Report of the Board of Directors

The Board of Directors is pleased to present the Group's interim results and interim financial statements for the six months ended 30 June 2005.

Financial Results

Results of the Group for the six months ended 30 June 2005 prepared in accordance with PRC GAAP and Hong Kong accounting standards are set out on page 37 and page 84 of this report, respectively.

(I) Business Review

Overview of China's telecommunications industry in the first six months of 2005

China's telecommunications sector experienced a decline in capital expenditure during the first six months of 2005 compared to the same period last year, influenced by industry restructuring and uncertainties relating to the grant of 3G licences. Domestic carriers reduced their investments in wireless communication products such as CDMA, PHS and GSM in anticipation of the imminent commercialization of 3G standards, while efforts to promote intelligent networks, caller tunes and multimedia messaging services resulted in increased investments in the abovesaid categories. Statistics from the Ministry of Information Industry indicated that capital expenditure in the telecommunications industry for the six months ended 30 June 2005 amounted to RMB77.81 billion, a decrease of 12.2% compared to the corresponding period last year. Reduced investments in the industry resulted in reduced domestic sales for telecommunications equipment manufacturers.

Overview of the global telecommunications industry in the first six months of 2005

Globally, the telecommunications sector maintained its growing trend during the first six months of 2005. Multinational carriers increased capital investments in emerging markets presenting significant business opportunities in regions such as Latin America and Africa. Meanwhile, carriers in developed countries continue to seek new drivers for business growth, and new equipment suppliers were introduced to meet the requirements for higher performance to price ratios of equipment and services. Such developments created a positive environment for ZTE's expansion efforts internationally.

Operating results of the Group for the first six months of 2005

The Group's operating results for the first six months of 2005 remained at similar levels as compared to the corresponding period last year. Domestically, the Group increased its market share on the back of its strong brand name and reputation, high performance to price ratios and effective marketing strategies. On the international front, the Group achieved significant sales growth by enhancing its market penetration and geographic reach, providing a major driver for the Group's business growth in the first six months.

Based on financial statements prepared in accordance with Hong Kong accounting standards and reviewed by Ernst & Young, the Group's turnover from principal operations for the first six months of 2005 amounted to RMB10,303 million, representing an increase of 1.22% compared to the same period last year. Net profit amounted to RMB660 million, representing a decrease of 8.80% compared to the same period last year. Earnings per share were RMB0.69. Net cash outflow from operating activities was RMB2.69 per share.

Based on financial statements prepared in accordance with PRC GAAP, the Group's turnover from principal operations for the first six months of 2005 amounted to RMB10,303 million, representing a decrease of 12.5% compared to the same period last year. Net profit amounted to RMB688 million, representing an increase of 34.0% compared to the same period last year. Earnings per share were RMB0.72. Net cash outflow from operating activities was RMB2.70 per share.

Operations on Major Products

During the Reporting Period, the Group made notable achievements in terms of research and development and market development for all its major product lines.

As one of the few manufacturers in the world capable of providing a full range of 3G equipment comprising WCDMA, CDMA2000 and TD-SCDMA, the Group has already been fully prepared for the imminent commercial application of 3G from both technology and marketing perspectives. In connection with WCDMA products, the Group made important breakthroughs with its development of chipsets, resulting in better system stability and a more diverse range of products. Active participation in test runs for China Mobile and China Netcom also yielded positive results. The Group's CDMA2000 1X EVDO products were ready for large-scale commercial launch as on-site experimental applications were conducted extensively across the country, while large-scale commercial applications were launched in a number of overseas markets. The Group's TD-SCDMA products showed excellent performance in various tests of the Ministry of Information Industry, leading the industry in key technical indicators such as the level of product integration and intelligent wireless applications.

Domestic sales of the Group's CDMA products decreased during the Reporting Period compared to the same period last year, as domestic carriers reduced their investment in CDMA systems. On the other hand, international sales of our CDMA products during the Reporting Period reported encouraging growth, resulting from proven commercial applications in the domestic market, high performance to price ratio and a dominant brand name. Meanwhile, the Group's GSM products made major inroads in the tenders for China Mobile's fringe networks. As a major PHS supplier in the country, the Group was duly affected by a significant reduction in investments in PHS systems by domestic carriers in the first six months of 2005, as reflected in subdued domestic sales of its PHS products.

For optical communications products, the Group continued to pursue functional improvements of its products based on customer requirements, and offered higher quality and services to meet its price competition. As at the end of the Reporting Period, the Group's optical communications products had been deployed in primary communications networks operated by all domestic carriers. International sales also increased substantially with large-scale applications being launched in Pakistan and India.

The Group succeeded in improving the competitiveness and marketability of its routers and Ethernet exchanges by strategically integrating these products under a newly established data business division during the Reporting Period, taking into account the characteristics of data products.

The Group has secured its position as a leading supplier in the domestic market and a strong competitor globally in NGN products by building an extensive portfolio ranging from core control equipment to gateways of various specifications. During the first six months of the year, the Group's NGN products continued to be employed extensively in commercial trials for major domestic carriers as they used NGN products as a means to enhance network intelligence within their fixed line networks. In the international market, the Group's NGN products were commercially applied in various countries and cities including Portugal, the U.S. and Hong Kong.

The Group's handset business was subject to enormous pricing pressure during the first six months of the year amid extremely intense competition. The Group sought to maintain its profit margin through technical innovation, while endeavouring to cater to more extensive external demands by adopting a hybrid marketing approach. Handset sales for the first six months of

2005 were largely unchanged as compared to the same period last year. Meanwhile, further inroads were made in the commercialization of the Group's 3G terminals, creating favourable conditions for future developments in the domestic as well as international markets.

The Company's commercial products such as intelligent networks, caller tunes and multimedia messaging services enjoyed rapid growth during the Reporting Period, driven by fixed line network intelligence upgrades and launch of innovative services by carriers.

(II) Management Discussion and Analysis under PRC GAAP

The following financial data are extracted from the financial statements of the Group prepared in accordance with PRC GAAP. The following discussion and analysis should be read in conjunction with the financial statements of the Group and its accompanying notes as set out in this report.

1. Analysis of Results from Principal Operations

Revenue from principal operations, profit from principal operations, net profit, net cash flow generated from operating activities and net increase in cash and cash equivalents increased/decreased compared to the corresponding period in the previous year as follows:

Unit: RMB in thousands

Item	Current	Corresponding period in the previous year	Percentage increase/ decrease
Revenue from principal operations	10,302,998	11,774,259	-12.50%
Profit from principal operations	3,843,072	4,303,111	-10.69%
Net profit	687,663	513,182	34.00%
Net cash flow generated from operating activities	(2,587,873)	113,661	-2,376.83%
Net increase in cash and cash equivalents	(3,800,867)	117,938	-3,322.77%

Notes:

(1) The increase in net profit was mainly attributable to a decrease of RMB153,858,000 in the net profit for the six months ended 30 June 2004 as a result of changes in accounting policies and accounting estimates implemented in 2004. (For further details please refer to the text of the 2004 interim report.);

(2) The substantial decrease in net cash inflow from operating activities as compared to the corresponding period in the previous year was mainly attributable to the Company's increased investment in technology development and overseas market expansion during the period in accordance with the stated use of proceeds from the H share issue and to the increase in trade receivables owing to longer period of the contracts and billing progress as a result of larger sizes and longer performance periods for sales contracts;

(3) The substantial reduction in net increase in cash and cash equivalents as compared to the corresponding period in the previous year was mainly attributable to the reduction in net cash inflow from operating activities and the increase in cash outflow from financing activities relating to the repayment of bank loans.

2. Analysis of Financial Condition

Unit: RMB in thousands

Item	30 June 2005	31 December 2004	Percentage increase/ decrease
Total assets	**19,608,882**	20,849,989	-5.95%
Accounts receivables	**4,155,622**	3,652,506	13.77%
Inventories	**1,970,962**	1,882,808	4.68%
Total owner's equity	**9,615,880**	9,174,439	4.81%

3. Financial indicators for the Reporting Period and comparison with the corresponding period last year by business segment

Business segment	Revenue from principal operations (RMB in thousands)	Costs of principal operations (RMB in thousands)	Gross profit margin	Increase/ decrease in revenue from principal operations compared with same period last year	Increase/ decrease in costs of principal operations compared with same period last year	Increase/ decrease in gross profit margin compared with same period last year
Telecommunications equipment	10,302,998	6,423,483	37.65%	-12.50%	-13.65%	0.83%
Total	10,302,998	6,423,483	37.65%	-12.50%	-13.65%	0.83%
Of which: connected transactions	31,760	20,263	36.20%	-24.04%	-19.50%	-3.60%
Pricing principles of connected transactions*	The prices at which the connected transactions between the Company and the connected parties were conducted were comparable to market prices.					
Statement on the necessity and continuity of connected transactions*	The Company's sales to such connected parties represented mainly the distribution of the Company's products by the connected parties and such transactions will continue in future.					

* This refers to connected transactions under PRC laws and regulations. Please refer to Note 6 to Financial Statements prepared in accordance with PRC GAAP.

4. Revenue and profit from principal operations for the Reporting Period by geographic segment:

Unit: RMB in thousands

	Revenue from principal operations	Year-on-year increase/decrease of revenue from principal operations	Profit from principal operations
PRC	7,155,786	-26.26%	2,421,335
Asia (excluding PRC)	1,991,468	34.00%	799,635
Africa	1,040,859	81.54%	570,203
Others	114,885	1,010.08%	51,899
Total	10,302,998	-12.50%	3,843,072

5. Financial indicators in relation to major products accounting for 10% of revenue or profit from the Group's principal operations:

Product	Revenue from principal operations (RMB in thousands)	Costs of principal operations (RMB in thousands)	Gross profit margin
Wireless communication systems	4,698,010	2,437,473	48.12%
Optical and data communications systems	1,491,294	979,503	34.32%
Handsets	2,214,613	1,980,083	10.59%

6. Difficulties encountered by the Group's operations in the first six months

China's telecommunications sector experienced a decline in capital expenditure during the Reporting Period compared to the corresponding period last year, underpinned by a marked decrease in CDMA and PHS investments. As one of the major domestic manufacturers of PHS and CDMA products, the Group suffered from the reduction in sales of these two products. In relation to CDMA products, the Group responded to the situation by increasing its efforts in international marketing to make up for the reduction in the domestic market, while simultaneously endeavouring to enlarge its domestic market share. In relation to PHS products, the Group also made focused efforts to increase its domestic market share while making selective moves in the international market.

Handset products of the Group were under enormous pricing pressure during the Reporting Period as competition in the market remained extremely intense. The Group responded to the pressure and challenge through efforts in research and development, marketing, production and quality control, aiming to enhance the competitive edge of its handset products while maintaining its profit margin.

7. Use of proceeds from the global offering of H shares

In December 2004, the Group made a global offering of 160,151,040 H shares (including H shares issued pursuant to the exercise of the over-allotment option) at an issue price of HK$22.00 per share, raising total proceeds of HK$3,523,322,880.00, equivalent to RMB3,734,722,252.80. After deduction of the underwriting fees and expenses relating to the global offering and reduction in shareholding of state-owned shares, the net proceeds of RMB3,542,177,725.94 were credited in full into the designated account of the Company on 9 December 2004 and 16 December 2004, respectively. Shenzhen Dahua Tiancheng Certified Public Accountants had examined and verified the net proceeds and issued a verification report ''Shenhua (2005) Yanzi No.(003)''.

The Group intends to use the aforesaid net proceeds for the following purposes:

- The Group intends to use approximately RMB2,125,306,635.56 from the abovementioned net proceeds for the expansion of the Group's overseas operations; and

- The Group intends to use approximately RMB1,416,871,090.38 from the abovementioned net proceeds for the research and development on new products and technologies of strategic importance.

As at the end of the Reporting Period, the aforesaid proceeds had been utilized by the Company as follows:

Unit: RMB in ten thousands

Gross amount of issue proceeds	354,217.8
Use of proceeds during the Reporting Period	106,318.5
Use of proceeds on a cumulative basis	222,350.4

Projects committed	**Amount of proceeds proposed to be invested**	**Any changes to project**	**Amounted invested during the Reporting Period**	**Earnings generated**	**Whether project schedule has been met**	**Whether expected earnings has been attained**
IP switching platforms for mobile communications	24,039.0	No	7,296.1	See below	Yes	Yes
Integrated mobile broadband service systems	22,525.0	No	4,558.0	See below	Yes	Yes
High speed packet mobile communication base station systems	23,820.0	No	3,657.1	See below	Yes	Yes
Intelligent wireless integrated access systems	12,890.1	No	4,548.8	See below	Yes	Yes
Core routers	20,838.0	No	3,719.8	See below	Yes	Yes
NGN systems	20,118.0	No	5,745.1	See below	Yes	Yes
Automated optical switching network systems	17,457.0	No	3,366.6	See below	Yes	Yes
Sub-total	141,687.1	—	32.891.5	—	—	—
Overseas operations	212,530.7	—	73,427.0	See below	Yes	Yes
Total	354,217.8	—	106.318.5	—	—	—

Note: Regarding proceeds from the issue not currently utilized, the Company applied funds that were idle for the time being as working capital subject to the progress of projects, with a view to enhancing the efficiency of fund application by reducing the demand for bank loans and hence financing costs. The Company will appropriate funds to relevant projects in strict accordance with project schedules.

The progress and return on the projects are described as follows:

IP switching platforms for mobile communications
Research and development of the IP switching platforms for mobile communications progressed well. Preparations for the production of commercial edition equipment for the core networks and base station controllers were completed and the products passed the bulk volume test of China Mobile and the bulk volume gateway performance test of China Telecom. Moreover, in the indoor test of the Ministry of Information Industry, Beijing, of TD-SCDMA concluded in June, ZTE's IP switching platforms for mobile communications have

passed all test criteria with excellent results. Currently, commercial stations and trial stations using IP switching equipment for mobile communications have been set up in a number of foreign countries.

Integrated mobile broadband service systems
Research and development in respect of relevant projects for integrated mobile broadband service systems has been almost completed and products are either being put to commercial application or going through commissioning tests at trial stations. With the imminent construction of extensive NGN and 3G networks, this project is well positioned for future growth.

High-speed packet mobile communications base stations
At present, the Group has developed capabilities for large-scale commercial production of CDMA2000 1xEVDO that supports the smooth upgrade of CDMA2000 1x systems to CDMA2000 1xEVDO. Although China has yet to issue any 3G licences, the Group has set up a number of CDMA2000 1xEVDO trial stations. Internationally, the Group's CDMA2000 1xEVDO products are widely recognised by carriers and tens of CDMA2000 1xEVDO commercial and trial stations have been developed.

Intelligent wireless integrated access systems
Proceeds from the new issue allocated to the project had been fully applied with the completion of research on the fusion of ADSL, WLAN and blue tooth technologies and the development of extension connectors for PHS, GSM, CDMA and 3G networks supporting wireless broadband access for voice, data and video. The system is currently pending commercial application.

Core routers
The Group is committed to further improving its product development capabilities for ZXR10 high-end routers with a view to becoming more competitive for the product. Core routers in the Group's current portfolio are capable of providing 640G in switching capacity and a 10G high-speed connector. Apart from supporting IPv6 router protocol and IPv6 transition, the products are also capable of simultaneously supporting IPV4/IPV6 dual-protocol. Certain products under the category of the ZXR10 high-end router had been launched and had started to contribute to the Group's overall income.

NGN systems
The Group has successfully developed, ahead of its competitors, bulk volume multimedia gateway equipment and ancillary bulk volume softswitch control equipment, thereby enhancing its ability to build large-scale NGN terminals, convergence stations and long-distance stations to maintain its competitive edge. The aforesaid products will debut in China Telecom's long-distance softswitch commercial trial network, which will be launched in cities and provincial capitals such as Beijing, Shanghai and Guangzhou, as well as being used in the construction of softswitch overlapping networks.

Automated optical switching network systems
Research and development plans for the project have been completed. Testing on the product inspection and acceptance process is under way to prepare for the next stage in commercial application, as core technologies have been mastered and improvements are being made to initial performance features. The technology is gradually becoming the centre of attention of carriers and bright market prospects are anticipated.

Proceeds used in overseas operations contributed to the growth of the Group's overseas business in the first six months of 2005. As the products of strategic importance mentioned above have not been put into large scale commercial use by the telecommunications services providers, the Group is increasing its research and development efforts on such products with a view to generating increased earnings from the products in the future.

8. Significant investments made out of funds other than proceeds from the global offering

As at the end of the Reporting Period, the Group did not have any significant investments made out of funds other than proceeds from the global offering.

(III) Management Discussion and Analysis under Hong Kong accounting standards

The financial data below are extracted from the Group's unaudited financial statements prepared in accordance with Hong Kong accounting standards. The following discussion and analysis should be read in conjunction with the Group's unaudited financial statements reviewed by Ernst & Young and the accompanying notes as set out in this report.

Turnover

Unit: RMB in millions

	Six months ended 30 June 2005		Six months ended 30 June 2004	
Product segment	**Revenue**	**As a percentage of turnover**	**Revenue**	**As a percentage of turnover**
Wireless communications	**4,698.0**	**45.6%**	4,497.5	44.2%
Wireline switch and access	**720.6**	**7.0%**	1,305.5	12.8%
Optical and data communications	**1,491.3**	**14.5%**	1,150.5	11.3%
Handsets	**2,214.6**	**21.5%**	2,603.7	25.6%
Telecommunications software systems, services and other products	**1,178.5**	**11.4%**	621.8	6.1%
Total	**10,303.0**	**100.0%**	10,179.0	100.0%

The following table sets out sales revenue of the Group and the corresponding percentage of the total turnover attributable to the PRC, Asia (excluding the PRC), Africa and other regions for the periods indicated:

Unit: RMB in millions

	Six months ended 30 June 2005		Six months ended 30 June 2004	
Region	**Revenue**	**As a percentage of turnover**	**Revenue**	**As a percentage of turnover**
The PRC	**7,155.8**	**69.5%**	8,815.3	86.6%
Asia (excluding the PRC)	**1,991.5**	**19.3%**	501.4	4.9%
Africa	**1,040.8**	**10.1%**	836.3	8.2%
Others	**114.9**	**1.1%**	26.0	0.3%
Total	**10,303.0**	**100.0%**	10,179.0	100.0%

The Group's turnover increased by 1.22% year-on-year to RMB10,303 million for the first six months of 2005. Turnover from international sales registered robust growth of 130.8% to RMB3,147 million. Analyzed by product, revenue from the wireless communications segment, optical and data communications segment and telecommunications software systems segment all recorded growth from the corresponding period last year, largely offset by decreases in sales revenue from the handsets and wireline switch and access segments, resulting in marginal growth in total turnover for the Group for the six months of 2005 compared to the previous year.

Revenue growth in the Group's wireless communications segment was attributable to sales growth of the Group's CDMA systems and GSM systems, which was partially offset by a decrease in the sales of PHS systems. The increase in the sales of CDMA systems was mainly attributable to the conversion of China Unicom's Phase III CDMA project contract into a formal sales contract during the period and the year-on-year increase of sales of CDMA systems in the international market during the period. Revenue from the sales of CDMA systems internationally was derived mainly from a number of countries including the Philippines and India. Increase in the sales of GSM systems was mainly attributable to substantial growth in international sales, which were mainly derived from a number of countries including Nigeria and Algeria.

Decrease in the turnover from the Group's wireline switch and access segment was mainly attributable to reduced investment by domestic carriers in these products during the period.

Increase of the Group's optical and data communications segment was mainly attributable to increasing domestic market share as well as international sales of optical transmission, routers and wireless access data products.

Decrease in the turnover from the Group's handset products was mainly attributable to the decrease in sales of PHS handsets and of unit selling prices of all handset products on a year-on-year basis.

Increase in the turnover from the Group's telecommunications software systems, services and other products segment was mainly attributable to the substantial increase in the sales of intelligent networks, caller tunes and multimedia messaging services coupled with the increase in revenue from telecommunications operations and fixed line operations. Increase in the sales of the Group's intelligent networks, caller tunes and multimedia messaging services mainly benefited from increased investments by domestic carriers and increased international sales of these products in countries such as Malaysia and India.

Cost of sales and gross profit

The following tables set out (1) the cost of sales of the Group and cost of sales as a percentage of turnover for each product segment and (2) the Group's gross profit and gross profit margin for each product segment for the periods indicated:

Unit: RMB in millions

Product category	Six months ended 30 June 2005 Cost of sales	Six months ended 30 June 2005 As a percentage of turnover	Six months ended 30 June 2004 Cost of sales	Six months ended 30 June 2004 As a percentage of turnover
Wireless communications	**2,517.7**	**53.6%**	2,741.5	61.0%
Wireline switch and access	**365.0**	**50.7%**	580.2	44.4%
Optical and data communications	**1,106.5**	**74.2%**	832.9	72.4%
Handsets	**1,872.8**	**84.6%**	2,037.0	78.2%
Telecommunications software systems, services and other products	**659.4**	**56.0%**	252.0	40.5%
Total	**6,521.4**	**63.3%**	6,443.6	63.3%

Unit: RMB in millions

Product category	Six months ended 30 June 2005 Gross profit	Six months ended 30 June 2005 Gross profit margin	Six months ended 30 June 2004 Gross profit	Six months ended 30 June 2004 Gross profit margin
Wireless communications	**2,180.3**	**46.4%**	1,756.0	39.0%
Wireline switch and access	**355.6**	**49.3%**	725.3	55.6%
Optical and data communications	**384.8**	**25.8%**	317.6	27.6%
Handsets	**341.8**	**15.4%**	566.7	21.8%
Telecommunications software systems, services and other products	**519.1**	**44.0%**	369.8	59.5%
Total	**3,781.6**	**36.7%**	3,735.4	36.7%

The cost of sales of the Group's principal operations increased 1.21% year-on-year to RMB6,521 million. The Group's overall gross profit margin remained level at 36.7%, as an increase in gross profit margin for wireless communications systems was offset by a decrease in gross profit margin for other products.

Cost of sales for the Group's wireless communications systems decreased by 8.2% to RMB2,518 million, while the gross profit margin rose to 46.4% compared to 39.0% for the corresponding period in the previous year. The higher gross profit margin was attributable to the increase in the gross profit margins for PHS systems and GSM systems, partially offset by a decrease in gross profit margin for CDMA systems. The gross profit margin for the Group's PHS systems increased as a result of higher gross profit generated by the Group in PHS system capacity expansion and upgrade contracts awarded by China Telecom and China Netcom for 2005, which conducted expansion and upgrade projects for their existing PHS networks.

The gross profit margin for the Group's wireline switch and access segment decreased to 49.3% compared to 55.6% for the corresponding period in the previous year, owing to increasing competition facing the Group in the market for wireline switch and access systems.

The gross profit margin in the Group's optical and data communications segment declined to 25.8%, compared to 27.6% for the corresponding period in the previous year, mainly because of increased competition which resulted in lower contract prices.

The gross profit margin in the Group's handset segment declined to 15.4%, compared to 21.8% for the corresponding period in the previous year, which was principally due to the reduced number of high-end PHS handsets purchased by China Telecom and China Netcom from the Group and, to a lesser extent, falling prices for GSM handsets amid intense market competition.

The gross profit margin in the Group's telecommunications software systems, services and other products segment declined to 44.0%, compared to 59.5% for the corresponding period in the previous year, reflecting primarily lower contract prices due to intense competition in this segment.

Other income and revenue, net

The net amount of other income and revenue decreased slightly to RMB246 million, as compared to RMB247 million in the same period in the previous year, as a decline in income from VAT subsidies was largely offset by an increase in technology funding granted by the government.

Research and development costs

The Group's research and development costs for the first six months of 2005 increased 9.76% to RMB1,144 million from RMB1,043 million for the corresponding period in the previous year, or from 10.24% to 11.11% as a percentage of turnover. The increase was mainly attributable to the hiring of additional R&D staff. Meanwhile, R&D management expenses also increased as a result of increased technical cooperation projects and purchases of R&D equipment.

Selling and distribution costs

The Group's selling and distribution costs for the first six months of 2005 increased by 2.66% to RMB1,485 million from RMB1,447 million for the corresponding period in the previous year, or from 14.22% to 14.42% as a percentage of turnover, primarily as a result of the increase in traveling and entertainment expenses, as a result of increased efforts in international marketing and the building of an overseas marketing platform, partially offset by a decrease in sales and marketing staff costs. While overseas marketing expenses increased rapidly, domestic marketing expenses dropped given a stable domestic customer base and a developed marketing platform.

Administrative expenses

Administrative expenses increased by 5.83% to RMB492 million, as compared to RMB465 million in the same period in the previous year, or from 4.57% to 4.78% as a percentage of income from principal operations. The increase was mainly attributable to an increase in depreciation and amortization expenses and in overseas rental expenses following the growth of our overseas business, partially offset by a decrease in staff costs.

Other operating expenses, net

The Group's other operating expenses for the first six months of 2005 decreased by 27.98% to RMB50 million from RMB69 million for the corresponding period in the previous year, primarily as a result of a decrease in provision for bad and doubtful debts.

Profit from operating activities

The Group's profit from operating activities for the first six months of 2005 decreased by 8.5% to RMB891 million from RMB973 million for the first six months of 2004 primarily as a result of the increase in R&D expenses and operating expenses as a percentage of revenue from principal operations, which was only partially offset by the increase in gross profit and gross profit margin.

Finance costs

The Group's finance costs for the first six months of 2005 increased by 27% to RMB75 million from RMB59 million for the corresponding period in the previous year primarily as a result of an increase in financing costs on factoring loans and bills discounted due to the discounting of greater amounts of factoring loans and bills, which was partially offset by a decrease in interest on bank loans due to a decrease in outstanding borrowings. The Group increased factoring loans and bills discounted to improve working capital turnover as the proportion of the Group's overseas contracts, which generally have longer contract payment periods, increased.

Tax

The Group's income tax expense for the first six months of 2005 increased by 6.6% to RMB74 million from RMB70 million for the corresponding period in the previous year, or from 7.6% to 9.1% as a percentage of pre-tax profit. The increase was mainly attributable to the payment of enterprise income tax at a reduced tax rate equivalent to 50% of the normal tax rate starting in 2005 by subsidiaries entitled to the tax concession policy of full exemption for two years and 50% reduction for three years, whereas in 2004 these subsidiaries were fully exempted from enterprise income tax.

Minority interests

The Group's minority interests for the first six months of 2005 decreased by 32.6% to RMB82 million from RMB121 million for the corresponding period in the previous year, or from 14.3% to 11.0% as a percentage of net profit. The decrease was mainly attributable to reduced income of Zhongxing Software, a majority-owned subsidiary, as a percentage of the Group's income as a result of the recognition by Zhongxing Software of R&D expenses and marketing expenses previously advanced by the parent company as Zhongxing Software's own operating expenses for the year, resulting in a decrease in the proportion of the Group's income-to-cost ratio for this subsidiary.

Net profit & margin

Net profit (after minority interests) of the Group decreased by 8.8% to RMB660 million, compared to RMB724 million for the same period in 2004. Net profit margin (after minority interests) was lower at 6.4% as compared to 7.1% for the same period in 2004.

Cash flow data

Unit: RMB in millions

	Six months ended 30 June 2005	**Six months ended 30 June 2004**
Net cash outflow from operating activities	**(2,579.5)**	(9.1)
Net cash outflow from investing activities	**(430.6)**	(254.4)
Net cash inflow/(outflow) from financing activities	**(806.4)**	517.7
Net increase/(decrease) in cash and cash equivalents	**(3,816.5)**	254.2

Operating activities

The Group had a net cash outflow from operating activities of RMB2,579 million for the first six months of 2005 compared to a net cash outflow of RMB9 million for the corresponding period of the previous year, primarily as a result of the cash outflow of RMB3,278 million resulting from changes in working capital for the first six months of 2005 as compared to a net cash outflow of RMB941 million for the first six months of 2004, and the reduction of operating profit excluding changes in working capital by 26% to RMB963 million for the first six months of 2005 from

RMB1,295 million for the first six months of 2004. The increased cash used for working capital was mainly attributable to an increase of RMB1,640 million in contract amounts due from customers and a decrease of RMB1,212 million in contract amounts due to customers. Trade and bills receivables and inventories also increased, and other payables and accruals decreased. The increase in contract amounts due from customers for the first six months of 2005 was the result of continued increase of outstanding sales contracts in tandem with business growth. The decrease in contract amounts due to customers was attributable to the decrease in prepayments received by the Group in respect of telecommunications contracts.

Investment activities

The net cash outflow from the Group's investment activities for the first six months of 2005 was RMB431 million as compared to RMB254 million for the corresponding period of the previous year, and this cash was mainly used in the expansion of the Group's operations and scale of production. Of the total, RMB436 million was applied in the acquisition of equipment and facilities, testing apparatus, computers, additional office equipment and building refurbishment, and projects including the construction of the Group's Shenzhen research and development center.

Financing activities

The Group had a net cash outflow from financing activities for the first six months of 2005 of RMB806 million, which was mainly applied to repay RMB834 million in bank loans.

Disclosure required by the Hong Kong Stock Exchange Listing Rules

In compliance with paragraph 40 of Appendix 16 to the Hong Kong Stock Exchange Listing Rules, the Company confirms that, save as disclosed herein, there has been no material change in the current information regarding the Company in relation to those matters set out in paragraph 32 of Appendix 16 to the Hong Kong Stock Exchange Listing Rules from the information in relation to the matters disclosed in the 2004 Annual Report of the Company.

(IV) Brief Outlook for the remainder of the year

A clearer picture should emerge in the latter half of the year in respect of the restructuring of the PRC telecommunications industry and the issuance of 3G licences. The Group expects domestic carriers to increase their capital expenditure in the latter half of the year as they seek to compete primarily on network quality and service standards by making more specific, customer-oriented investments.

Internationally, the Group expects the positive expansionary trend of the telecommunications sector in the first six months to continue in the latter half of the year. With a well-developed overseas marketing regime, the Group will be able to optimize its resource allocation and fully make use of its marketing strategies. As such, the Group expects continued strong growth in its international operations in the latter half of the year.

As it continues to venture towards the goal of becoming a world-class quality enterprise, the Group will seek to enhance its core competitive strengths and revenue levels by improving its internal operational efficiency through the following management measures, to be adopted in the latter half of 2005:

- Enhance efforts to develop our overseas marketing regime and improve its management processes, with a view to promoting our business in the international market;

- Further improve the Group's research and development process by revamping our R&D management system for a stronger emphasis on marketing;

- Enhance the overall competitive edge of the Group's 3G product lines with strengthened research and development capabilities and market management for our 3G business;

- Further improve the Group's human resource management and gear up efforts in corporate culture building on all fronts;

- Further enhance the Group's financial management standards with strict control over costs and expenditure and to improve our internal operating efficiency.

(V) Other Matters

1. The Group did not make any profit forecasts on the operating results for the Reporting Period.

2. The Group did not disclose any business plans for 2005 in its 2004 annual report.

3. During the Reporting Period, there was no significant change in the composition of the Group's profit and principal operations or the profitability of its principal operations.

4. During the Reporting Period, the Group was not engaged in any other operating activities that had a significant impact on profit.

5. *Operations and results of major subsidiaries*
During the Reporting Period, there was no individual company in which the Group held a stake that generated investment gains accounting for more than 10% of the Company's net profit.

6. *Model Code for Securities Transactions by Directors of Listed Issuers*
The Directors of the Company confirm that the Company has adopted the Model Code for Securities Transactions by Directors of Listed Issuers (the "Model Code") set out in Appendix 10 to the Hong Kong Stock Exchange Listing Rules. After making specific enquiries with the Directors and Supervisors of the Company, the Company is not aware of any information that would reasonably indicate that the Directors and Supervisors of the Company was not in compliance with the requirements of the Model Code during the Reporting Period.

7. *Audit Committee*
The Company has established an Audit Committee comprising seven members, all of whom are Non-executive Directors (including four Independent Directors). The Audit Committee has carried out discussions with the Company's management on the accounting standards and practices adopted by the Group as well as matters pertaining to auditing, internal control and financial reporting. It has also reviewed the financial statements of the Group for the six months ended 30 June 2005 prepared in accordance with PRC GAAP, and financial statements of the Group for the same period prepared in accordance with Hong Kong accounting standards and reviewed by Ernst & Young.

8. *Purchase, sale and redemption of shares*
During the Reporting Period, the Group did not purchase, sell or redeem any listed securities of the Company.

9. *Implementation of the Code on Corporate Governance Practices*
The Group complied with all Code Provisions set out in the Code of Corporate Governance Practices contained in Appendix 14 of the Hong Kong Stock Exchange Listing Rules, except for certain deviations from the Code Provisions listed below (other than Code Provision C.2 relating to internal controls) as described below:

A.1.3
Code Provision: Notice of at least 14 days should be given of a regular board meeting to give all directors an opportunity to attend. For all other board meetings, reasonable notice should be given.

Deviation: The Company's usual practice was to provide notice of only 10 days for a board meeting.

Explanation: To ensure full compliance with provisions of the Code of Corporate Governance Practices, the Company has commenced giving 14 days' notice for regular board meetings.

A.5.4
Code Provision: The board should establish written guidelines on no less exacting terms than the Model Code for relevant employees in respect of their dealings in the securities of the issuer.

Deviation: There are currently no written guidelines issued by the board of directors for relevant employees in respect of their dealings in the securities of the Company.

Explanation: To ensure full compliance with provisions of the Code of Corporate Governance Practices, the directors will establish and adopt written guidelines and establish mechanisms for the distribution, training and consultation for relevant employees in respect of their dealings in the securities of the issuer.

B.1.3
Code Provision: The terms of reference of the remuneration committee should include, as a minimum, the following specific duties:

(b) to have the delegated responsibility to determine the specific remuneration packages of all executive directors and senior management, including benefits in kind, pension rights and compensation payments, including any compensation payable for loss or termination of their office or appointment, and make recommendations to the board of the remuneration of non-executive directors. The remuneration committee should consider factors such as salaries paid by comparable companies, time commitment and responsibilities of the directors, employment conditions elsewhere in the group and desirability of performance-based remuneration;

(c) to review and approve performance-based remuneration by reference to corporate goals and objectives resolved by the board from time to time;

(d) to review and approve the compensation payable to executive directors and senior management in connection with any loss or termination of their office or appointment to ensure that such compensation is determined in accordance with relevant contractual terms and that such compensation is otherwise fair and not excessive for the issuer;

(e) to review and approve compensation arrangements relating to dismissal or removal of directors for misconduct to ensure that such arrangements are determined in accordance with relevant contractual terms and that any compensation payment is otherwise reasonable and appropriate;

Deviation: In light of the scope of responsibilities of the Remuneration and Evaluation Committee provided for in the aforesaid Code Provision, the Remuneration and Evaluation Committee of the Company had not fully performed its duties in actual operation. While the performance management rules of the Company's senior management (including the President) have been reviewed and approved by the Remuneration and Evaluation Committee, the specific remuneration packages for senior management (except the President) of the Company were not subject to review and approval by the Remuneration and Evaluation Committee.

Explanation: The amended terms of reference of the Remuneration and Evaluation Committee, revised in accordance with the Code of Corporate Governance Practices to comply with Rule B.1.3, were considered and approved by the board of directors of the Company at its meeting on 10 April 2005. Since 10 April 2005, the Company has strictly complied with the new requirements of the Code of Corporate Governance Practices.

C.3.3

Code Provision: The terms of reference of the audit committee should include at least the following duties:

(b) to review and monitor the external auditor's independence and objectivity and the effectiveness of the audit process in accordance with applicable standard. The audit committee should discuss with the auditor the nature and scope of the audit and reporting obligations before the audit commences;

(c) to develop and implement policy on the engagement of an external auditor to supply non-audit services. For this purpose, external auditor shall include any entity that is under common control, ownership or management with the audit firm or any entity that a reasonable and informed third party having knowledge of all relevant information would reasonably conclude as part of the audit firm nationally or internationally. The audit committee should report to the board, identifying any matters in respect of which it considers that action or improvement is needed and making recommendations as to the steps to be taken;

(f) to review the issuer's financial controls, internal controls and risk management systems;

(g) to discuss with the management the system of internal control and ensure that management has discharged its duty to have an effective internal control system.

Deviation: In light of the scope of responsibilities of the Audit Committee provided for in the aforesaid Code Provision, the Audit Committee of the Company had not fully performed its duties in its actual operations.

Explanation: The amended terms of reference of the Audit Committee, revised in accordance with the Code of Corporate Governance Practices to comply with Rule C.3.3, were considered and approved by the board of directors of the Company at its meeting on 10 April 2005. Since 10 April 2005, the Company has strictly complied with the new requirements of the Code of Corporate Governance Practices.