint venture parties, the duration of the joint venture and the basis on which the assets are to be realised upon its dissolution. The profits and losses from the joint venture company's operations and any distributions of surplus assets are shared by the venturers, either in proportion to their respective capital contributions, or in accordance with the terms of the joint venture agreement.

A joint venture company is treated as:

- (a) a subsidiary, if the Company has unilateral control, directly or indirectly, over the joint venture company;
- (b) a jointly-controlled entity, if the Company does not have unilateral control, but has joint control, directly or indirectly, over the joint venture company;
- (c) an associate, if the Company does not have unilateral or joint control, but holds, directly or indirectly, generally not less than 20% of the joint venture company's registered capital and is in a position to exercise significant influence over the joint venture company; or
- (d) a long term investment, if the Company holds, directly or indirectly, less than 20% of the joint venture company's registered capital and has neither joint control of, nor is in a position to exercise significant influence over, the joint venture company.

Jointly-controlled entities

A jointly-controlled entity is a joint venture company which is subject to joint control, resulting in none of the participating parties having unilateral control over the economic activity of the jointly-controlled entity.

The Group's share of the post-acquisition results and reserves of jointly-controlled entities is included in the consolidated profit and loss account and consolidated reserves, respectively. The Group's interests in jointly-controlled entities are stated in the consolidated balance sheet at the Group's share of net assets under the equity method of accounting, less any impairment losses.

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3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Jointly-controlled entities (continued)

The results of jointly-controlled entities are included in the Company's profit and loss account to the extent of dividends received and receivable. The Company's interests in jointly-controlled entities are treated as long term assets and are stated at cost less any impairment losses.

Associates

An associate is a company, not being a subsidiary or a jointly-controlled entity, in which the Group has a long term interest of generally not less than 20% of the equity voting rights and over which it is in a position to exercise significant influence.

The Group's share of the post-acquisition results and reserves of associates is included in the consolidated profit and loss account and consolidated reserves, respectively. The Group's interests in associates are stated in the consolidated balance sheet at the Group's share of net assets under the equity method of accounting, less any impairment losses.

The results of associates are included in the Company's profit and loss account to the extent of dividends received and receivable. The Company's interests in associates are treated as long term assets and are stated at cost less any impairment losses.

Goodwill

Goodwill arising on the acquisition of subsidiaries represents the excess of the cost of the acquisition over the Group's share of the fair values of the identifiable assets and liabilities acquired as at the date of acquisition.

Goodwill arising on acquisition is recognised in the consolidated balance sheet as an asset and amortised on the straight-line basis over its estimated useful life of 10 years.

On disposal of subsidiaries, the gain or loss on disposal is calculated by reference to the net assets at the date of disposal, including the attributable amount of goodwill which remains unamortised and any relevant reserves, as appropriate.

The carrying amount of goodwill is reviewed annually and written down for impairment when it is considered necessary. A previously recognised impairment loss for goodwill is not reversed unless the impairment loss was caused by a specific external event of an exceptional nature that was not expected to recur, and subsequent external events have occurred which have reversed the effect of that event.

Negative goodwill

Negative goodwill arising on the acquisition of subsidiaries represents the excess of the Group's share of the fair values of the identifiable assets and liabilities acquired as at the date of acquisition, over the cost of the acquisition.

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3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Negative goodwill (continued)

To the extent that negative goodwill relates to expectations of future losses and expenses that are identified in the acquisition plan and that can be measured reliably, but which do not represent identifiable liabilities as at the date of acquisition, that portion of negative goodwill is recognised as income in the consolidated profit and loss account when the future losses and expenses are recognised.

To the extent that negative goodwill does not relate to identifiable expected future losses and expenses as at the date of acquisition, negative goodwill is recognised in the consolidated profit and loss account on a systematic basis over the remaining average useful life of the acquired depreciable/ amortisable assets. The amount of any negative goodwill in excess of the fair values of the acquired non-monetary assets is recognised as income immediately.

On disposal of subsidiaries, the gain or loss on disposal is calculated by reference to the net assets at the date of disposal, including the attributable amount of negative goodwill which has not been recognised in the consolidated profit and loss account and any relevant reserves as appropriate.

Related parties

Parties are considered to be related if one party has the ability, directly or indirectly, to control the other party or exercise significant influence over the other party in making financial and operating decisions. Parties are also considered to be related if they are subject to common control or common significant influence. Related parties may be individuals or corporate entities.

Impairment of assets

An assessment is made at each balance sheet date of whether there is any indication of impairment of any asset, or whether there is any indication that an impairment loss previously recognised for an asset in prior years may no longer exist or may have decreased. If any such indication exists, the asset's recoverable amount is estimated. An asset's recoverable amount is calculated as the higher of the asset's value in use and its net selling price.

An impairment loss is recognised only if the carrying amount of an asset exceeds its recoverable amount. An impairment loss is charged to the profit and loss account in the period in which it arises, unless the asset is carried at a revalued amount, when the impairment loss is accounted for in accordance with the relevant accounting policy for that revalued asset.

A previously recognised impairment loss is reversed only if there has been a change in the estimates used to determine the recoverable amount of an asset, however not to an amount higher than the carrying amount that would have been determined (net of any depreciation/amortisation), had no impairment loss been recognised for the asset in prior years. A reversal of an impairment loss is credited to the profit and loss account in the period in which it arises.

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3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Fixed assets and depreciation

Fixed assets, other than construction in progress, are stated at cost less accumulated depreciation and any impairment losses. The cost of an asset comprises its purchase price and any directly attributable costs of bringing the asset to its working condition and location for its intended use. Expenditure incurred after fixed assets have been put into operation, such as repairs and maintenance, is normally charged to the profit and loss account in the period in which it is incurred. In situations where it can be clearly demonstrated that the expenditure has resulted in an increase in the future economic benefits expected to be obtained from the use of the fixed asset, the expenditure is capitalised as an additional cost of that asset.

Depreciation is calculated on the straight-line basis to write off the cost of each asset over its estimated useful life, after taking into account its estimated residual value. The estimated useful lives of fixed assets are as follows:

Land use rights	50 years
Buildings	2 to 30 years
Leasehold improvements	Over the lease terms or 10 years, whichever is shorter
Machinery, computer and office equipment	5 to 10 years
Motor vehicles	5 to 10 years

The gain or loss on disposal or retirement of a fixed asset recognised in the profit and loss account is the difference between the net sales proceeds and the carrying amount of the relevant asset.

Construction in progress

Construction in progress represents buildings, plant and machineries and other fixed assets under construction or installation, which are stated at cost less any impairment losses and are not depreciated. Cost comprises the direct costs of construction, installation and capitalised borrowing costs on related borrowed funds during the period of construction. Construction in progress is reclassified to the appropriate category of fixed assets when completed and ready for use.

Intangible assets

Technology know-how

Purchased technology know-how is stated at cost, less any impairment losses, and is amortised on the straight-line basis over its estimated useful life of not more than 10 years.

Computer software

Purchased computer software is stated at cost less any impairment losses and is amortised on the straight-line basis over its estimated useful life of 5 years.

Operating concession

Operating concession represents the right to operate a telecommunications company, and is stated at cost less accumulated amortisation and any impairment losses. Amortisation is provided on the straight-line basis over 20 years, being the period that the operating concession granted to the Group.

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3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Intangible assets (continued)

Research and development costs

All research costs are charged to the profit and loss account as incurred.

Expenditure incurred on projects to develop new products is capitalised and deferred only when the projects are clearly defined; the expenditure is separately identifiable and can be measured reliably; there is reasonable certainty that the projects are technically feasible; and the products have commercial value. Product development expenditure which does not meet these criteria is expensed when incurred.

Deferred development costs are stated at cost less any impairment losses and are amortised using the straight-line basis over the commercial lives of the underlying products not exceeding 5 years, commencing from the date when the products are put into commercial production.

Long term investments

Long term investments are non-trading investments in unlisted equity securities intended to be held on a long term basis.

Unlisted securities are stated at their estimated fair values, on an individual basis. The estimated fair values of unlisted investments are determined by the directors having regard to, inter alia, the attributable net asset value of the investments, with allowance made for the lower liquidity of the unlisted securities.

The gains or losses arising from changes in the fair value of the investments are recognised directly in equity until the securities is sold or determined to be impaired, at which time the cumulative gain or loss is included in the profit and loss account for the year.

Short term investments

Short term investments are investments in equity securities held for trading purposes and are stated at their fair values on the basis of their quoted market prices at the balance sheet date, on an individual investment basis. The gains or losses arising from changes in the fair value of a security are credited or charged to the profit and loss account in the period in which they arise.

Operating leases

Leases where substantially all the rewards and risks of ownership of assets remain with the lessor are accounted for as operating leases. Where the Group is the lessor, assets leased by the Group under operating leases are included in non-current assets and rental receivables under the operating leases are credited to the profit and loss account on the straight-line basis over the lease terms. Where the Group is the lessee, rentals payable under the operating leases are charged to the profit and loss account on the straight-line basis over the lease terms.

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3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Inventories

Inventories are stated at the lower of cost and net realisable value. Cost is determined on the weighted average basis and, in the case of work in progress and finished goods, comprises direct materials, direct labour, an appropriate proportion of overheads and/or subcontracting fee. Net realisable value is based on estimated selling prices less any estimated costs to be incurred to completion and disposal.

Construction contracts

Contract revenue comprises the agreed contract amount and appropriate amounts from variation orders, claims and incentive payments in respect of telecommunications systems contracts. Contract costs incurred comprise direct materials, the costs of subcontracting, direct labour and an appropriate proportion of variable and fixed construction overheads.

Revenue from fixed price telecommunications systems contracts is recognised using the percentage of completion method when the contract activities have progressed to a stage where economic benefit can be reasonably foreseen and is measured by reference to the proportion of costs incurred to date to the estimated total cost of the relevant contract.

Provision is made for foreseeable losses as soon as they are anticipated by management.

Where contract costs incurred to date plus recognised profits less recognised losses exceed progress billings, the surplus is treated as an amount due from customers for contract work.

Where progress billings exceed contract costs incurred to date plus recognised profits less recognised losses, the surplus is treated as an amount due to customers for contract work.

Government grants

Government grants are recognised at their fair value where there is reasonable assurance that the grant will be received and all attaching conditions will be complied with. When the grant relates to an expense item, it is recognised as income over the periods necessary to match the grant on a systematic basis to the costs that it is intended to compensate. Where the grant relates to an asset, the fair value is credited to other payable or other long-term payable accounts and is released to the profit and loss account over the expected useful life of the relevant asset by equal annual instalments.

Provisions

A provision is recognised when a present obligation (legal or constructive) has arisen as a result of a past event and it is probable that a future outflow of resources will be required to settle the obligation, provided that a reliable estimate can be made of the amount of the obligation.

When the effect of discounting is material, the amount recognised for a provision is the present value at the balance sheet date of the future expenditures expected to be required to settle the obligation. The increase in the discounted present value amount arising from the passage of time is included in finance costs in the profit and loss account.

Provisions for warranties granted by the Group on construction contracts are recognised based on cost of sales and past experience of the level of repairs and returns.

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3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Income tax

Income tax comprises current and deferred tax. Income tax is recognised in the profit and loss account, or in equity if it relates to items that are recognised in the same or a different period directly in equity.

Deferred tax is provided, using the liability method, on all temporary differences at the balance sheet date between the tax bases of assets and liabilities and their carrying amounts for financial reporting purposes.

Deferred tax liabilities are recognised for all taxable temporary differences:

- except where the deferred tax liability arises from goodwill or the initial recognition of an asset or liability in a transaction that is not a business combination and, at the time of the transaction, affects neither the accounting profit nor taxable profit or loss; and
- in respect of taxable temporary differences associated with investments in subsidiaries, associates and interests in joint ventures, except where the timing of the reversal of the temporary differences can be controlled and it is probable that the temporary differences will not reverse in the foreseeable future.

Deferred tax assets are recognised for all deductible temporary differences, carryforward of unused tax assets and unused tax losses, to the extent that it is probable that taxable profit will be available against which the deductible temporary differences, and the carryforward of unused tax assets and unused tax losses can be utilised:

- except where the deferred tax asset relating to the deductible temporary differences arises from negative goodwill or the initial recognition of an asset or liability in a transaction that is not a business combination and, at the time of the transaction, affects neither the accounting profit nor taxable profit or loss; and
- in respect of deductible temporary differences associated with investments in subsidiaries, associates and interests in joint ventures, deferred tax assets are only recognised to the extent that it is probable that the temporary differences will reverse in the foreseeable future and taxable profit will be available against which the temporary differences can be utilised.

The carrying amount of deferred tax assets is reviewed at each balance sheet date and reduced to the extent that it is no longer probable that sufficient taxable profit will be available to allow all or part of the deferred tax asset to be utilised. Conversely, previously unrecognised deferred tax assets are recognised to the extent that it is probable that sufficient taxable profit will be available to allow all or part of the deferred tax asset to be utilised.

Deferred tax assets and liabilities are measured at the tax rates that are expected to apply to the period when the asset is realised or the liability is settled, based on tax rates (and tax laws) that have been enacted or substantively enacted at the balance sheet date.

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3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Retirement benefits scheme

Defined contribution pension scheme

The Company and certain of its subsidiaries established in the PRC have joined a number of defined contribution pension schemes organised by the relevant provincial and municipal social insurance management bodies in the PRC governments for certain of its employees. The Company, these subsidiaries and the employees are required to make monthly contributions to these plans calculated as a percentage of the employees salaries during the year. The contributions payable are charged as an expense to the profit and loss account as incurred. The assets of the schemes are held separately from those of the Group in independently administered funds.

Defined benefits pension scheme

In addition, the Group provides certain employees, who joined the group before 1 January 2002, with post-retirement monthly pension payments. The cost of providing these benefits under the Group's defined benefits plan is actuarially determined and recognised over the employees' service period by using the projected unit credit method. The Group makes monthly pension payments to eligible retirees and no contribution has been made to fund future obligations since the commencement of the defined benefits scheme. Therefore, there are no assets held separately from those of the Group in independently administered funds and no actuarial valuation for the plan assets has been conducted.

Foreign currencies

Foreign currency transactions are recorded at the applicable exchange rates ruling at the transaction dates. Monetary assets and liabilities denominated in foreign currencies at the balance sheet date are translated at the applicable exchange rates ruling at that date. Exchange differences are dealt with in the profit and loss account.

On consolidation, the assets and liabilities of the overseas subsidiaries and jointly-controlled entities denominated in foreign currencies are translated into Renminbi at the applicable rates of exchange ruling at that date. The profit and loss account of the overseas subsidiaries and jointly-controlled entities denominated in foreign currencies are translated into Renminbi at weighted average exchange rates for the year. The resulting translation differences are included in the exchange fluctuation reserve.

For the purpose of the consolidated cash flow statement, the cash flows of overseas subsidiaries denominated in foreign currencies are translated into Renminbi at the exchange rates at the date of the cash flows. Frequently recurring cash flows of overseas subsidiaries which arise throughout the year are translated into Renminbi at the weighted average exchange rates for the year.

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3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Cash and cash equivalents

For the purpose of the consolidated cash flow statement, cash and cash equivalents comprise cash on hand and demand deposits, and short term highly liquid investments which are readily convertible into known amounts of cash and which are subject to an insignificant risk of changes in value, and have a short maturity of generally within three months when acquired, less bank overdrafts which are repayable on demand and form an integral part of the Group's cash management.

For the purpose of the balance sheet, cash and cash equivalents comprise cash on hand and at banks, including term deposits, which are not restricted as to use.

Revenue recognition

Revenue is recognised when it is probable that the economic benefits will flow to the Group and when the revenue can be measured reliably, on the following bases:

- (a) from the sale of goods, when the significant risks and rewards of ownership have been transferred to the buyer, provided that the Group maintains neither managerial involvement to the degree usually associated with ownership, nor effective control over the goods sold;
- (b) from the construction contracts, on the percentage of completion basis, as further explained in the accounting policy for "Construction contracts" above;
- (c) from the rendering of services, when services are rendered;
- (d) interest income, on a time proportion basis taking into account the principal outstanding and the effective interest rate applicable; and
- (e) dividend income, when the shareholders' right to receive payment has been established.

Dividends

Final dividends proposed by the directors are classified as a separate allocation of retained profits within the capital and reserves section of the balance sheet, until they have been approved by the shareholders in a general meeting. When these dividends have been approved by the shareholders and declared, they are recognised as a liability.

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4. SEGMENT INFORMATION

Segment information is presented by way of two segments: (i) on a primary segment reporting basis, by business segment; and (ii) on a secondary segment reporting basis, by geographical segment.

The Group's operating business are structured and managed separately, according to the nature of their operations and the products and services they provide. Each of the Group's business segments represents a strategic business unit that offers products and services which are subject to risks and returns that are different from those of the other business segments. Summary details of the business segments are as follows:

- (a) The wireless communications segment engages in the provision of systems integration and the sale of equipment for mobile phone network systems, primarily in respect of CDMA, GSM and wireless local access (PHS) systems.
- (b) The wireline switch and access segment engages in the manufacture and sale of wireline, circuit-switches and narrow-band access systems for fixed line phone systems.
- (c) The optical and data communications segment engages in the provision of DSL systems, SDH, WDM systems and softswitch systems, broadband routing switches, wireless access data products and other data communications products.
- (d) The handsets segment engages in the manufacture and sale of CDMA and GSM mobile phone handsets and wireless local access (PHS) handsets.
- (e) The telecommunications software systems and services and other products segment represented the provision of telecommunications software systems such as intelligent networks, and operation support systems and the provision of fee-based services.

In determining the Group's geographical segments, revenues are attributed to the segments based on the location of the customers, and assets are attributed to the segments based on the location of the assets.

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4. SEGMENT INFORMATION (continued)

(a) Business segments

The following tables present revenue, profit and certain asset, liability and expenditure information for the Group's business segments.

Group

	Wireless communications		Wired switch and access		Optical and data communications		Handsets		Telecommunications software systems, services and other products		Consolidated	
	2004	2003	2004	2003	2004	2003	2004	2003	2004	2003	2004	2003
	RMB'000	RMB'000	RMB'000	RMB'000	RMB'000	RMB'000	RMB'000	RMB'000	RMB'000	RMB'000	RMB'000	RMB'000
Segment revenue:												
Contract revenue from external customers	8,786,407	7,783,341	2,598,588	2,257,949	2,335,273	2,210,966	-	-	1,484,827	1,157,177	15,205,095	13,409,433
Sale of goods	-	-	-	-	-	-	6,014,967	3,626,650	-	-	6,014,967	3,626,650
Total	8,786,407	7,783,341	2,598,588	2,257,949	2,335,273	2,210,966	6,014,967	3,626,650	1,484,827	1,157,177	21,220,062	17,036,083
Segment results	2,654,012	1,453,239	1,150,138	1,028,488	258,586	580,549	(64,871)	233,959	609,038	552,240	4,606,903	3,828,475
Interest and unallocated gains											534,129	251,969
Unallocated expenses											(3,408,984)	(2,618,602)
Profit from operating activities											1,732,048	1,461,842
Finance costs											(140,397)	(171,154)
Share of profit and losses of:												
Jointly-controlled entities	-	-	-	-	3,442	(1,479)	-	-	(32)	(289)	3,410	(1,768)
Associates	-	-	-	-	-	-	-	-	32	(1,740)	32	(1,740)
Profit before tax											1,595,093	1,287,180
Tax											(115,259)	(198,541)
Profit before minority interests											1,479,834	1,088,639
Minority interests											(207,345)	(60,333)
Net profit from ordinary activities attributable to shareholders											1,272,489	1,028,306
Segment assets	3,975,515	4,067,092	1,319,962	1,547,723	1,624,418	2,118,074	2,460,313	1,354,319	740,563	204,189	10,120,771	9,291,397
Interests in jointly-controlled entities	-	-	-	-	4,035	3,374	-	-	3,751	1,945	7,786	5,319
Interests in associates	-	-	-	-	-	-	-	-	8,845	300	8,845	300
Unallocated assets											10,870,361	7,179,371
Total assets											21,007,763	16,476,387
Segment liabilities	1,486,801	1,319,520	407,707	665,502	275,238	321,211	248,998	2,680	148,985	462,092	2,567,729	2,771,005
Unallocated liabilities											8,744,502	8,878,899
Total liabilities											11,312,231	11,649,904
Other segment information:												
Depreciation and amortisation	106,452	64,298	22,906	100,203	50,605	48,081	70,939	50,068	30,255	8,016	361,003	356,818
Amortisation of goodwill	-	-	-	-	-	-	2,958	-	1,738	2,344	4,696	2,344
Capital expenditure	266,426	88,843	57,329	265,249	126,652	81,618	177,542	38,033	75,722	76,085	703,671	549,828

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4. SEGMENT INFORMATION (continued)

(b) Geographical segments

The following tables present revenue information for the Group's geographical segments. Over 90% of the Group's assets are located in the PRC. Accordingly, no analysis of the assets and capital expenditure by geographical segment is presented.

Group

	The PRC		Asia (excluding the PRC)		Africa		Others		Consolidated	
	2004	2003	2004	2003	2004	2003	2004	2003	2004	2003
	RMB'000	RMB'000	RMB'000	RMB'000	RMB'000	RMB'000	RMB'000	RMB'000	RMB'000	RMB'000
Segment revenue:										
Contract revenue from external customers	10,636,190	11,519,753	2,453,308	979,252	1,513,052	829,288	602,545	81,140	15,205,095	13,409,433
Sale of goods	6,008,332	3,556,605	6,635	70,045	-	-	-	-	6,014,967	3,626,650
	16,644,522	15,076,358	2,459,943	1,049,297	1,513,052	829,288	602,545	81,140	21,220,062	17,036,083

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5. TURNOVER AND OTHER REVENUE AND GAINS

Turnover represents the aggregate of an appropriate proportion of contract revenue from construction contracts and the invoiced value of goods sold, net of value-added tax ("VAT"), and after allowances for goods returns and trade discounts. All significant intra-group transactions have been eliminated on consolidation.

An analysis of the Group's turnover and other revenue and gains is as follows:

	Notes	2004 RMB'000	2003 RMB'000
Turnover			
Telecommunications systems contracts		15,205,095	13,409,433
Sale of goods		6,014,967	3,626,650
		21,220,062	17,036,083
Other revenue			
Government grants		68,710	33,463
Sale of scrap materials		–	47,878
Service fees		22,968	7,545
VAT subsidies, exemptions and refunds [#]		395,424	133,316
Interest income		30,118	29,703
		517,220	251,905
Gains			
Gain on disposal of a subsidiary	36(b)	–	64
Negative goodwill recognised	36(a)	4,770	–
Gain on disposal of short-term investments		12,139	–
		16,909	64
		534,129	251,969

[#] During the year ended 31 December 2003 and 2004, the Company received VAT subsidies on the amount of VAT paid for high-technology products as approved by Shenzhen Economic and Trade Bureau (深圳市經濟貿易局), Shenzhen Science and Technology Bureau (深圳市科技局), Shenzhen Finance Bureau (深圳市財政局), Shenzhen State Tax Bureau (深圳市國家稅務局) and Shenzhen Local Tax Bureau (深圳市地方稅務局). In addition, for the year ended 31 December 2003 and 2004, Shenzhen Zhongxing Software Company, Limited ("Zhongxing Software"), being a designated software enterprise, was entitled to VAT refunds on the effective VAT rate in excess of 3% after the payment of statutory net output VAT of 17%. Such VAT refunds were approved by Shenzhen State Tax Bureau (深圳市國家稅務局) and had been received by Zhongxing Software.

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6. PROFIT FROM OPERATING ACTIVITIES

The Group's profit from operating activities is arrived at after charging:

	Notes	2004 RMB'000	2003 RMB'000
Cost of inventories sold		13,322,040	10,833,539
Depreciation	15	281,157	270,666
Amortisation of intangible assets	16	79,846	86,152
Goodwill:			
Amortisation for the year*	17	4,696	2,344
Impairment arising during the year*	17	13,037	–
		17,733	2,344
Impairment of intangible assets	16	7,847	–
Loss on retirement and disposal of intangible assets		19,605	–
Provision for bad and doubtful debts*		100,027	162,514
Provision for warranties**	32	129,930	106,310
Provision against inventory obsolescence and net realisable value**		279,575	10,037
Minimum lease payments under operating leases on land and buildings		109,054	50,207
Auditors' remuneration		4,190	950
Staff costs (including directors' and supervisors' remuneration – note 8):			
Wages, salaries, bonuses, allowances and welfares		2,892,283	2,133,480
Pension scheme contributions:			
Defined benefits pension scheme – note 30		2,473	2,790
Defined contribution pension scheme		128,022	87,741
		3,022,778	2,224,011
Impairment of long-term investments*		–	674
Exchange losses, net*		13,334	669
Loss on disposal of fixed assets*		11,654	22,657
Write-off of fixed assets*		–	24,995

* The amortisation and impairment of goodwill, provision for bad and doubtful debts, impairment of long-term investments, exchange losses, net, loss on disposal and write-off of fixed assets are included in "Other operating expenses" on the face of the consolidated profit and loss account.

** The provision for warranties and provision against inventory obsolescence and net realisable value are included in "Cost of sales" on the face of the consolidated profit and loss account.

NOTES TO FINANCIAL STATEMENTS

(Prepared under Hong Kong accounting standards)

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7. FINANCE COSTS

	Group	
	2004 RMB'000	2003 RMB'000
Interest on bank loans wholly repayable:		
Within five years	75,056	114,641
Beyond five years	-	1,333
	75,056	115,974
Finance costs on factoring loans and bills discounted	65,341	55,180
	140,397	171,154

8. DIRECTORS' AND SUPERVISORS' REMUNERATION

Directors' and supervisors' remuneration for the year, disclosed pursuant to the Listing Rules and Section 161 of the Companies Ordinance, are as follows:

	Group	
	2004 RMB'000	2003 RMB'000
Fees	-	-
Other emoluments of executive directors and supervisors:		
Salaries, bonuses, allowances and welfare	3,073	1,980
Performance related bonuses	5,544	3,521
Retirement benefits scheme contribution	58	87
	8,675	5,588

Other emoluments include allowances of RMB335,000 (2003: Nil) in aggregate paid to the independent non-executive directors during the year.

The number of directors and supervisors whose remuneration fell within the following band is as follows:

	Number of directors and supervisors	
	2004	2003
Nil to RMB1,000,000	18	22
RMB1,000,001 – RMB1,500,000	5	-
	23	22

There was no arrangement under which a director waived or agreed to waive any remuneration during the year.

NOTES TO FINANCIAL STATEMENTS

(Prepared under Hong Kong accounting standards)

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9. FIVE HIGHEST PAID EMPLOYEES

The five highest paid employees during the year included nil (2003: Nil) directors, details of whose remuneration are set out in note 8 above. Details of the remuneration of the remaining 5 (2003: 5) non-director and non-supervisor, highest paid employees for the year are as follows:

	2004 RMB'000	2003 RMB'000
Salaries, bonuses, allowances and welfare	833	2,212
Performance related bonuses	7,289	3,511
Retirement benefits scheme contribution	-	11
	8,122	5,734

The number of non-director, non-supervisor, highest paid employees whose remuneration fell within the following bands is as follows:

	Number of employees	
	2004	2003
Nil to RMB1,000,000	-	1
RMB1,000,001- RMB1,500,000	-	4
RMB1,500,001- RMB2,000,000	5	-
	5	5

During the year, no director or supervisor waived or agreed to waive any emolument, and no emoluments were paid by the Group to the directors, supervisors or any of the five highest paid employees as an inducement to join or upon joining the Group or as compensation for loss of office.

10. TAX

	2004 RMB'000	2003 RMB'000
Group:		
Current – Hong Kong	5,735	2,664
Current – Mainland China		
Charge for the year	113,651	243,514
Overprovision in prior years	(52,513)	-
Current – Overseas	9,567	9,513
Deferred tax (note 33)	38,514	(57,264)
	114,954	198,427
Jointly-controlled entities:		
Mainland China	305	114
Total tax charge for the year	115,259	198,541

NOTES TO FINANCIAL STATEMENTS

(Prepared under Hong Kong accounting standards)

31 December 2004

10. TAX (continued)

Hong Kong profits tax has been provided at the rate of 17.5% (2003: 17.5%) on the estimated assessable profits arising in Hong Kong during the year. Taxes on profits assessable elsewhere have been calculated at the rates of tax prevailing in the countries in which the Group operates, based on existing legislation, interpretations and practices in respect thereof.

Under the relevant PRC income tax law, except for certain preferential treatment available to the Company and its subsidiaries, the Group's entities established in the PRC are subject to corporate income tax at a rate of 33% on their taxable income.

The Company and its subsidiaries that are registered and operating in the Shenzhen Special Economic Zone of the PRC are entitled to a preferential income tax rate of 15%.

On 31 July 1997, ZTE Kangxun Telecom Company, Limited ("Kangxun"), a major subsidiary of the Company was approved by the Shenzhen Local Tax Bureau to be exempted from corporate income tax for two years and a 50% relief in the three years thereafter starting from the first profitable year which was effective from 1 January 1997 until 31 December 2001. Kangxun was also certified as a high-technology enterprise on 1 August 2001. In December 2001, Kangxun obtained an approval from the Shenzhen Local Tax Bureau to extend the 50% relief from corporate income tax for a further three years effective from 1 January 2002 until 31 December 2004. The income tax rate applicable to Kangxun was 7.5% during this period. Upon cessation of the tax relief period, Kangxun will be subject to an income tax rate of 15% commencing from 1 January 2005.

As a designated software enterprise, Zhongxing Software, a major subsidiary of the Company was approved as a new software enterprise and entitled to full exemption from corporate income tax for two years and a 50% relief in the three years thereafter starting from the first profitable year which was effective from 1 January 2003 until 31 December 2007.

Shanxi Zhongxing Telecom Equipment Company, Limited and Wuxi Zhongxing Optoelectronics Technologies Company, Limited were both certified by the relevant authorities as high-technology enterprise. Pursuant to the relevant income tax laws in the PRC, these enterprises are subject to a preferential corporate income tax rate of 15%.

ZTEIC Design Co., Ltd ("ZTEIC Design") and ZTE Mobile Tech Co., Ltd ("ZTE Mobile") are both entitled to full exemption from corporate income tax for two years, starting from their first profitable years and a 50% relief in the three years thereafter. ZTEIC Design and ZTE Mobile each have not entered into their first profitable year since establishment.

NOTES TO FINANCIAL STATEMENTS

(Prepared under Hong Kong accounting standards)

31 December 2004

10. TAX (continued)

A reconciliation of the tax expense applicable to profit before tax using the statutory rates for the countries in which the Company and its subsidiaries, jointly-controlled entities and associates are domiciled to the tax expense at the effective tax rates, and a reconciliation of the applicable rates (i.e., the statutory tax rates) to the effective tax rates, are as follows:

	2004		2003	
	RMB'000	%	RMB'000	%
Profit before tax	1,595,093		1,287,180	
Tax at statutory tax rate	526,381	33.0	424,769	33.0
Lower tax rate for specific provinces or local authority	(287,117)	(18.0)	(231,692)	(18.0)
Expenses not deductible for tax	115,735	7.2	89,229	6.9
Income not subject to tax	(49,480)	(3.1)	(28,134)	(2.1)
Tax holiday	(202,910)	(12.7)	(70,403)	(5.5)
Tax losses of subsidiaries	12,650	0.8	14,772	1.1
Tax charge at the Group's effective rate	115,259	7.2	198,541	15.4

11. NET PROFIT FROM ORDINARY ACTIVITIES ATTRIBUTABLE TO SHAREHOLDERS

The net profit from ordinary activities attributable to shareholders for the year ended 31 December 2004 dealt with in the financial statements of the Company, was approximately RMB150,233,000 (2003: RMB1,241,786,000).

12. DIVIDENDS

	2004	2003
	RMB'000	RMB'000
Proposed final	239,880	200,188
	239,880	200,188

The proposed final dividend for the year is subject to the approval of the Company's shareholders at the forthcoming annual general meeting.

NOTES TO FINANCIAL STATEMENTS

(Prepared under Hong Kong accounting standards)

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13. EARNINGS PER SHARE

The calculation of basic earnings per share is based on the net profit attributable to shareholders for the year of RMB1,272,489,000 (2003: RMB1,028,306,000) and the weighted average of 810,759,661 (2003: 800,755,200) ordinary shares in issue during the year, as adjusted to reflect the bonus issue of 133,459,200 A shares on 5 May 2004.

No diluted earnings per share has been presented as the Company did not have any dilutive potential ordinary shares during the year.

14. DISTRIBUTION OF PROFIT

In accordance with the PRC Company Law and the Company's articles of association, the Company and its subsidiaries registered in the PRC, except for Sino-foreign joint ventures, are required to appropriate 10% of the net profit after tax (after offsetting any prior years' losses) calculated in accordance with "Accounting Standards for Business Enterprises" and "Accounting System for Business Enterprises" and other related standards (collectively "PRC GAAP") to the statutory surplus reserve (except where the reserve balance has reached 50% of each entity's capital), and 5% to 10% to the statutory public welfare fund and, on an optional basis, the discretionary surplus reserve fund. The statutory surplus reserve can be utilised to offset prior years' losses or to increase capital. However, the balance of the statutory surplus reserve must be maintained at a minimum of 25% of capital after such usages. The statutory public welfare fund can only be utilised for collective benefits to the employees of the respective companies. The above reserves cannot be used for purposes other than those for which they are created and are not distributable as cash dividends. Statutory surplus reserve and statutory public welfare fund were collectively presented as statutory reserve fund in the financial statements.

The Company can distribute dividends based on the lower of the Company's retained profits determined under PRC GAAP or Hong Kong accounting standards.

NOTES TO FINANCIAL STATEMENTS

(Prepared under Hong Kong accounting standards)

31 December 2004

15. FIXED ASSETS

Group

	Land use rights RMB'000	Buildings RMB'000	Leasehold improvements RMB'000	Machinery, computer and office equipment RMB'000	Motor vehicles RMB'000	Construction in progress RMB'000	Total RMB'000
Cost:							
At beginning of year	62,379	649,951	46,101	1,416,418	118,228	19,378	2,312,455
Additions	414	387	8,952	497,865	32,656	106,694	646,968
Transfer	-	-	4,967	5,531	-	(10,498)	-
Acquisition of subsidiaries	-	-	-	12,432	192	-	12,624
Disposals	-	-	-	(77,776)	(3,888)	-	(81,664)
Reclassifications	-	(186)	-	(11,080)	11,266	-	-
Exchange realignments	-	-	-	1,720	87	-	1,807
At 31 December 2004	62,793	650,152	60,020	1,845,110	158,541	115,574	2,892,190
Accumulated depreciation:							
At beginning of year	6,977	51,769	31,647	551,795	41,969	-	684,157
Change for the year	1,887	33,104	5,866	224,532	15,768	-	281,157
Acquisition of subsidiaries	-	-	-	511	21	-	532
Disposals	-	-	-	(62,051)	(2,204)	-	(64,255)
Reclassifications	-	898	-	(3,107)	2,209	-	-
Exchange realignments	-	-	-	941	71	-	1,012
At 31 December 2004	8,864	85,771	37,513	712,621	57,834	-	902,603
Net book value:							
At 31 December 2004	53,929	564,381	22,507	1,132,489	100,707	115,574	1,989,587
At 31 December 2003	55,402	598,182	14,454	864,623	76,259	19,378	1,628,298

NOTES TO FINANCIAL STATEMENTS

(Prepared under Hong Kong accounting standards)

31 December 2004

15. FIXED ASSETS (continued)

Company

	Land use rights RMB'000	Buildings RMB'000	Leasehold improvements RMB'000	Machinery, computer and office equipment RMB'000	Motor vehicles RMB'000	Construction in progress RMB'000	Total RMB'000
Cost:							
At beginning of year	52,607	625,068	42,382	1,240,179	109,027	13,672	2,082,935
Additions	-	-	170	376,325	25,679	89,396	491,570
Transfer	-	-	4,967	-	-	(4,967)	-
Transfer from a subsidiary	-	-	-	17,980	-	-	17,980
Transfer to subsidiaries	-	-	-	(509,311)	(21,874)	-	(531,185)
Disposal	-	-	-	(51,888)	(3,888)	-	(55,776)
Reclassifications	-	(186)	-	(9,767)	9,953	-	-
Exchange realignments	-	-	-	39	55	-	94
At 31 December 2004	52,607	624,882	47,519	1,063,557	118,952	98,101	2,005,618
Accumulated depreciation:							
At beginning of year	614	40,814	29,473	487,305	38,657	-	596,863
Charge for the year	1,279	32,130	4,670	160,332	11,639	-	210,050
Transfer from a subsidiary	-	-	-	7,661	-	-	7,661
Transfer to subsidiaries	-	-	-	(200,579)	(8,762)	-	(209,341)
Disposals	-	-	-	(41,227)	(2,204)	-	(43,431)
Reclassifications	-	898	-	(3,107)	2,209	-	-
Exchange realignments	-	-	-	33	65	-	98
At 31 December 2004	1,893	73,842	34,143	410,418	41,604	-	561,900
Net book value:							
At 31 December 2004	50,714	551,040	13,376	653,139	77,348	98,101	1,443,718
At 31 December 2003	51,993	584,254	12,909	752,874	70,370	13,672	1,486,072

As at 31 December 2004, the Group was in the process of obtaining real estate title certificates for certain buildings located in Shenzhen, the PRC, with a net book value of approximately RMB9.7 million, included in the Group's buildings.

As at 31 December 2004, the Group was in the process of obtaining the land use right certificate of a piece of land in Wuxi, the PRC, with a net book value of approximately RMB3.7 million.

NOTES TO FINANCIAL STATEMENTS

(Prepared under Hong Kong accounting standards)

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15. FIXED ASSETS (continued)

All of the Group's and Company's land and buildings are situated in the PRC and are held under medium term leases.

The Group's land and buildings, included above at cost, were valued at HK\$747,901,000 as at 30 September 2004 as included in the prospectus issued on 29 November 2004 in connection with the listing of the Company's H shares on 9 December 2004. Had the Group's land and buildings been included in these financial statements at such valuation amount throughout the year ended 31 December 2004, an additional depreciation charge of approximately RMB 7.8 million would have been charged to the consolidated profit and loss account for the year ended 31 December 2004.

16. INTANGIBLE ASSETS

Group

	Technology know-how RMB'000	Computer software RMB'000	Operating concession RMB'000	Deferred development costs RMB'000	Total RMB'000
Cost:					
At beginning of year	1,280	162,297	39,840	244,296	447,713
Additions	-	48,856	-	7,847	56,703
Retirements and disposals	-	(1,732)	-	(112,104)	(113,836)
At 31 December 2004	1,280	209,421	39,840	140,039	390,580
Accumulated amortisation and impairment:					
At beginning of year	469	65,936	5,971	116,793	189,169
Provided during the year	128	35,477	1,992	42,249	79,846
Retirements and disposals	-	(894)	-	(93,337)	(94,231)
Impairment during the year recognised in the profit and loss account	-	-	-	7,847	7,847
At 31 December 2004	597	100,519	7,963	73,552	182,631
Net book value:					
At 31 December 2004	683	108,902	31,877	66,487	207,949
At 31 December 2003	811	96,361	33,869	127,503	258,544

NOTES TO FINANCIAL STATEMENTS

(Prepared under Hong Kong accounting standards)

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16. INTANGIBLE ASSETS (continued)

Company

	Computer software RMB'000	Deferred development costs RMB'000	Total RMB'000
Cost:			
At beginning of year	144,417	199,387	343,804
Additions	43,945	–	43,945
Retirements and disposals	(1,731)	(59,349)	(61,080)
At 31 December 2004	186,631	140,038	326,669
Accumulated amortisation:			
At beginning of year	61,906	79,175	141,081
Provided during the year	32,270	39,877	72,147
Retirements and disposals	(893)	(45,501)	(46,394)
At 31 December 2004	93,283	73,551	166,834
Net book value:			
At 31 December 2004	93,348	66,487	159,835
At 31 December 2003	82,511	120,212	202,723

17. GOODWILL

	Group RMB'000
Cost:	
At beginning of year	24,884
Acquisition of additional interests in a subsidiary	2,146
At 31 December 2004	27,030
Accumulated amortisation and impairment:	
At beginning of year	3,613
Provided during the year	4,696
Impairment provided during the year	13,037
At 31 December 2004	21,346
Net book value:	
At 31 December 2004	5,684
At 31 December 2003	21,271

NOTES TO FINANCIAL STATEMENTS

(Prepared under Hong Kong accounting standards)

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18. INTERESTS IN SUBSIDIARIES

	Company	
	2004 RMB'000	2003 RMB'000
Unlisted shares, at cost	532,297	338,964
Less: Provision for impairment	(136,014)	(81,100)
	396,283	257,864

The Company's trade receivables, other receivables, trade payables and other payables balances with the subsidiaries are disclosed in notes 24, 25, 27 and 28, respectively. The amounts due from/to subsidiaries are unsecured, interest-free and repayable on demand.

Particulars of the subsidiaries are as follows:

Name	Place and date of incorporation/ registration and operations	Nominal value of issued ordinary/registered share capital	Percentage of equity interests attributable to the Company		Principal activities
			Direct	Indirect	
ZTE Kangxun Telecom Company, Limited ("Kangxun")#(i) (深圳市中興康訊電子 有限公司)	The PRC 1 November 1996	RMB50,000,000	90	-	Manufacture and sale of electronic components
Nanjing Zhong Xing Software Development Technology Co., Limited#(ii) (南京中興軟創科技 有限責任公司)	The PRC 21 February 2003	USD7,231,029	81	-	Development, manufacture and marketing of computer software and digital equipment
Shanxi Zhongxing Telecom Equipment Company, Limited ("Shanxi Zhongxing")#(i) (山西中興通訊設備 有限公司)	The PRC 26 November 1997	RMB8,000,000	51	-	Development, manufacture and marketing of information technology products and provision of related technical services

NOTES TO FINANCIAL STATEMENTS

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18. INTERESTS IN SUBSIDIARIES (continued)

Name	Place and date of incorporation/ registration and operations	Nominal value of issued ordinary/registered share capital	Percentage of equity interests attributable to the Company		Principal activities
			Direct	Indirect	
Shenzhen Zhongxing Software Company, Limited ("Zhongxing Software")#(i) (深圳市中興軟件有限責任公司)	The PRC 9 July 2003	RMB50,000,000	90	–	Development of telecommunications systems software and provision of related consultancy services
Wuxi Zhongxing Optoelectronics Technologies Company, Limited ("Wuxi Zhongxing")#(i) (無錫市中興光電子技術有限公司)	The PRC 31 January 2000	RMB10,000,000	65	–	Development of technology for optical electronic products and provision of related technical services
Shenzhen Force Science and Technology Company, Limited#(i) (深圳市福斯科技有限公司)	The PRC 23 July 2001	RMB3,000,000	–	52	Development, manufacture and sale of optical electronic products and provision of related technical services
Yangzhou Zhongxing Mobile Telecom Equipment Co., Limited#(i) (揚州中興移動通訊設備有限公司)	The PRC 30 July 2002	RMB6,000,000	65	–	Development, manufacture and sale of computer software and integrated information systems
ZTE Integration Telecom Ltd.#(i) (深圳市中興集訊通信有限公司)	The PRC 27 June 2003	RMB55,000,000	75	5	Development, manufacture and sale of information technology products

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18. INTERESTS IN SUBSIDIARIES (continued)

Name	Place and date of incorporation/ registration and operations	Nominal value of issued ordinary/registered share capital	Percentage of equity interests attributable to the Company		Principal activities
			Direct	Indirect	
ZTE Mobile Tech Co., Limited ("ZTE Mobile")#(i) (深圳市中興移動技術 有限公司)	The PRC 12 September 2001	RMB33,333,000	95	-	Development, manufacture and sale of telecommunications related products
ZTEIC Design Co., Ltd. ("ZTEIC Design")#(i) (深圳市中興集成電路設計 有限責任公司)	The PRC 20 March 2000	RMB50,000,000	60	-	Development, manufacture and sale of integrated circuit products
Shenzhen Guoxing Electronics Development Company, Limited ("Guoxing")#(i) (深圳市國鑫電子發展 有限公司)	The PRC 10 January 1992	RMB13,000,000	90	9	Development, manufacture and sale of integrated circuit products
Shenzhen Zhongxing Mobile Telecom Equipment Co., Ltd.#(i) (深圳市中興移動通信設備 有限公司)	The PRC 30 March 2000	RMB10,000,000	90	9	Manufacture and sale of mobile telecommunications equipment
Telrise (Cayman) Telecom Limited	Cayman Islands 23 March 2001	USD950,000 Ordinary	52.85	-	Research and development of telecommunications related products
Telrise Inc.	United States of America 13 October 2000	USD1,609,000 Ordinary	-	52.85	Research and development of telecommunications related technology
ZTE (USA) Inc.## (中興通訊美國 有限公司)	United States of America 10 November 1998	USD20,000 Ordinary	100	-	Sale of telecommunications equipment and provision of related technical services

NOTES TO FINANCIAL STATEMENTS

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18. INTERESTS IN SUBSIDIARIES (continued)

Name	Place and date of incorporation/ registration and operations	Nominal value of issued ordinary/registered share capital	Percentage of equity interests attributable to the Company		Principal activities
			Direct	Indirect	
ZTE do Brasil Ltda## (中興通訊(巴西) 有限責任公司)	Brazil 7 August 2002	USD200,000 Ordinary	100	–	Development, manufacture and sale of telecommunications related products and provision of related technical services
ZTE Future Tel Company, Limited ["Future Tel"] ## (韓國中興前景股份 有限公司)	Republic of Korea 6 September 1999	WON 4,275,530,000 Ordinary	54.14	–	Research and development of mobile phones
Congo-Chine Telecom S.A.R.L. ["Congo-Chine"] ## (剛中電信有限責任公司)	The Democratic Republic of Congo 14 November 2000	USD9,800,000 Ordinary	51	–	Construction and operation of telecommunications networks
Zhongxing Telecom Pakistan (Private) Limited## (中興通訊巴基斯坦(私人) 有限公司)	Islamic Republic of Pakistan 21 September 1998	Rupees10,000,000 Ordinary	92.99	–	Manufacture and sale of telecommunications systems equipment
ZTE (H.K.) Limited (中興通訊(香港) 有限公司)	Hong Kong 27 October 2000	HKD50,000,000 Ordinary	100	–	Marketing and sale of telecommunications systems equipment and provision of management services
Anhui Wantong Posts and Telecommunications Company, Limited ["Anhui Wantong"]#(i) (安徽皖通郵電股份 有限公司)	The PRC 16 April 1997	RMB22,214,400	51	–	Development, manufacture and sale of computer software and integrated information systems

NOTES TO FINANCIAL STATEMENTS

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18. INTERESTS IN SUBSIDIARIES (continued)

Name	Place and date of incorporation/ registration and operations	Nominal value of issued ordinary/registered share capital	Percentage of equity interests attributable to the Company		Principal activities
			Direct	Indirect	
Anhui Wantong Iron Tower Installation Company, Limited ("Wantong Iron")#(iii) (安徽皖通鐵塔安裝有限公司)	The PRC 8 August 2001	RMB2,000,000	-	45.9 ###	Construction and installation of telecommunications infrastructure
Anhui Wantong Information System Integration Company, Limited ("Wantong Information")#(iii) (安徽皖通信息系統集成有限責任公司)	The PRC 4 May 1999	RMB3,000,000	-	26.01 ###	Design and sale of telecommunications systems equipment, development of computer software and networking solutions
Telrise Nanjing Telecom Limited#(ii) (南京德瑞通訊技術有限公司)	The PRC 22 April 2002	USD100,000	-	52.85	Research and development of telecommunications related products
ZTE (UK) Limited	United Kingdom 13 August 2001	GBP604,000 Ordinary	51	-	Sale of telecommunications systems equipment and provision of related technical services
ZTE Holdings (Thailand) Co., Ltd (iii)	Thailand 10 July 2002	Baht100,000 Ordinary	49	-	Investment holding
ZTE (Thailand) Co., Ltd.	Thailand 31 July 2002	Baht2,000,000 Ordinary	49	-	Sale of telecommunications systems equipment and provision of related technical services

NOTES TO FINANCIAL STATEMENTS

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18. INTERESTS IN SUBSIDIARIES (continued)

Name	Place and date of incorporation/ registration and operations	Nominal value of issued ordinary/registered share capital	Percentage of equity interests attributable to the Company		Principal activities
			Direct	Indirect	
000 ZTE Russia Co., Limited (中興通訊(俄羅斯)有限責任公司)##	Russia 27 October 2003	USD760,000 Ordinary	100	-	Sale of telecommunications systems equipment and solutions and provision of related technical services
ZTE Wistron Telecom AB## (中興通訊歐洲研究所)	Sweden 19 March 2002	SEK1,000,000 Ordinary	100	-	Development of telecommunications systems equipment
ZTE Portugal – Projectos de Telecomunicacoes, Unipessoal, Lda	Portugal 19 September 2003	EUR50,000 Ordinary	-	100	Provision of telecommunications solutions and related technical services
ZTE Microelectronics Technology Co., Ltd.#(i) (深圳市中興微電子技術有限公司)	The PRC 28 November 2003	RMB15,000,000	-	81	Design, manufacture and sale of integrated circuit products
Shenzhen Zhongxing Special Equipment Company, Limited#(i) (深圳市中興特種設備有限責任公司)	The PRC 8 February 2003	RMB1,000,000	54	-	Development, manufacture and sale of telecommunications related products
ZTE Corporation Mexico, S. DE R. L DE C.V.## (中興通訊(墨西哥)可變資本有限責任公司)	Mexico 8 April 2003	USD5,000 Ordinary	100	-	Sale of telecommunications products and provision of related technical services

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18. INTERESTS IN SUBSIDIARIES (continued)

Name	Place and date of incorporation/ registration and operations	Nominal value of issued ordinary/registered share capital	Percentage of equity interests attributable to the Company		Principal activities
			Direct	Indirect	
Guangdong New Pivot Technology & Service Company, Limited#(i) (廣東新支點技術服務有限公司)	The PRC 27 February 2004	RMB5,000,000	90	-	Design, development and sale of telecommunications systems equipment and computer software and provision of related technical services
Shenzhen Zhongxing Telecom Equipment Technology & Service Company, Limited#(i) (深圳市中興通訊技術服務有限責任公司)	The PRC 17 May 2004	RMB50,000,000	90	9	Development, manufacture and sale of telecommunications systems equipment
Shenzhen Changfei Investment Company, Limited ("Changfei")#(i) (深圳市長飛投資有限公司)	The PRC 6 February 2004	RMB30,000,000	51	-	Investment holding
Shanghai Zhongxing Telecom Equipment Technology & Service Company, Limited#(i) (上海中興通訊技術有限責任公司)	The PRC 10 May 2004	RMB10,000,000	51	-	Development, manufacture and sale of computer software and telecommunications systems equipment
Shenzhen Kangquan Electromechanical Company, Limited ("Kangquan") # (iii) (深圳市康銓機電有限公司)	The PRC 2 June 2003	RMB16,000,000	-	29.33 ###	Sale of telecommunications systems equipment and provision of related technical services
Shenzhen Lead Communications Company, Limited ("Lead")#(iii) (深圳市立德通訊器材有限公司)	The PRC 17 June 2003	RMB10,000,000	-	31.88 ###	Sale of telecommunications systems equipment and provision of related technical services

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18. INTERESTS IN SUBSIDIARIES (continued)

Name	Place and date of incorporation/ registration and operations	Nominal value of issued ordinary/registered share capital	Percentage of equity interests attributable to the Company		Principal activities
			Direct	Indirect	
Shenzhen Ruide Electronic Industrial Company, Limited #(iii) (深圳市睿德電子實業 有限公司)	The PRC 27 April 2004	RMB8,700,000	-	32.76 ###	Sale of telecommunications systems equipment and provision of related technical services
ZTEiT USA Inc ## (中興集訊(美國)公司)	United States of America 17 February 2004	USD95,000 Ordinary	-	80	Research and development of telecommunications related products
ZTE Kangxun Telecom Company India Private Ltd ("ZTE India")	India 15 September 2003	USD22,222 Ordinary	100	-	Manufacture and sale of telecommunications related products
Closed Joint Stock Company TK Mobile ("TK Mobile")	Tajikistan 27 November 2003	USD4,000,000 Ordinary	51	-	Construction and operation of telecommunications networks
Shanghai XingFei Technology Company, Limited #(iii) 上海興飛科技有限公司	The PRC 17 September 2004	RMB1,000,000	-	40.8 ###	Provision of after sale services of mobile phones
Zimax (Cayman) Holding Ltd ("Zimax")	Cayman Islands 13 August 2004	USD2,500,000 Ordinary	100	-	Investment holding
ZTE Malaysia Corporation sdn. bhd. ("ZTE Malaysia")	Malaysia 16 February 2004	USD60,000 Ordinary	100	-	Sale and distribution of telecommunications products and provision of related technical and after sale services
ZTE Romania S.R.L.	Romania 17 November 2004	USD100,000	100	-	Sale and distribution of telecommunications products and provision of related technical and after sale services

(i) These subsidiaries are registered as limited companies under the PRC law.

(ii) The subsidiary is registered as sino-foreign joint ventures under the PRC law.

(iii) The Group has unilateral controls over these subsidiaries.

The English names of these subsidiaries are directly translated from their Chinese names.

The Chinese names of these subsidiaries are directly translated from their registered names.

These subsidiaries are the subsidiaries of a non wholly-owned subsidiary of the Company, and accordingly, are accounted for as subsidiaries by virtue of the Company's control over them.

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19. INTERESTS IN JOINTLY-CONTROLLED ENTITIES

	Group		Company	
	2004 RMB'000	2003 RMB'000	2004 RMB'000	2003 RMB'000
Unlisted shares, at cost	–	–	2,500	2,500
Share of net assets	7,786	5,319	–	–
	7,786	5,319	2,500	2,500

The Company's trade receivable balance with a jointly-controlled entity is disclosed in note 24 to the financial statements. The amounts due from the jointly-controlled entities are unsecured, interest-free and repayable on demand.

Particulars of the principal jointly-controlled entities are as follows:

Name	Business structure	Place and date of incorporation/ registration and operations	Issued and paid-up capital/ registered capital	Percentage of			Principal activities
				Ownership interest	Voting power	Profit sharing	
Beijing Zhongxing Telecom Ltd. ("Beijing Zhongxing")# (北京中興新通訊設備有限公司)	Corporate	The PRC 17 March 1998	RMB5,000,000	50	50	50	Sale of telecommunications systems equipment, computer network and peripheral devices and provision of consultancy and equipment leasing services
Beijing Zhongxing Intelligent Transportation Systems Ltd. ("Beijing Zhongxing Intelligent")# (北京中興智能交通系統工程有限公司)	Corporate	The PRC 24 April 2000	RMB5,000,000	35	30	35	Development, manufacture and sale of transportation monitoring and related telecommunications products
Bestel Communications Limited	Corporate	Republic of Cyprus 28 May 2001	CYP600,000 Ordinary	50	50	50	Provision of telecommunications solutions and related consultancy services

The English names of these jointly-controlled entities are directly translated from their Chinese names.

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20. INTERESTS IN ASSOCIATES

	Group		Company	
	2004 RMB'000	2003 RMB'000	2004 RMB'000	2003 RMB'000
Unlisted shares, at cost	–	–	4,013	3,000
Share of net assets	8,845	300	–	–
	8,845	300	4,013	3,000

The Company's trade receivable balance with an associate is disclosed in note 24 to the financial statements. The amount due from the associate is unsecured, interest-free and repayable on demand.

Particulars of the principal associates are as follows:

Name	Business structure	Place and date of incorporation/ registration and operations	Issued and paid-up capital/ registered capital	Percentage of ownership interest attributable to the Group	Principal activities
Beijing Zhongxing Yuanjing Technology Co., Ltd. ("Beijing Yuanjing")# (北京中興遠景科技 有限公司)	Corporate	The PRC 18 October 2000	RMB10,000,000	30	Research and development of telecommunications related products
KAZNURTEL Limited Liability Company	Corporate	Kazakstan 22 October 2004	USD3,000,000	49	Construction of CDMA network, sale, and distribution of related products, and provision of training and technical services
Shenzhen Weigao Semi-conductor Technology Co., Ltd.# (深圳市微高半導體科技 有限公司)	Corporate	The PRC 15 June 2004	RMB10,000,000	20	Design, research, development and sale of semi-conductor products
Wuxi Kaier Technology Co., Ltd.# (無錫凱爾科技 有限公司)	Corporate	The PRC 26 November 2004	RMB10,000,000	23	Development, manufacture and sale of camera lenses for mobile phone

The English names of these associates are directly translated from their Chinese names.

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21. LONG-TERM INVESTMENTS

	Group		Company	
	2004 RMB'000	2003 RMB'000	2004 RMB'000	2003 RMB'000
Unlisted equity investments, at cost	45,021	10,514	40,264	8,264
Provision for impairment	(674)	(674)	-	-
	44,347	9,840	40,264	8,264

The directors considered that the carrying value of the unlisted equity investments approximates their estimated fair value.

22. INVENTORIES

	Group		Company	
	2004 RMB'000	2003 RMB'000	2004 RMB'000	2003 RMB'000
Raw materials	983,326	912,066	633,186	692,206
Work in progress	338,981	225,589	199,289	165,215
Finished goods	402,760	185,652	370,955	122,144
	1,725,067	1,323,307	1,203,430	979,565

The carrying amount of inventories carried at net realisable value included in the above balance was approximately RMB568,119,000 (2003: RMB217,437,000).

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23. CONSTRUCTION CONTRACTS

	Group		Company	
	2004 RMB'000	2003 RMB'000	2004 RMB'000	2003 RMB'000
Amount due from customers for contract work	2,752,024	3,652,991	3,414,540	3,919,395
Amount due to customers for contract work	(2,318,731)	(2,771,004)	(2,162,901)	(2,241,642)
	433,293	881,987	1,251,639	1,677,753
Contract costs incurred plus recognised profits less recognised losses to date	15,327,336	12,072,503	14,992,094	10,474,833
Less: Progress billings	(14,894,043)	(11,190,516)	(13,740,455)	(8,797,080)
	433,293	881,987	1,251,639	1,677,753

24. TRADE AND BILLS RECEIVABLES

Progress payment for construction contracts are normally made in accordance with the agreed payment schedule. The Group's trading terms with its major customers are mainly on credit, except for new customers, where payment in advance is normally required. The credit period is generally for a period of 90 days and are extendable up to 2 years depending on customer's credit worthiness. The credit terms for major customers are reviewed regularly by senior management. The Group seeks to maintain strict control over its outstanding receivables and has a credit control department to minimise credit risk. Overdue balances are reviewed regularly by senior management.

NOTES TO FINANCIAL STATEMENTS

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24. TRADE AND BILLS RECEIVABLES (continued)

An aged analysis of the trade and bills receivables as at the balance sheet date, based on invoice date and net of provision, is as follows:

	Group		Company	
	2004 RMB'000	2003 RMB'000	2004 RMB'000	2003 RMB'000
Within 6 months	4,252,421	4,716,359	4,901,198	5,283,612
Between 7 to 12 months	1,453,143	282,756	1,116,903	260,570
1 to 2 years	194,940	198,275	193,718	187,892
2 to 3 years	5,609	3,438	43,213	447
Over 3 years	6,156	105,901	1,835	102,259
	5,912,269	5,306,729	6,256,867	5,834,780
Current portion of trade and bills receivables	(5,912,181)	(5,203,773)	(6,256,867)	(5,733,056)
Long-term portion	88	102,956	-	101,724

The balances due from the ultimate holding company, subsidiaries, a jointly-controlled entity, an associate and related companies included in the above are as follows:

	Group		Company	
	2004 RMB'000	2003 RMB'000	2004 RMB'000	2003 RMB'000
Subsidiaries	-	-	587,821	755,156
The ultimate holding company	169	167	-	-
A jointly-controlled entity	2,354	6,419	2,354	6,419
An associate	4,197	4,016	4,197	4,016
Related companies	7,151	35,625	3,087	2,049
	13,871	46,227	597,459	767,640

The balances are unsecured, interest-free and repayable on demand, and on similar credit terms to those offered to the major customers of the Group.

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25. PREPAYMENTS, DEPOSITS AND OTHER RECEIVABLES

	Group		Company	
	2004 RMB'000	2003 RMB'000	2004 RMB'000	2003 RMB'000
Prepayments	157,518	271,709	57,252	140,877
Deposits and other receivables	488,174	176,404	557,470	145,334
Due from subsidiaries	-	-	602,911	373,750
Due from related companies	5,609	8,528	4,894	7,913
Dividend receivable	-	-	1,871	851
	651,301	456,641	1,224,398	668,725

The amounts due from subsidiaries and related companies are unsecured, interest-free and repayable on demand.

26. CASH AND CASH EQUIVALENTS AND PLEDGED BANK DEPOSITS

	Note	Group		Company	
		2004 RMB'000	2003 RMB'000	2004 RMB'000	2003 RMB'000
Cash and bank balances		4,775,748	3,556,548	3,766,385	2,667,069
Time deposits		2,822,475	113,404	2,696,780	71,006
		7,598,223	3,669,952	6,463,165	2,738,075
Less: Pledged bank deposits	29	(88,978)	(97,085)	(44,512)	(63,064)
Cash and cash equivalents		7,509,245	3,572,867	6,418,653	2,675,011

NOTES TO FINANCIAL STATEMENTS

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27. TRADE AND BILLS PAYABLES

An aged analysis of the trade and bills payables as at the balance sheet date, based on invoice date, is as follows:

	Group		Company	
	2004 RMB'000	2003 RMB'000	2004 RMB'000	2003 RMB'000
Within 6 months	4,180,450	4,195,701	6,688,650	5,600,115
Between 7 to 12 months	61,260	86,424	25,512	78,030
1 to 2 years	68,391	116,019	5,934	28,297
2 to 3 years	8,200	7,656	4,997	6,614
Over 3 years	22,810	23,668	23,509	19,459
	4,341,111	4,429,468	6,748,602	5,732,515

The balances due to the ultimate holding company, subsidiaries and related companies, included in the above are as follows:

	Group		Company	
	2004 RMB'000	2003 RMB'000	2004 RMB'000	2003 RMB'000
Subsidiaries	-	-	5,135,686	4,392,440
The ultimate holding company	51,168	23,464	-	3,052
Related companies	78,166	74,994	3,426	3,622
	129,334	98,458	5,139,112	4,399,114

The balances are unsecured, interest-free and repayable on demand.

28. OTHER PAYABLES AND ACCRUALS

	Note	Group		Company	
		2004 RMB'000	2003 RMB'000	2004 RMB'000	2003 RMB'000
Receipts in advance		310,360	241,611	260,970	198,281
Other payables		998,087	1,042,750	718,953	651,324
Accruals		1,313,173	864,959	924,997	788,090
Due to related companies		313	2,262	313	313
Due to subsidiaries		-	-	512,665	405,884
Provision for warranties	32	186,227	160,573	186,227	157,819
		2,808,160	2,312,155	2,604,125	2,201,711

The balances due to subsidiaries and related companies are unsecured, interest-free and repayable on demand.

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29. INTEREST-BEARING BANK BORROWINGS

	Group		Company	
	2004 RMB'000	2003 RMB'000	2004 RMB'000	2003 RMB'000
Bank loans:				
Secured	361,596	404,893	340,344	394,903
Unsecured	1,085,361	1,332,000	950,000	1,202,000
	1,446,957	1,736,893	1,290,344	1,596,903
Bank loans repayable:				
Within one year or on demand	421,695	977,893	340,344	917,903
In the second year	677,262	235,667	650,000	229,000
In the third to fifth years, inclusive	348,000	490,000	300,000	450,000
Beyond five years	–	33,333	–	–
	1,446,957	1,736,893	1,290,344	1,596,903
Portion classified as current liabilities	(421,695)	(977,893)	(340,344)	(917,903)
Long term portion	1,025,262	759,000	950,000	679,000

The Group and the Company's secured bank loans or banking facilities were secured by:

	Note	Group		Company	
		2004 RMB'000	2003 RMB'000	2004 RMB'000	2003 RMB'000
Pledged deposits	26	88,978	97,085	44,512	63,064
Trade receivables		340,344	394,903	340,344	394,903
		429,322	491,988	384,856	457,967

Certain of the Group and Company's unsecured bank loans were guaranteed by:

	Group		Company	
	2004 RMB'000	2003 RMB'000	2004 RMB'000	2003 RMB'000
A shareholder of the ultimate holding company	–	87,000	–	87,000
Others	580,000	330,000	500,000	250,000
	580,000	417,000	500,000	337,000

The bank loan guaranteed by a shareholder of the ultimate holding company was fully repaid during the year.

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30. PROVISION FOR RETIREMENT BENEFITS

The Group and the Company provide certain of the eligible staff with post-retirement benefits pursuant to a retirement benefits plan. The plan is funded solely by the Group on an actual payment basis.

The latest actuarial valuation of the plan was conducted as at 31 December 2004 in accordance with Hong Kong Statement of Standard Accounting Practice ("SSAP") 34 "Employee benefits" by qualified actuaries of Watson Wyatt Hong Kong Limited. The present value of defined benefits obligations and current service costs are determined actuarially based on the projected unit credit method, which involves a number of assumptions and estimates including the rate of inflation, discount rate, employees' turnover ratio as well as mortality rate. Actuarial gains/(losses) are recognised by amortising the amount by which cumulative unrecognised gains/(losses) exceed 10% of the greater of the assets of the plan and the defined benefits obligation over the average expected future working lifetime of the active members of the plan.

The benefits obligation recognised in the balance sheet are as follows:

Group and Company

	2004 RMB'000	2003 RMB'000
Present value of the obligation	39,046	46,463
Unrecognised actuarial losses	(10,123)	(19,273)
Net liability in the balance sheet	28,923	27,190

Movements in the net liability recognised in the balance sheet during the year are as follows:

	2004 RMB'000	2003 RMB'000
Net liability at beginning of year	27,190	25,085
Benefit expenses recognised in the consolidated profit and loss account (note 6)	2,473	2,790
Pension payments made	(740)	(685)
Net liability at end of year	28,923	27,190

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30. PROVISION FOR RETIREMENT BENEFITS (continued)

The principal assumptions used in determining pension benefits obligation are shown below:

	2004	2003
(a) Discount rate	5%	3.5%
(b) The expected rate of increase in salary ranged from 1% to 7.5% per annum, which was based on the number of years of employment.		

The benefit expense recognised in the consolidated profit and loss account for the year is as follows:

	2004 RMB'000	2003 RMB'000
Current service cost	-	-
Interest cost on benefits obligation	1,581	1,626
Net actuarial losses recognised in the year	892	1,164
Benefit expenses included in staff costs (note 6)	2,473	2,790

31. OTHER LONG-TERM PAYABLES

Other long-term payables represent government grants which are unsecured, interest-free and have no fixed terms of repayment.

32. PROVISION FOR WARRANTIES

	Group		Company	
	2004 RMB'000	2003 RMB'000	2004 RMB'000	2003 RMB'000
At beginning of year	160,573	90,845	157,819	90,845
Additional provisions	129,930	106,310	129,930	103,556
Amounts utilised during the year	(104,276)	(36,582)	(101,522)	(36,582)
At 31 December 2004	186,227	160,573	186,227	157,819

In respect of telecommunications systems contracts, the Group and the Company provide warranties to their customers for twelve months after contract completion dates, during which free repair and maintenance services are provided. A provision for warranties is made at between 0.5% to 1.0% of the cost of equipment sold during the year, and is estimated based on the equipment return rate and past experience of the level of repairs and maintenance. The estimation is reviewed on an ongoing basis and revised where appropriate.

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32. PROVISION FOR WARRANTIES (continued)

In respect of handsets, the Group and the Company generally provide one-year warranty to their customers under which faulty products would be repaired or replaced. The amount of provision for warranties is estimated based on sales volume and past experience of the level of repairs and return.

33. DEFERRED TAX

The movements in deferred tax assets and liabilities during the year are as follows:

	Group		Company	
	2004 RMB'000	2003 RMB'000	2004 RMB'000	2003 RMB'000
Deferred tax assets:				
At beginning of year	143,195	85,931	90,135	42,429
Increase/(decrease) during the year	(38,514)	57,264	(13,660)	47,706
At end of year	104,681	143,195	76,475	90,135
Deferred tax assets:				
Provision for doubtful other receivables	-	56,215	-	56,215
Provision against inventories	53,015	28,608	50,636	28,061
Provision for warranties	33,934	23,673	33,934	23,673
Provision for retirement benefits	4,350	4,079	4,350	4,079
Unrealised profit arising on consolidation	25,827	52,513	-	-
Deferred tax liabilities:				
Intangible assets	(9,973)	(18,032)	(9,973)	(18,032)
Government grants	(2,472)	(3,861)	(2,472)	(3,861)
Deferred tax assets, net	104,681	143,195	76,475	90,135

At 31 December 2003 and 2004, there were no significant unrecognised deferred tax liability for taxes that would be payable on the unremitted earnings of certain of the Group's subsidiaries, jointly-controlled entities and associates as the Group has no liability to additional tax should such amounts be remitted.

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34. SHARE CAPITAL

	2004 RMB'000	2003 RMB'000
Registered, issued, and fully paid		
State owned equity interest shares of RMB1.00 each	462,273	386,381
Legal pension A shares of RMB1.00 each	35,044	29,203
Individual A shares of RMB1.00 each	302,054	251,712
H shares of RMB1.00 each	160,151	–
	959,522	667,296

The movements in share capital are as follows:

	Number of shares in issue	Issued share capital RMB'000	Capital reserve RMB'000	Total RMB'000
At 1 January 2004	667,296,000	667,296	2,079,104	2,746,400
Bonus issues	133,459,200	133,459	–	133,459
Issue of H shares	160,151,040	160,151	3,574,571	3,734,722
Share issue expenses	–	–	(161,685)	(161,685)
Conversion of state owned equity interest shares	(1,384,590)	(1,384)	(29,475)	(30,859)
At 31 December 2004	959,521,650	959,522	5,462,515	6,422,037

Pursuant to an ordinary resolution passed on 5 May 2004, the Company issued 133,459,200 bonus shares of RMB1 each to the shareholders of the Company on the basis of one bonus A share for every five A shares held on 31 December 2003, credited as fully paid by way of capitalisation of an amount of RMB133,459,200 standing to the credit of the Company's retained profits.

On 9 December and 14 December 2004, 148,529,040 of the Company's H shares of RMB1 each and 11,622,000 additional H shares of RMB1 each, respectively, were issued at a price of HK\$22 (equivalent to approximately RMB23.32) per share. Of all the newly issued H Shares, 1,384,590 H shares were converted from the state owned equity interest shares. The aggregate net proceeds were approximately HK\$3,370,789,000 (equivalent to approximately RMB3,573,037,000) after deducting related expenses for the placing and initial public offering of approximately RMB161,685,000.

Pursuant to a resolution at an extraordinary general meeting held on 30 June 2004 and approvals from relevant government authorities, during the listing of the Company's H shares, certain of the Company's state owned equity interest shareholders converted an aggregate of 1,384,590 state owned equity interest shares into H shares and offered them in the placement of the Company's H shares. Net proceeds of approximately RMB30,859,000 obtained from the newly issued H shares were related to such conversion and such proceeds would be remitted to the State Social Security Fund in accordance with the relevant PRC government requirement.

The H shares rank pari passu in all material respects with the A shares of the Company.

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35. RESERVES

(a) Group

The amounts of the Group's reserves and the movements therein for the current and prior years are presented in the consolidated statement of changes in equity on page 180 of the financial statements.

The capital reserves of the Group include the non-distributable reserves of the Company and its subsidiaries created in accordance with accounting and financial regulations in the PRC.

In accordance with the PRC Company Law and the Company's articles of association, the Company and its subsidiaries registered in the PRC are required to appropriate certain percentage of the statutory net profit after tax to the statutory reserve fund. Subject to certain restrictions set out in the relevant PRC regulations and in the subsidiaries' articles of association, the statutory reserve fund may be used either to offset losses, or for capitalisation issues by way of paid-up capital. The reserves cannot be used for purposes other than those for which they are created and are not distributable as cash dividends.

(b) Company

	Issued share capital RMB'000	Capital reserve RMB'000	Statutory reserves RMB'000	Exchange fluctuation reserve RMB'000	Retained profits RMB'000	Proposed final dividend RMB'000	Total RMB'000
At 1 January 2003	556,080	2,190,320	315,235	1,696	(253,179)	111,216	2,921,368
Issue of bonus shares	111,216	(111,216)	-	-	-	-	-
Net profit from ordinary activities attributable to shareholders	-	-	-	-	1,241,786	-	1,241,786
Transfer from/(to) retained profits	-	-	161,141	-	(161,141)	-	-
Final 2002 dividend declared	-	-	-	-	-	(111,216)	(111,216)
Proposed final 2003 dividend	-	-	-	-	(200,188)	200,188	-
Exchange realignments	-	-	-	(153)	-	-	(153)
At 31 December 2003 and 1 January 2004	667,296	2,079,104	476,376	1,543	627,278	200,188	4,051,785
Final 2003 dividend declared	-	-	-	-	-	(200,188)	(200,188)
Issue of H shares	160,151	3,574,571	-	-	-	-	3,734,722
Conversion of state owned equity interest shares	(1,384)	(29,475)	-	-	-	-	(30,859)
Transfer from/(to) retained profits	-	-	174,342	-	(174,342)	-	-
Issue of bonus shares	133,459	-	-	-	(133,459)	-	-
Share issue expenses	-	(161,685)	-	-	-	-	(161,685)
Net profit from ordinary activities attributable to shareholders	-	-	-	-	150,233	-	150,233
Proposed final 2004 dividend	-	-	-	-	(239,880)	239,880	-
Exchange realignments	-	-	-	2,018	-	-	2,018
At 31 December 2004	959,522	5,462,515	650,718	3,561	229,830	239,880	7,546,026

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(Prepared under Hong Kong accounting standards)

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35. RESERVES (continued)

(b) Company (continued)

At 31 December 2004, the Company had retained profits of approximately RMB229.8 million (2003: RMB627.3 million), after appropriation of proposed final dividend, as determined in accordance with the lower of either the amount determined under PRC GAAP or Hong Kong accounting standards, available for distribution by way of cash in kind.

36. NOTES TO THE CONSOLIDATED CASH FLOW STATEMENT

(a) Acquisition of subsidiaries

	2004 RMB'000	2003 RMB'000
Net assets acquired:		
Fixed assets	12,092	–
Inventories	23,663	–
Trade and bills receivables	70,545	–
Prepayments, deposits and other receivables	3,584	–
Cash and bank balances	7,848	–
Trade and bills payables	(80,299)	–
Tax payable	(557)	–
Other payables and accruals	(1,735)	–
Bank loans	(8,000)	–
Minority interests	(6,921)	–
	20,220	–
Negative goodwill on acquisition	(4,770)	–
	15,450	–
Satisfied by:		
Cash	15,450	–
	15,450	–

NOTES TO FINANCIAL STATEMENTS

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36. NOTES TO THE CONSOLIDATED CASH FLOW STATEMENT (continued)

(a) Acquisition of subsidiaries (continued)

An analysis of the net outflow of cash and cash equivalents in respect of the acquisition of subsidiaries is as follows:

	2004 RMB'000	2003 RMB'000
Cash consideration	(15,450)	–
Cash and bank balances acquired	7,848	–
Net outflow of cash and cash equivalents in respect of the acquisition of subsidiaries	(7,602)	–

In April 2004, Changfei, a subsidiary of the Group, acquired 62.5% and 57.5% equity interests in Lead and Kangquan for cash considerations of approximately RMB6 million and RMB9 million, respectively.

The subsidiaries acquired during the year ended 31 December 2004 had no significant impact in respect of the cash flows for the Group's operating activities, investing activities and financing activities for the year.

The results of the subsidiaries acquired during the year ended 31 December 2004 had no significant impact on the Group's consolidated turnover or profit after tax for the year.

(b) Disposal of a subsidiary

	2004 RMB'000	2003 RMB'000
Net assets disposed of:		
Fixed assets	–	2,879
Inventories	–	61
Trade and other receivables	–	10
Cash and bank balances	–	129
Other payables and accruals	–	(2,564)
	–	515
Gain on disposal of a subsidiary	–	64
	–	579
Satisfied by:		
Cash	–	579

NOTES TO FINANCIAL STATEMENTS

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36. NOTES TO THE CONSOLIDATED CASH FLOW STATEMENT (continued)

(b) Disposal of a subsidiary (continued)

An analysis of the net inflow of cash and cash equivalents in respect of the disposal of a subsidiary is as follows:

	2004 RMB'000	2003 RMB'000
Cash consideration	-	579
Cash and bank balances disposed of	-	(129)
Net inflow of cash and cash equivalents in respect of the disposal of a subsidiary	-	450

The subsidiary disposed of during the year ended 31 December 2003 had no significant impact in respect of the cash flows for the Group's operating activities, investing activities and financing activities for that year.

The results of the subsidiary disposed of in the year ended 31 December 2003 had no significant impact on the Group's consolidated turnover or profit after tax for that year.

37. CONTINGENT LIABILITIES

- (a) At the balance sheet date, contingent liabilities not provided for in the financial statements were as follows:

Group and Company

	2004 RMB'000	2003 RMB'000
Bills discounted with recourse	440,885	975,202
Trade debtors factored with recourse	691,744	-
Guarantees given to banks in connection with facilities granted to third parties	-	12,840
Guarantees given to banks in respect of performance bonds	1,626,070	1,114,336
	2,758,699	2,102,378

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37. CONTINGENT LIABILITIES (continued)

- (b) On 26 April 2000, the Company approved and declared an one-off share bonus of approximately RMB34 million and RMB30 million to its then employees who had elected to participate in a Deferred Share Bonus Scheme (the "DSBS") with a term of either 3 years or 5 years. Pursuant to the DSBS, the total amount of bonus payable to each qualified employee was used to purchase a total of 1,884,250 A shares of the Company during 2001 and these A shares were locked up for a period of either 3 years or 5 years under the 3 years DSBS and 5 years DSBS until 20 April 2004 and 20 June 2006, respectively. The Company has guaranteed the employees that, upon disposal of these shares in 2004 and 2006, respectively, the disposal price would not be less than approximately RMB18.5 per share, after being adjusted for the Company's bonus issues in 2001, 2003 and 2004.

As at 31 December 2004, a total of 2,600,849 A Shares are subject to the guaranteed disposal price.

In the opinion of the directors, any resulting liabilities arising from the guaranteed disposal price under DSBS would not have material adverse impact on the Group's financial statements. Therefore, no provision in respect of such guarantee has been made in the financial statements.

38. OPERATING LEASE ARRANGEMENTS

The Group and Company leases certain of its offices under operating lease arrangements, with leases negotiated for terms ranging from 1 to 12 years.

At 31 December 2004, the Group and the Company had total future minimum lease payments under non-cancellable operating leases falling due as follows:

	2004 RMB'000	2003 RMB'000
Within one year	74,350	38,724
In the second to fifth years, inclusive	67,542	39,918
After five years	7,431	3,151
	149,323	81,793

39. COMMITMENTS

In addition to the operating lease commitments detailed in note 38 above, the Group and the Company had the following commitments at the balance sheet date:

Capital commitments

	2004 RMB'000	2003 RMB'000
Land and buildings:		
Authorised, but not contracted for	-	296,684
Contracted, but not provided for	282,446	3,318
	282,446	300,002

NOTES TO FINANCIAL STATEMENTS

(Prepared under Hong Kong accounting standards)

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40. DIFFERENCES IN FINANCIAL STATEMENTS PREPARED UNDER PRC GAAP AND HONG KONG ACCOUNTING STANDARDS

Ernst & Young is responsible for the audit of the financial statements prepared under Hong Kong accounting standards.

The effects on the net profit and the shareholders' equity arising from material differences between the consolidated financial statements prepared under PRC GAAP and Hong Kong accounting standards are summarised as follows:

	Notes	2004 RMB'000	2003 RMB'000 (Restated)
Net profit			
Net profit from ordinary activities attributable to shareholders under PRC GAAP		1,008,870	704,128
Add back /(deduct):			
Accounting standards differences:			
Recognition of government grants	(i)	38,630	26,312
Recognition of deferred bonuses	(ii)	(127,951)	71,701
Provision for retirement benefits	(iii)	(1,733)	(2,105)
Deferred development costs	(iv)	(38,763)	(35,314)
Other differences:			
Difference in accounting estimates in respect of revenue recognised using percentage of completion method for telecommunications systems contracts	(v)	(668,042)	504,084
Recognition of income tax and deferred tax	(vi)	94,881	(79,183)
Difference in accounting estimates in respect of provision for trade receivables, other receivables and prepayments and net realisable value of inventories	(vii)	553,402	(38,573)
Consolidation of subsidiaries	(viii)	112,653	(41,166)
Estimated useful lives of fixed assets	(ix)	132,988	(15,566)
Accrual of performance bonuses	(x)	167,554	(66,012)
Net profit from ordinary activities attributable to shareholders under Hong Kong accounting standards		1,272,489	1,028,306

NOTES TO FINANCIAL STATEMENTS

(Prepared under Hong Kong accounting standards)

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40. DIFFERENCES IN FINANCIAL STATEMENTS PREPARED UNDER PRC GAAP AND HONG KONG ACCOUNTING STANDARDS (continued)

	Notes	31 December 2004 RMB'000	31 December 2003 RMB'000 (Restated)
Shareholders' equity			
Shareholders' equity under PRC GAAP		9,174,439	4,810,414
Add back/(deduct):			
Accounting standards differences:			
Recognition of government grants	(i)	5,149	(33,340)
Recognition of deferred bonuses	(ii)	–	127,951
Provision for retirement benefits	(iii)	(28,923)	(27,190)
Deferred development costs	(iv)	66,487	108,418
Other differences:			
Difference in accounting estimates in respect of revenue recognised using percentage of completion method for telecommunications systems contracts	(v)	–	680,451
Recognition of income tax and deferred tax	(vi)	–	(95,567)
Difference in accounting estimates in respect of provision for trade receivables, other receivables and prepayments and net realisable value of inventories	(vii)	–	(546,355)
Consolidation of subsidiaries	(viii)	–	(124,310)
Estimated useful lives of fixed assets	(ix)	–	(132,988)
Accrual of performance bonuses	(x)	–	(167,554)
Shareholders' equity under Hong Kong accounting standards		9,217,152	4,599,930

(i) Government grants

Government grants for specific research and development projects are accounted for as specific payables under PRC GAAP. Whereas under Hong Kong accounting standards, such grants are accounted for as deferred income in the other payable or other long-term payable accounts.

Under PRC GAAP, the research and development costs are recognised as technology development costs in inventory to the extent of the granted amounts, and the specific payables thereof will be transferred to the inventory account to off-set the technology development costs upon completion of the projects.

Under Hong Kong accounting standards, the deferred income is recognised as income over the periods necessary to match the grants on a systematic basis to the costs that they are intended to compensate.

NOTES TO FINANCIAL STATEMENTS

(Prepared under Hong Kong accounting standards)

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40. DIFFERENCES IN FINANCIAL STATEMENTS PREPARED UNDER PRC GAAP AND HONG KONG ACCOUNTING STANDARDS (continued)

(ii) Recognition of deferred bonuses

Under the PRC GAAP, there is no specific standard, regulation or rules for the recognition of deferred bonuses. All the deferred bonuses are expensed as declared irrespective of whether or not the employee has qualified to entitle such bonuses.

Under Hong Kong accounting standards, the deferred bonuses are recognised when the employee is qualified to entitle the bonuses and charged to the profit and loss account over the required service period.

(iii) Provision for retirement benefits

Under the PRC GAAP, there is no specific standard, regulation or rules for the recognition of post-retirement benefits under defined retirement benefits plan. The costs of post-retirement benefits are expensed as incurred.

Under the Hong Kong accounting standards, the costs of providing these benefits under the defined retirement benefits plan is actuarially determined and recognised over the employees' service period.

(iv) Deferred development costs

Under PRC GAAP, all research and development costs are charged to the profit and loss account as incurred.

Under Hong Kong accounting standards, expenditures incurred on projects to develop new products is capitalised and deferred only when the projects are clearly defined; the expenditure is separately identifiable and can be measured reliably; there is reasonable certainty that the projects are technically feasible; and the products have commercial value. Product development expenditure which does not meet these criteria is expensed when incurred.

(v) Revenue recognition using percentage of completion method

In the preparation of the financial statements under PRC GAAP for the year ended 31 December 2004, the stage of completion relating to the revenue recognition for telecommunications systems contracts is revised to be estimated by reference to the completion of the physical proportion of the work or the proportion of costs incurred to date to the estimated total cost of the relevant contract.

Subsequent to the change of accounting estimates for the preparation of financial statements under PRC GAAP, there are no differences between the construction contracts recorded under PRC GAAP and Hong Kong accounting standards.

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40. DIFFERENCES IN FINANCIAL STATEMENTS PREPARED UNDER PRC GAAP AND HONG KONG ACCOUNTING STANDARDS (continued)

(vi) Income tax and deferred tax

Due to the differences on accounting estimates and differences between PRC GAAP and Hong Kong accounting standards, differences in respect of revenue and profit before tax had arisen in the preparation of the Group's financial statements under PRC GAAP and Hong Kong accounting standards. Deferred tax is recognised to account for the effect of temporary differences on income tax.

(vii) Provisioning rates

In the preparation of the financial statements under PRC GAAP for the year ended 31 December 2004, the Group had changed its accounting estimates during the year in respect of the provisioning rates applied for trade receivables, other receivables and prepayments and net realisable value of inventories.

Subsequent to the change of accounting estimates for the preparation of financial statements under PRC GAAP, there are no differences between the provisions accounted for under PRC GAAP and Hong Kong accounting standards.

(viii) Consolidation of subsidiaries

The differences represent historic discrepancies on the carrying values of interests in subsidiaries recorded by the Company under PRC GAAP as compared to the shareholders' equity and current account balances recorded in the financial statements of individual subsidiaries prepared under PRC GAAP or Hong Kong accounting standards.

(ix) Estimated useful lives of fixed assets

In the preparation of the financial statements under PRC GAAP for the year ended 31 December 2004, the Group had changed its accounting estimates during the year in respect of useful lives of certain fixed assets.

Subsequent to the change of accounting estimates for the preparation of financial statements under PRC GAAP, there are no differences between the depreciation charged under PRC GAAP and Hong Kong accounting standards.

(x) Accrual of performance bonuses

Performance bonuses were accrued upon approval in the preparation of the financial statements under Hong Kong accounting standards. Such performance bonuses were only charged to the profit and loss account upon actual payment in 2004 and included in the financial statements prepared under PRC GAAP for the year ended 31 December 2004.

NOTES TO FINANCIAL STATEMENTS

(Prepared under Hong Kong accounting standards)

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41. RELATED PARTY TRANSACTIONS

In addition to the transactions and balances detailed elsewhere in these financial statements, the Group had the following material related party transactions during the year:

Name of related parties	Relationship with the Group	Nature of transactions	Pricing policy	2004	2003
				RMB'000	RMB'000
Beijing Zhongxing (北京中興新通訊設備有限公司)	Jointly-controlled entity	Purchase of raw materials	(a)	312	7
		Sale of finished goods	(b)	12,757	3,091
Beijing Zhongxing New System Integrated Circuit Construction Co., Ltd # (北京中興新系統集成工程有限公司)	Jointly-controlled entity	Sale of finished goods	(b)	-	42
Beijing Zhongxing Intelligent (北京中興智能交通系統工程有限公司)	Jointly-controlled entity	Sale of finished goods	(b)	19,411	7,778
Beijing Yuanjing (北京中興遠景科技有限公司)	Associated company	Sale of finished goods	(b)	16,316	14,943
Zhongxingxin (深圳市中興新通訊設備有限公司)	Related party (i)	Sale of finished goods	(b)	2	7,397
		Purchase of raw materials	(a)	297,726	397,180
Shenzhen Zhongxing Xindi Telecommunications Equipment Company, Limited # (深圳市中興新地通信器材有限公司)	Related party (ii)	Purchase of raw materials	(a)	170,422	35,369
		Sale of finished goods	(b)	6,660	-
Shenzhen Zhongxing WXT Equipment Company, Ltd # ("Zhongxing WXT") (深圳市中興維先通設備有限公司)	Related party (iii)	Purchase of raw materials	(a)	126,176	113,237
		Sale of finished goods	(b)	1,849	1,417
Xian Microelectronics Technology Research Institute # ("Xian Microelectronics") (西安微電子技術研究所)	Related party (iii)	Purchase of raw materials	(a)	14,160	12,952
		Sale of finished goods	(b)	61,480	34,884
		Corporate guarantee	(c)	-	87,000
Lead (深圳市立德通訊器材有限公司)	Related party (iv)	Purchase of raw materials	(a)	46,503	78,711
		Sale of finished goods	(b)	41,098	32,257

NOTES TO FINANCIAL STATEMENTS

[Prepared under Hong Kong accounting standards]

31 December 2004

41. RELATED PARTY TRANSACTIONS (continued)

Name of related parties	Relationship with the Group	Nature of transactions	Pricing policy	2004	2003
				RMB'000	RMB'000
Kangquan (深圳市康銓機電有限公司)	Related party (iv)	Purchase of raw materials	(a)	2,923	-
Shenzhen Zhongxing Information Technique Co., Ltd.# (深圳市中興信息技術有限公司)	Related party (v)	Purchase of raw materials	(a)	8,542	2,595
		Sale of finished goods	(b)	4,018	10,628
The Government of the Democratic Republic of Congo	Related party (vi)	Corporate guarantee	(c)	80,000	80,000
Shenzhen Zhongxing Xinyu FPC Company Limited (深圳市中興新宇軟電路有限公司)	Related party (ii)	Purchase of raw materials	(a)	7,823	-
Shenzhen Zhongxing Development Company Limited (深圳中興發展有限公司)	Related party (vii)	Sale of finished goods	(b)	3,489	-
Shenzhen Gaodong Hua Telecommunication Technique Company, Limited (深圳市高東華通信技術有限公司)	Related party (vii)	Purchase of raw materials	(a)	14,080	-
Chung Hing (Hong Kong) Development Company Limited (中興香港發展有限公司)	Related party (v)	Purchase of raw materials	(a)	1,755	-

The English names of these companies are directly translated from their Chinese names.

In the opinion of the directors, the above transactions were conducted in the ordinary course of business.

Notes:

- (a) The purchase of raw materials were made in accordance with published prices and conditions similar to those offered by the supplier to its major customers.
- (b) The sale of finished goods were made in accordance with published prices and conditions offered to the major customers of the Group.

NOTES TO FINANCIAL STATEMENTS

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41. RELATED PARTY TRANSACTIONS (continued)

Notes:(continued)

- (c) The guarantees in respect of bank borrowings were provided by related parties at nil consideration.
 - (i) Zhongxingxin is the ultimate holding company of the Company.
 - (ii) Shenzhen Zhongxing Xindi Telecommunications Equipment Company, Limited and Shenzhen Zhongxing Xinyu FPC Company Limited are controlled and beneficially owned by Zhongxingxin, the ultimate holding company.
 - (iii) Zhongxing WXT and Xian Microelectronics are shareholders of Zhongxingxin, the ultimate holding company.
 - (iv) Changfei was established in the PRC in February 2004 with 51% equity interests held by the Group. In April 2004, Changfei acquired 62.5% and 57.5% equity interests of Lead and Kangquan, respectively, which became subsidiaries of the Group. Further details of the acquisitions were disclosed in note 36(a). Before the acquisition of Lead and Kangquan by Changfei, Zhongxingxin and Zhongxing WXT held 45% and 55% equity interests in Lead and Kangquan, respectively.
 - (v) Shenzhen Zhongxing Information Technique Co., Ltd. and Chung Hing (Hong Kong) Development Company Limited are controlled and beneficially owned by a director of the Company.
 - (vi) The Government of the Democratic Republic of Congo is the minority shareholder of Congo-Chine, a subsidiary of the Group.
 - (vii) Shenzhen Zhongxing Development Company Limited and Shenzhen Gaodong Hua Telecommunication Technique Company, Limited as controlled and beneficially owned by Zhongxing WXT, a shareholder of Zhongxingxin, the ultimate holding company.

42. POST BALANCE SHEET EVENTS

There were no significant events after 31 December 2004.

43. APPROVAL OF THE FINANCIAL STATEMENTS

The financial statements were approved and authorised for issue by the board of directors on 10 April 2005.