

CONSOLIDATION BALANCE SHEET

(Prepared under PRC GAAP)

(All amounts in RMB'000 unless otherwise stated)
(English Translation for Reference Only)

ASSETS	Note V	31 Dec, 2005	31 Dec, 2004 (Restated)
Current assets			
Cash in banks and on hands	1	5,573,132	7,598,223
Notes receivable	2	1,244,853	2,258,088
Trade receivables	3	3,441,922	3,652,506
Factored trade receivables	4	36,416	—
Other receivables	5	279,975	257,595
Accounts prepaid	6	151,174	145,398
Inventories	7	2,519,547	1,871,767
Amount due from customers for contract work	8	4,689,157	2,752,024
Prepaid expenses		—	478
Total current assets		17,936,176	18,536,079
Long-term investment			
Long-term equity investments	9	85,459	67,176
Total long-term investments		85,459	67,176
Fixed assets			
Fixed assets — cost	10	3,623,940	2,785,789
Less: accumulated depreciation	10	1,148,789	830,873
Net fixed assets	10	2,475,151	1,954,916
Less: fix assets impairment provision	10	94,980	94,980
Fixed assets — net book value	10	2,380,171	1,859,936
Construction in progress	11	126,741	114,677
Total fixed assets		2,506,912	1,974,613
Intangible and other assets			
Intangible assets	12	160,264	146,214
Long-term prepaid expenses	13	—	1,315
Long-term trade receivables	3	307,666	—
Factored long-term trade receivables	4	687,765	—
Long-term deferred assets	14	13,996	—
Total intangible and other assets		1,169,691	147,529
Deferred taxes			
Deferred taxes assets	15	80,893	104,625
TOTAL ASSETS		21,779,131	20,830,022

Notes on pages 115 to pages 175 form an integral part of these financial statements.

CONSOLIDATION BALANCE SHEET

(Prepared under PRC GAAP)

(All amounts in RMB'000 unless otherwise stated)
(English Translation for Reference Only)

LIABILITIES AND OWNER'S EQUITY	Note V	31 Dec, 2005	31 Dec, 2004 (Restated)
Current liabilities			
Short-term loans	16	99,695	405,695
Bank advances on factored trade receivables	4	36,416	—
Notes payable	17	1,977,584	1,422,401
Accounts payable	18	4,292,208	2,919,483
Amount due to customers for contract work	8	733,455	2,318,731
Advances from customers	19	861,024	292,023
Accrued payroll		622,804	1,031,464
Welfare payable		394,216	437,786
Dividends payable	20	163,008	40,921
Taxes payable	21	(670,282)	52,459
Other levies		7,134	13,197
Other payables	22	626,066	698,727
Accrued expenses	23	346,668	268,534
Provision	24	20,035	20,000
Long-term loans due within 1 year	25	500,000	16,900
Total current liabilities		10,010,031	9,938,321
Non-current liabilities			
Long-term loans	26	80,000	1,025,263
Bank advances on factored long-term trade receivables	4	687,765	—
Specific payables	27	405,511	227,320
Total non-current liabilities		1,173,276	1,252,583
Total liabilities		11,183,307	11,190,904
Minority interests		470,729	464,679
Owner's equity:			
Share capital	28	959,522	959,522
Capital surplus	29	5,506,424	5,491,658
Surplus reserves	30	1,264,060	985,356
of which: statutory public welfare fund		344,908	252,006
Undistributed profits	31	2,171,190	1,495,431
Exchange differences		(15,981)	2,592
Declared cash dividends		239,880	239,880
Total owner's equity		10,125,095	9,174,439
TOTAL LIABILITIES AND OWNER'S EQUITY		21,779,131	20,830,022

Notes on pages 115 to pages 175 form part of these financial statements.

The financial statements on pages 103 to pages 175 were signed by the followings:

Legal representative
Hou Weigui

Chief Financial Officer:
Wei Zaisheng

Head of Finance Division
Shi Chunmao

CONSOLIDATED INCOME STATEMENTS & STATEMENTS OF INCOME DISTRIBUTION

(Prepared under PRC GAAP)

(All amounts in RMB'000 unless otherwise stated)
(English Translation for Reference Only)

	Note V	31 Dec, 2005	31 Dec, 2004
Revenue from principal operations	32	21,575,920	22,698,153
Less: Cost of sales	32	13,944,797	14,369,106
Taxes and surcharges	33	105,660	70,912
Profit from principal operations		7,525,463	8,258,135
Add: Profit from other operations	34	15,779	41,339
Less: Operating expenses		3,023,126	2,929,110
General and administrative expenses		3,137,066	3,899,003
Finance expenses	35	288,751	284,978
Operating profit		1,092,299	1,186,383
Add: Investment income	36	(59,354)	(3,669)
Subsidy income	37	458,014	378,698
Non-operating income	38	27,627	18,041
Less: Non-operating expenses	39	16,722	160,637
Total profit		1,501,864	1,418,816
Less: Income tax		158,545	207,935
Minority interests		148,976	202,011
Net profit		1,194,343	1,008,870
Add: Undistributed profits at beginning of year		1,495,431	1,221,165
Distributable profit		2,689,774	2,230,035
Less: Statutory surplus reserves		185,802	240,843
Statutory public welfare fund		92,902	120,422
Profit available for distribution to owners		2,411,070	1,868,770
Less: Proposed ordinary shares dividends		239,880	239,880
Ordinary shares dividends converted to shares		—	133,459
Undistributed profits at year-end		2,171,190	1,495,431

Supplemental Information

Item	2005	2004
1. Gains received from sale or disposal of business departments or investee units	—	—
2. Losses resulting from natural disaster	—	—
3. Increase (or decrease) in total profit as a result of changes in accounting policies	—	—
4. Increase (or decrease) in total profit as a result of changes in accounting estimates	145,920	(238,637)
5. Losses resulting from debt restructuring	—	—
6. Others	—	—

Notes on pages 115 to pages 175 form part of these financial statements.

CONSOLIDATED CASH FLOW STATEMENT

(Prepared under PRC GAAP)

(All amounts in RMB'000 unless otherwise stated)

(English Translation for Reference Only)

Items	Note V	2005	2004
1. Cash flows from operating activities			
Cash received from sale of goods or rendering services		21,315,221	23,200,614
Cash received from taxes returned		458,014	369,663
Cash received relating to other operating activities		119,215	184,514
Sub-total of cash inflow		21,892,450	23,754,791
Cash paid for goods and services		13,915,822	15,560,704
Cash paid to and on behalf of employees		2,793,854	2,278,869
Payments of taxes and levies		1,679,312	1,490,169
Cash paid relating to other operating activities	40	3,326,157	2,780,430
Sub-total of cash outflow		21,715,145	22,110,172
Net cash flows from operating activities		177,305	1,644,619
2. Cash flows from investing activities			
Cash received from sale of investments		331	95,213
Net cash received from (paid for) the disposal of subsidiaries		(31,555)	—
Cash received from gains of investment		—	2,619
Net cash received from disposal of fixed asset, intangible assets and other long-term assets		41,372	990
Sub-total of cash inflow		10,148	98,822
Cash paid to acquire fixed asset, intangible assets and other long-term assets		921,463	542,178
Cash paid for acquisition of equity investments		72,955	122,976
Cash paid relating to other investing activities		—	85
Sub-total of cash outflow		994,418	665,239
Net cash flow from investing activities		(984,270)	(566,417)

CONSOLIDATED CASH FLOW STATEMENT

(Prepared under PRC GAAP)

(All amounts in RMB'000 unless otherwise stated)
(English Translation for Reference Only)

Items	2005	2004
3. Cash flows from financing activities		
Cash received from investment	25,227	3,540,417
Cash received from borrowings	108,695	2,775,971
Cash received relating to other financing activities	—	31,112
Sub-total of cash inflow	133,922	6,347,500
Cash paid for debt repayments	869,867	3,237,824
Cash payments for distribution of dividends and interest expenses	459,553	344,042
Cash paid relating to other financing activities	—	33,227
Sub-total of cash outflow	1,329,420	3,615,093
Net cash flow from financing activities	(1,195,498)	2,732,407
4. Effect of foreign exchange rate changes on cash	(22,628)	2,592
5. Net increase (decrease) in cash and cash equivalents	(2,025,091)	3,813,201

Notes on pages 115 to pages 175 form an integral part of these financial statements.

CONSOLIDATED CASH FLOW STATEMENT

(Prepared under PRC GAAP)

(All amounts in RMB'000 unless otherwise stated)

(English Translation for Reference Only)

Items	2005	2004
1. Reconciliation of net profit to cash flows from operating activities		
Net profit	1,194,343	1,008,870
Add: Minority interests	148,976	202,011
Provision for impairment of assets	362,300	1,166,771
Depreciation of fixed assets	394,984	307,691
Amortization of intangible assets	51,009	53,928
Amortization of long-term prepaid expenses	1,616	6,359
Decrease in prepaid expenses	478	2,011
Increase in accrued expenses (less: decrease)	78,134	(54,963)
Losses on disposal of fixed assets, intangible assets and other long-term assets (less: gains)	(909)	84
Losses on retirement of fixed assets	7,072	43,785
Finance expense	175,884	151,182
Losses on investment	59,354	9,367
Deferred tax credit (less: debit)	23,732	(38,211)
Decrease in inventories (less: increase)	(866,316)	2,194,557
Increase in operating receivable items	(2,015,438)	(4,097,689)
Increase in operating payable items	562,086	688,866
Net cash flows from operating activities	177,305	1,644,619
2. Net increase (decrease) in cash and cash equivalents		
Cash at end of year	5,573,132	7,598,223
Less: Cash at beginning of year	7,598,223	3,785,022
Add: Cash equivalents at end of year	—	—
Less: Cash equivalents at beginning of year	—	—
Net increase (decrease) in cash and cash equivalents	(2,025,091)	3,813,201

Notes on pages 115 to pages 175 form part of these financial statements.

BALANCE SHEET

(Prepared under PRC GAAP)

(All amounts in RMB'000 unless otherwise stated)
(English Translation for Reference Only)

ASSETS	Note V	31 Dec, 2005	31 Dec, 2004 (Restated)
Current assets			
Cash in banks and on hands		4,258,936	6,463,165
Notes receivable		1,209,151	2,240,530
Dividends receivable		16,465	1,371
Trade receivables	3	4,481,796	4,016,330
Factored trade receivables		5,007	—
Other receivables	5	1,230,352	751,559
Accounts prepaid		67,305	58,380
Inventories		1,557,312	1,350,130
Amount due from customers for contract work		4,440,842	3,414,540
Total current assets		17,267,166	18,296,005
Long-term investment			
Long-term equity investments	9	2,833,305	2,992,995
Total long-term investments		2,833,305	2,992,995
Fixed assets			
Fixed assets — cost		2,491,000	1,877,501
Less: accumulated depreciation		712,768	469,997
Net fixed assets		1,778,232	1,407,504
Less: fix assets impairment provision		87,002	87,002
Fixed assets — net book value		1,691,230	1,320,502
Construction in progress		77,261	98,100
Total fixed assets		1,768,491	1,418,602
Intangible and other assets			
Intangible assets		87,081	94,358
Long-term trade receivables	3	327,122	—
Factored long-term accounts receivable		683,598	—
Total intangible and other assets		1,097,801	94,358
Deferred taxes			
Deferred taxes assets		76,419	76,419
TOTAL ASSETS		23,043,182	22,878,379

Notes on pages 115 to pages 175 form a part of these financial statements.

BALANCE SHEET

(Prepared under PRC GAAP)

(All amounts in RMB'000 unless otherwise stated)
(English Translation for Reference Only)

LIABILITIES AND OWNER'S EQUITY	Note V	31 Dec, 2005	31 Dec, 2004 (Restated)
Current liabilities			
Short-term loans		—	340,344
Bank advances on factored trade receivables		5,007	—
Notes payable		1,918,831	1,453,282
Accounts payable		6,538,622	5,295,321
Amount due to customers for contract work		688,876	2,162,901
Advances from customers		493,438	249,004
Accrued payroll		367,583	663,925
Welfare benefits payable		326,370	362,467
Dividends payable		928	920
Taxes payable		(844,875)	(175,111)
Other levies		2,996	900
Other payables		1,084,091	1,078,453
Accrued expenses		286,561	248,486
Provision		16,000	20,000
Long-term loans due within 1 year		500,000	—
Total current liabilities		11,384,428	11,700,892
Non-current liabilities			
Long-term loans		—	950,000
Bank advances on factored long-term trade receivables		683,598	—
Other long-term liabilities		359,220	177,800
Total non-current liabilities		1,042,818	1,127,800
Total liabilities		12,427,246	12,828,692
Owner's equity			
Share capital		959,522	959,522
Capital surplus		5,532,896	5,515,822
Surplus reserves		769,603	650,718
of which: statutory public welfare fund		242,464	202,836
Undistributed profits		3,116,070	2,682,269
Exchange differences		(2,035)	1,476
Declared cash dividends		239,880	239,880
Total owner's equity		10,615,936	10,049,687
TOTAL LIABILITIES AND OWNER'S EQUITY		23,043,182	22,878,379

Notes on pages 115 to pages 175 form an integral part of these financial statements.

The financial statements on pages 103 to pages 175 were signed by the followings:

Legal representative
Hou Weigui

Chief Financial Officer:
Wei Zaisheng

Head of Finance Division
Shi Chunmao

INCOME STATEMENTS & STATEMENTS OF INCOME DISTRIBUTION

(Prepared under PRC GAAP)

(All amounts in RMB'000 unless otherwise stated)
(English Translation for Reference Only)

	Note V	31 Dec, 2005	31 Dec, 2004
Revenue from principal operations	32	20,565,052	21,572,945
Less: Cost of sales	32	16,671,822	16,285,819
Taxes and surcharges		56,009	55,427
Profit from principal operations		3,837,221	5,231,699
Add: Profit from other operations		149,282	160,095
Less: Operating expenses		2,360,822	2,852,561
General and administrative expenses		1,451,749	1,952,482
Finance expenses		294,898	256,903
Operating profit		(120,966)	329,848
Add: Investment income	36	919,713	1,149,900
Subsidy income		8,259	38,179
Non-operating income		19,834	7,486
Less: Non-operating expenses		6,321	152,878
Total profit		820,519	1,372,535
Less: Income tax		27,953	210,252
Net profit		792,566	1,162,283
Add: Undistributed profits at beginning of year		2,682,269	2,067,667
Distributable profit		3,474,835	3,229,950
Less: Statutory surplus reserve		79,257	116,228
Statutory public welfare fund		39,628	58,114
Profit available for distribution to owners		3,355,950	3,055,608
Less: Proposed ordinary shares dividends		239,880	239,880
Ordinary shares dividends converted to shares		—	133,459
Undistributed profits at year-end		3,116,070	2,682,269

Notes on pages 115 to pages 175 form an integral part of these financial statements.

CASH FLOW STATEMENT

(Prepared under PRC GAAP)

(All amounts in RMB'000 unless otherwise stated)

(English Translation for Reference Only)

Items	2005	2004
1. Cash flows from operating activities		
Cash received from sale of goods or rendering services	22,269,031	21,978,079
Cash received from taxes returned	8,259	29,444
Cash received relating to other operating activities	205,278	100,510
Sub-total of cash inflow	22,482,568	22,108,033
Cash paid for goods and services	18,549,739	16,082,179
Cash paid to and on behalf of employees	1,788,552	1,367,834
Payments of taxes and levies	724,097	705,936
Cash paid relating to other operating activities	1,756,749	2,498,971
Sub-total of cash outflow	22,819,137	20,654,920
Net cash flows from operating activities	(336,569)	1,453,113
2. Cash flows from investing activities		
Cash received from sale of investments	331	—
Cash received from gains of investment	2,621	2,516
Net cash received from disposal of fixed assets, intangible assets and other long-term assets	172,186	136
Sub-total of cash inflow	175,138	2,652
Cash paid to acquire fixed assets, intangible assets and other long-term assets	796,746	423,726
Cash paid for equity investment	43,552	225,645
Cash paid relating to other investing activities	—	—
Sub-total of cash outflow	840,298	649,371
Net cash flow from investing activities	(665,160)	(646,719)

CASH FLOW STATEMENT

(Prepared under PRC GAAP)

(All amounts in RMB'000 unless otherwise stated)
(English Translation for Reference Only)

Items	2005	2004
3. Cash flows from financing activities		
Cash received from investment	—	3,504,747
Cash received from borrowings	—	1,286,924
Cash received relating to other financing activities	—	30,859
Sub-total of cash inflow	—	4,822,530
Cash paid for debt repayments	790,344	1,593,483
Cash payments for distribution of dividends and interest expenses	407,651	310,361
Cash paid relating to other financing activities	—	32,500
Sub-total of cash outflow	1,197,995	1,936,344
Net cash flow from financing activities	(1,197,995)	2,886,186
4. Effect of foreign exchange rate changes on cash	(4,505)	1,476
5. Net increase (decrease) in cash and cash equivalents	(2,204,229)	3,694,056

Notes on pages 115 to pages 175 form an integral part of these financial statements.

CASH FLOW STATEMENT

(Prepared under PRC GAAP)

(All amounts in RMB'000 unless otherwise stated)
(English Translation for Reference Only)

Items	2005	2004
1. Reconciliation of net profit to cash flows from operating activities		
Net profit	792,566	1,162,283
Add: Provision for impairment of assets	236,168	1,136,149
Depreciation of fixed assets	392,118	207,105
Amortization of intangible assets	16,004	35,204
Amortization of long-term prepaid expenses	—	3,852
Decrease in prepaid expenses	—	990
Increase in accrued expenses (less: decrease)	38,075	(72,421)
Losses on disposal of fixed assets, intangible assets and other long-term assets	—	(136)
Losses on retirement of fixed assets	3,558	40,338
Finance expenses	167,779	129,822
Losses on investment	(919,713)	(1,162,936)
Deferred tax debit	—	(10,005)
Decrease in inventories	(335,921)	1,060,307
Increase in operating receivable items	(2,171,944)	(2,972,220)
Increase in operating payable items	1,444,741	1,894,781
Net cash flows from operating activities	(336,569)	1,453,113
3. Net increase (decrease) in cash and cash equivalents		
Cash at end of year	4,258,936	6,463,165
Less: Cash at beginning of year	6,463,165	2,769,109
Add: Cash equivalents at end of year	—	—
Less: Cash equivalents at beginning of year	—	—
Net increase (decrease) in cash and cash equivalents	(2,204,229)	3,694,056

Notes on pages 115 to pages 175 form an integral part of these financial statements.

NOTES TO FINANCIAL STATEMENTS

(Prepared under PRC GAAP)

(All amounts in RMB'000 unless otherwise stated)

I. COMPANY BACKGROUND

ZTE Corporation ("The Company") is a joint-stock limited company jointly founded by Shenzhen Zhongxingxin Telecommunications Equipment Company, Limited, China Precision Machinery Import & Export Shenzhen Company, Lishan Microelectronics Corporation, Shenzhen Zhaoke Investment Development Co., Limited, Hunan Nantian (Group) Company, Limited, Shaanxi Shunda Communications Corporation (now renamed Shaanxi Telecommunications Industrial Company), No. 7 Research Institute of Post, Telegraphs & Telephones Ministry (郵電部第七研究所) (now renamed China Mobile Telecommunications No. 7 Research Institute), Jilin Posts and Telecommunications Equipment Company and Hebei Telecommunications Equipment Company, Limited and incorporated in People's Republic of China through a public offering of shares to the general public. As approved under Document Zheng Jian Fa Zi (1997) No. 452 and Document Zheng Jian Fa Zi No. 453 issued by China Securities Regulatory Commission, on 6 October 1997, the Company issued within the network 58,500,000 ordinary shares with a par value of RMB1.00 per share through the Shenzhen Stock Exchange and issued 6,500,000 ordinary shares with a par value of RMB1.00 per share to its employees at an issue price of RMB6.81 per share.

In 2003, Shenzhen Zhaoke Investment Development Co., Limited transferred its entire shareholdings in the Company to Shenzhen Gaotejia Venture Investment Co., Limited. The time of the share transfer was already more than three years from the date of establishment of the Company and was therefore in compliance with the applicable provision under the Company Law. In December 2003, Shenzhen Gaotejia Venture Investment Co., Limited transferred its entire shareholdings in the Company to Fortune Trust & Investment Co., Ltd. Fortune Trust & Investment Co., Ltd. transferred its entire shareholdings in the Company to Jade Dragon (Mauritius) Company Limited in November 2005.

On 11 November 1997, the Company was registered and established upon approval by Guangdong Shenzhen Industrial and Commercial Administrative Bureau with registration no. of 4403011015176 (revised), and was issued a Corporate Business License (license no.: Shen Si Zi N35868). The Company and its subsidiaries mainly engage in production of remote control switch systems, multi-media communications systems and communications transmission systems; provision of technical design, development, consultation and related services for the research and manufacture and production of mobile communications systems equipment, satellite communications, microwave communications equipment, beepers, computer hardware and software, closed-circuit TVs, microwave communications, automated signal control, computer information processing, process monitoring systems, fire alarm systems; provision of technical design, development, consultation and related services for wireline and wireless communications projects of railways, mass transit railways, urban rail transit, highways, plants and mines, ports and terminals and airports (excluding restricted projects); purchase and sale of electronics devices, micro-electronics components (excluding franchised, state-controlled and monopolized merchandises); sub-contracting of communications and related projects outside the PRC and global tendering projects within the PRC, as well as import and export of the equipment and materials required by the aforesaid projects outside the PRC and sending labors and workers for carrying out the aforesaid projects outside the PRC; technical development and sale of electronics systems equipment (excluding restricted items and franchised, state controlled and monopolized merchandises); operations of import and export businesses (implemented in accordance with the provision under the certificate of qualifications approved and issued by Shenzhen Bureau of Trade and Development); specialized sub-contracting of telecommunications projects.

On 18 November 1997, the 58,500,000 ordinary shares publicly issued by the Company to the general public were listed and traded on the Shenzhen Stock Exchange.

NOTES TO FINANCIAL STATEMENTS

(Prepared under PRC GAAP)

(All amounts in RMB'000 unless otherwise stated)

I. COMPANY BACKGROUND (continued)

On 11 September 1998, as approved by Document Shen Zheng Ban Fu (1998) No. 72 issued by the Securities Administration Office of Shenzhen, the Company increased its capital by a total of 75,000,000 shares by way of an issue of 3 shares transferred from its capital surplus reserves as at 30 June 1998 for every 10 shares. Thereupon the Company's registered capital was increased to RMB325,000,000.

On 27 May 1999, pursuant to the consent under Document Shen Zheng Ban Zi (1999) No. 78 issued by the Securities Administration Office of Shenzhen and the approval under Document Zheng Jian Gong Si Zi (1999) No. 42 issued by China Securities Regulatory Commission, the Company placed 19,500,000 ordinary shares to the public shareholders. The placing was completed on 18 August 1999. Thereupon the Company's registered capital was increased to RMB344,500,000.

On 20 May 2000, pursuant to the approval at the Company's shareholders' general meeting, the Company increased its capital by a total of 68,900,000 shares by way of an issue of 2 shares transferred from its capital surplus reserves as at 31 December 1999 for every 10 shares. Thereupon the Company's registered capital was increased to RMB413,400,000.

On 20 March 2001, as approved under Document Zheng Jian Gong Si Zi (2001) No. 25 issued by China Securities Regulatory Commission, the Company issued an additional of 50,000,000 ordinary shares to the public at an issue price of RMB32.70 per share. Thereupon the Company's registered capital was increased to RMB463,400,000.

On 16 October 2001, pursuant to the approval at the Company's shareholders' general meeting, the Company increased its capital by a total of 92,680,000 shares by way of a bonus issue on the basis of 2 shares for every 10 shares then held based on its share capital as at 30 June 2001. Thereupon the Company's registered capital was increased to RMB556,080,000.

On 25 April 2003, pursuant to a resolution passed at the Company's shareholders' general meeting, the Company increased its capital by a total of 111,216,000 shares by way of an issue of 2 shares transferred from its capital surplus reserves as at 31 December 2002 for every 10 shares. Thereupon the Company's registered capital was increased to RMB667,296,000.

On 17 May 2004, pursuant to a resolution passed at the Company's shareholders' general meeting, the Company increased its capital by a total of 133,459,200 shares by way of a bonus issue on the basis of 2 shares for every 10 shares then held based on its share capital as at 31 December 2003. Thereupon the Company's registered capital was increased to RMB800,755,000. The alteration formalities for industrial and commercial registration have been completed.

On 9 December 2004, pursuant to a resolution adopted at the Company's second temporary shareholders' general meeting and the provision under the revised Articles of Association, and upon approval under Document Guo Zi Gai Ge [2004] No. 865 issued by State-owned Assets Supervision and Administration Commission of the State Council and verification and approval under Document Zheng Jian Guo He Zi [2004] No. 38 issued by China Securities Regulatory Commission, the Company made an overseas public offering of 160,151,040 overseas listed foreign invested shares (H Shares), of which 158,766,450 new shares were issued by the Company and 1,384,590 shares were sold by the Company's state-owned corporate shareholders. The Company's registered capital after alteration was RMB959,522,000.

(All amounts in RMB'000 unless otherwise stated)

I. COMPANY BACKGROUND (continued)

On 28 December 2005, the share reform plan of the Company was formally implemented and completed. On the first trading day subsequent to the implementation of the share reform plan, all original non-tradable shares held by non-tradable shareholders of the Company obtained the right of listing and circulation, but had undertaken not to transfer or trade within the first twelve months. In the event that Shenzhen Zhongxingxin Telecommunications Equipment Company, Limited ("Zhongxingxin") intends to sell its shares subsequent to the expiry of the said moratorium, it will not sell more than five percent and ten percent of the total share capital of the Company during the period from the thirteenth month to the twenty-fourth month and the period from the twenty-fifth month to the thirty-sixth month after such shares have been granted the right of listing and circulation and without limitation thereafter. Zhongxingxin further undertakes that where it sells its shares during the period from the thirteenth month to the twenty-fourth month after such shares have been granted the right of listing and circulation on the Shenzhen Stock Exchange, the price at which the shares are sold shall not be lower than 115% of the arithmetic average of the closing prices of its A Shares for the 60 trading days prior to the first announcement of the Share Reform Plan by the Board, that is, RMB26.75 per share, that is, RMB30.76 (such price to be on an ex-rights basis and net of any dividends, bonus issues and capitalisation of capital reserve between the period from the implementation date of the Share Reform Plan to the respective dates of sale). The proceeds from any sale in breach of such undertaking shall be reverted to the Company's account for the benefits of all shareholders of the Company. Sales restrictions of other restricted shares are released twelve months after such shares have been granted the right of listing and circulation. Shareholders of tradable A Shares whose names appeared on the register of shareholders on the registration date for entitlement of the Share Reform Plan received 2.5 Shares for every 10 Shares held. Following the implementation of the share reform plan, namely compensation arrangements of the non-circulating shareholders, the shareholding structure of the Company was changed. As at 31 December 2005, the total accumulated share capital in issue of the Company was 959,522,000 shares. Please see Notes V.28 for details.

II. PRINCIPAL ACCOUNTING POLICIES, ACCOUNTING ESTIMATES AND CONSOLIDATION OF FINANCIAL STATEMENTS

The financial information set out in the financial statements was prepared in accordance with the following principal accounting policies and accounting estimates which were proposed in accordance with Accounting Standards for Business Enterprises and "Accounting System for Business Enterprises" and other related supplementary regulations as issued by China.

1. Accounting system

The Group has implemented Accounting Standards for Business Enterprises and "Accounting System for Business Enterprises"

2. Financial year

The financial year of the Group is from 1 January to 31 December of each calendar year.

3. Reporting currency

Reporting currency and the currency used in preparing the financial statements are Renminbi. The amounts in the financial statements are denominated in Renminbi, unless otherwise stated.

NOTES TO FINANCIAL STATEMENTS

(Prepared under PRC GAAP)

(All amounts in RMB'000 unless otherwise stated)

II. PRINCIPAL ACCOUNTING POLICIES, ACCOUNTING ESTIMATES AND CONSOLIDATION OF FINANCIAL STATEMENTS (continued)

4. Recording basis and accounting principle

The Company adopts the accrual basis as basis of accounting. All items are recorded at historical cost.

5. Foreign currency transaction

Foreign currency transactions are translated into the reporting currency at the exchange rates quoted by the People's Bank of China (or SAFE) prevailing at the beginning of the month.

At the end of the year, balance of foreign currency accounts is adjusted at the mid-point exchange rates quoted at the end of the year. Exchange differences arising from these translations are recorded in the current income statement as profit or loss from exchange differences. Foreign exchange gain or loss arising from special borrowings in foreign currency to finance the acquisition or construction of fixed assets are dealt with according to the principle of the capitalization of borrowing costs.

6. Foreign currency translation

All assets and liabilities are translated to Renminbi at the exchange rates prevailing at the balance sheet date; shareholders' equity, with the exception of "undistributed profit", are translated at the exchanged rates prevailing at the transaction date; "undistributed profit" are recorded based on the amount stated on the statement of income and profit appropriation after translation adjustments; differences arising from the difference between total translated assets and the sum of total translated liabilities and translated shareholders' equity are dealt with in the exchange fluctuation reserve as a separate allocation of "exchange differences". All statement of income and profit appropriation items are translated at the average exchange rates during the year. All cash flow statement items are translated at exchange rate prevailing at the balance sheet date. All opening balances and last year actual amounts are stated at last year translated amounts.

7. Cash equivalents

Cash equivalents represent short term highly liquid investments which are readily convertible into known amounts of cash, subject to an insignificant risk of changes in value.

8. Bad debts provision

(1) Recognition criteria for bad debts:

- the irrecoverable amount of a bankrupt or deceased debtor who has insufficient assets or estate to repay the debt;
- the irrecoverable receivables, supported by evident characteristics, of a debtor who is unable to comply with the repayment obligation after the debt fell due.

(All amounts in RMB'000 unless otherwise stated)

II. PRINCIPAL ACCOUNTING POLICIES, ACCOUNTING ESTIMATES AND CONSOLIDATION OF FINANCIAL STATEMENTS (continued)

8. Bad debts provision (continued)

- (2) The Group adopted the provision method to account for bad debt losses, whereby specific and general provisions were made to account for possible bad debt losses expected to be incurred. A specific provision refers to a bad debt provision based on management's assessment of the recoverability of individual receivables. A general provision refers to a bad debt provision made by the management, other than the specific provision, on the year-end balances of other receivables and accounts prepaid based on the ageing analysis.

Provision for expenses on other receivables is made as follows:

Ageing	Percentage of provision for bad debts (%)	Remark
1-2 months	—	Applicable to other receivables arising from domestic operations
Over 2 months	100%	Applicable to other receivables arising from domestic operations
1-3 months	—%	Applicable to other receivables arising from oversea operations
3-4 months	58%	Applicable to other receivables arising from oversea operations
4-5 months	75%	Applicable to other receivables arising from oversea operations
5-6 months	92%	Applicable to other receivables arising from oversea operations
Over 6 months	100%	Applicable to other receivables arising from oversea operations

Provision for bad debts of accounts prepaid is made as follows:

Ageing	Percentage of provision for bad debts (%)	Remark
1-6 months	—	Applicable to all accounts prepaid
6-12 months	—	Applicable to accounts prepaid for the purchase of fixed assets
6-12 months	50%	Applicable to accounts prepaid for the purchase of raw materials
12-24 months	75%	Applicable to accounts prepaid for the purchase of raw materials
12-24 months	50%	Applicable to accounts prepaid for the purchase of fixed assets
Over 24 months	100%	Applicable to all accounts prepaid

For details of changes in accounting estimates relating to the method of calculating bad debt provision for trade receivables, please refer to Note II.21.

NOTES TO FINANCIAL STATEMENTS

(Prepared under PRC GAAP)

(All amounts in RMB'000 unless otherwise stated)

II. PRINCIPAL ACCOUNTING POLICIES, ACCOUNTING ESTIMATES AND CONSOLIDATION OF FINANCIAL STATEMENTS (continued)

9. Inventories

Inventories include raw materials, work-in-progress, finished goods, materials for construction-in-progress and materials sub-contracted for processing, etc. Inventories are finished goods or merchandise held by an enterprise for sale in the ordinary course of business, or work in progress in the process of production for such sale, or in the form of materials or supplies to be consumed in the production process or in the rendering of services.

Inventories are recorded at actual costs and recognized using the weighted moving average method when dispatched.

Cost of finished products and work in progress comprises direct materials, direct labor and an appropriate proportion of manufacturing overheads.

Inventories are valued using the perpetual inventories system.

Inventories at the end of the year are stated at the lower of cost or net realizable value. Provision for impairment of inventories is made on the basis of individual categories in respect of any shortfall where the net realizable value is lower than cost. Net realizable values represent estimated selling prices less any estimated costs to be incurred to completion, estimated selling expenses and relevant tax amounts.

At the end of the period, the carrying values of all mouldy stocks or expired stocks with no transferred value or stocks that are no longer required in production process as well as stocks that are sufficiently proved to be of no use value and transferred value are transferred into gains or losses for the current period for reducing the amount of provision for inventories.

10. Construction contract works

The amount of construction contract works is represented by costs incurred to date and recognized gross profit (loss) less progress billings. Contract costs incurred comprise direct materials, the costs of subcontracting, direct labor, construction machinery costs, other direct costs and an appropriate proportion of construction overheads. The amount of contract costs incurred to date plus recognized gross profit (loss) in excess of progress billings is recognized as assets; whereas, the amount of progress billings in excess of contract costs incurred to date plus recognized gross profit (loss) is recognized as liabilities.

The proportion of construction contract work completion is represented by the contract costs incurred to date as a percentage of estimated total contract costs.

Turnover of raw materials used is accounted for on a one-off basis.

Provision for anticipated contract losses is made in respect of contracts for which the amount of estimated total contract costs exceeds estimated total contract revenue to the extent of the difference between the amount of estimated total contract costs in excess of estimated total contract revenue and recognized losses.

Upon the realisation of anticipated contract losses of contracts for which estimated losses have been provided for, the estimated contract losses provided for will be written back and the actual amount of loss will be recognized.

II. PRINCIPAL ACCOUNTING POLICIES, ACCOUNTING ESTIMATES AND CONSOLIDATION OF FINANCIAL STATEMENTS (continued)

11. Long-term investments

Long term equity investments are recorded at initial investment cost on acquisition.

The cost method is used in accounting for long-term equity investments where the Company has no control or jointly-control or significant influence over the investee company; the equity method is used in accounting for long-term equity investments where the Company has control or jointly-control or significant influence over the investee company.

When the equity method is adopted, the amount of initial cost of the investment in excess of the investor's share of the owner's equity in the investee company is regarded as an equity investment difference is amortized over a period of not more than 10 years (including 10 years). The amount of initial cost of the investment fall short of the investor's share of the owner's equity in the investee company is credited to the capital reserve. In the event of that the corresponding investment took place before 17 March 2003, it is included in the difference of long-term equity investments and amortized by equal installments over a period of not less than 10 years.

When the equity method is adopted, the Group should, after the acquisition of the equity investment, adjust the book value of the investment according to its attributable share of the investee enterprise's net profit or loss and recognized as investment income or loss for the current period accordingly. It recognizes net losses incurred by the investee enterprise to the extent that the book value of the investment is reduced to zero.

When the cost method is adopted, profit or cash dividends declared to be distributed by the investee enterprise should be recognized as investment income in the current period after the investment acquired by the Group. The excess should be treated as a recovery of investment cost.

At the end of the year, long-term investments are measured at the lower of the book value and the recoverable amount. Provision for impairment of long-term investments is made on the basis of individual categories in respect of any shortfall where the recoverable amount is lower than cost and set-off against the equity investment component in the capital reserve. Any shortfall will be dealt with in the current profit and loss.

12. Fixed assets

Fixed assets represent tangible assets held for the purposes of production of products, provision of services, leasing or operational use. They are of relatively high value and have useful lives exceeding 1 year.

Fixed assets are recognized at cost. The cost of purchasing fixed assets comprises the purchase price, tax payments (such as value-added tax and import tariffs) and other expenses incurred in bringing fixed assets to the expected state for use that are directly attributable to the asset, such as transportation and installation fees. Subsequent expenses relating to fixed assets are charged to fixed assets to the extent that possible inflow of economic benefits into the enterprise resulting from such expenses exceed original estimates.

NOTES TO FINANCIAL STATEMENTS

(Prepared under PRC GAAP)

(All amounts in RMB'000 unless otherwise stated)

II. PRINCIPAL ACCOUNTING POLICIES, ACCOUNTING ESTIMATES AND CONSOLIDATION OF FINANCIAL STATEMENTS (continued)

12. Fixed assets (continued)

Depreciation is provided on fixed assets using the straight-line method, the estimated useful lives, estimated residual value and annual depreciation rate of each category of fixed assets are as follows:

	Estimated useful life	Estimated residual value	Annual depreciation rate
Leasehold improvement	5 years	0%	20%
Buildings (excluding temporary plants)	30 years	5%	3.17%
Buildings — temporary plants	3 years	5%	31.67%
Machinery equipment	5–10 years	5%	9.5%–19%
Electronic equipment	5 years	5%	19%
Motor vehicles	10 years	5%	9.5%
Other equipment	5 years	5%	19%

At the end of the period, fixed assets are measured at the lower of the book value and the recoverable amount. The difference between the recoverable amount and the book value of the fixed asset is recognized as an impairment provision and charged to the current period's profit and loss. Recoverable amount refers to the higher of the net selling price and the value in use of the fixed asset. Value in use refers to the present value of estimated future cash flows expected to arise from the continuing use of the fixed asset and from its disposal at the end of its useful life. Impairment provisions for fixed assets are made on an individual basis.

13. Construction in progress

Construction in progress represents the necessary costs incurred in the purchase and construction of fixed assets in bringing construction from its preparation stage to its working condition. Cost comprises direct materials, direct labor, equipment cost, installation and management fee, net profit or loss from trial run and borrowings cost for capitalization.

Until such time as the assets are completed and put into operational use, construction-in-progress is recognized as a fixed asset.

Provision for construction-in-progress impairment shall be made and be recognized in the income statement in the event that construction has stopped already for a long time and is estimated not to be restarted in the next 3 years or; economic return on the construction is ultimately uncertain with inferior construction quality and backward technology.

(All amounts in RMB'000 unless otherwise stated)

II. PRINCIPAL ACCOUNTING POLICIES, ACCOUNTING ESTIMATES AND CONSOLIDATION OF FINANCIAL STATEMENTS (continued)

14. Intangible assets

Intangible assets are recorded at the actual cost on acquisition.

Intangible assets are amortized by equal installments over its estimated useful lives, the beneficial period stipulated by the related contract or the effective period stipulated by applicable laws (whichever the shorter). The amortization periods of intangible assets are as follows:

Category	Amortization period
Patent technology	10 years
Operating concession	20 years
Land use rights	50 years
Software	5 years

At the end of the year, intangible assets are measured at the lower of the book value and the recoverable amount. Any excess of the book value of the asset over the expected recoverable amount is recognized as an impairment provision and is charged to the income statement in the current year.

15. Long-term prepaid expenses

Long-term prepaid expenses of the Group refer to expenses incurred by the company with an amortization period of over 1 year. Long-term prepaid expenses are amortized by equal installments over the beneficial period.

16. Recognition of revenue

Telecommunications systems contracts

Operating income from telecommunications systems contracts is recognized by reference to the estimated completion based on the proportion of costs incurred to date to the estimated total cost of the relevant contract and costs will be accounted for where the total revenue and total costs can be measured reliably and where transaction-related amounts are allowed to pass into the Company, and costs will be accounted for accordingly.

Sales of goods:

Revenue from sales of goods is recognized when the significant risks in connection with the ownership of the product and the payment have been transferred to the buyer, and the Group no longer has custody and control over the product if the economic benefits flow to the Group.

Supply of labor service:

The revenue from labor service is recognized when the supply of labor service has been completed within one accounting year since its commencement; if the commencement and completion of supply of labor service do not take place in the same accounting year, when transaction result of the supply of labor service can be measured reliably, related revenue from labor service is recognized according to the percentage of completion on the balance sheet date, otherwise revenue is recognized only to the extent of cost incurred that are expected to be recoverable.

NOTES TO FINANCIAL STATEMENTS

(Prepared under PRC GAAP)

(All amounts in RMB'000 unless otherwise stated)

II. PRINCIPAL ACCOUNTING POLICIES, ACCOUNTING ESTIMATES AND CONSOLIDATION OF FINANCIAL STATEMENTS (continued)

17. Provision

The Group recognizes as liability an obligation that fulfill that following criteria and relate to contingent matters: the obligation in question is a present obligation of the Group that can be reliably measured and it will probably results in an outflow of economic resources.

18. Income tax

The Group adopts tax-effect accounting method and adopts the liability method in case of changes in the income tax rates.

19. Subsidy income

The Group's subsidy income is mainly derived from refunds of VAT and contributions to development fund, as well as financial subsidy for new products, and is recorded as subsidy income upon the actual receipt of such refunds of VAT and contributions to development fund and financial subsidy for new products.

20. Related parties

A party is deemed to be a related party of the Group if it directly or indirectly controls or is controlled by, is in common control of or under common control with, or if it exercises significant influence on or under the significant influence of the Group in financial and operational decisions. A party is also deemed to be a related party of the Group if they are subject to the control of the same party together with the other party or parties.

21. Changes in accounting estimates

Save as discussed below, the accounting estimates adopted in these financial statements are consistent with those adopted in respect of the previous year.

It was resolved at the sixteenth meeting of the third session of Board of Directors that, effective from 1 January 2005, the Group has revised its method of making bad debt provision for trade receivables taking into account actual circumstances and with reference to international practices as the method of bad debt provision for trade receivables varies according to the credit rating and repayment profile of debtors. The Group is of the view that the revised bad debt provision method will more accurately reflect the financial conditions and operating results of an enterprise.

Prior to the change: bad debt provision is made, using ageing analysis, in respect of the balance of trade receivables less amounts due from related companies and amounts for which there is concrete evidence for recoverability: The proportions concerned are as follows:

Age	Proportion
1-6 months	—
6-12 months	15%
12-18 months	50%
18-24 months	75%
Over 24 months	100%

(All amounts in RMB'000 unless otherwise stated)

II. PRINCIPAL ACCOUNTING POLICIES, ACCOUNTING ESTIMATES AND CONSOLIDATION OF FINANCIAL STATEMENTS (continued)

21. Changes in accounting estimates (continued)

After the change: specific bad debt provision shall be separately made in respect of trade receivables for which there is direct evidence that impairment has occurred. Separate impairment tests shall be conducted in respect of individual trade receivables with a significant amount or prolonged overdue period, and specific bad debt shall be made if there is objective evidence that impairment has occurred. For trade receivables in respect of which no separate test has been carried out or no impairment has been recorded in separate test shall be consolidated into an asset portfolio that shows similar credit risk features for impairment tests and a specific bad debt provision will be made. The grading of credit risk and its corresponding empirical impairment ratios are differentiated and determined on the basis of with the current financial conditions of customers, historical trading records and overdue periods of trade receivables.

As a result of the change in such accounting estimates, net profit and net assets of the Group increased by RMB145,920,000 and net profit and net assets of the Company increased by RMB75,342,000, respectively, under the new bad debt provision method, as compared to the previous method.

22. Preparation of consolidated financial statements

Consolidated financial statements are prepared in accordance with relevant provisions of the Provisional Regulations Governing Consolidated Financial statements (Cai Kuai Zi [1995] No. 11) issued by the Ministry of Finance and the Enterprise Accounting System.

Consolidated statements comprise the financial statements of a listed company with limited liability together with its subsidiaries. A subsidiary is a company in which the listed company with limited liability owns 50% or above of its voting capital, or in which it exercises effective control even though it does not own 50% or above of the voting capital.

Results of the Group's associates are not consolidated on a pro-rata basis when the Company prepares its consolidated financial statements, but are recognized using the equity accounting method, as the associates do not have any significant impact on the Group's financial position and operating results.

Results of subsidiaries are included in the consolidated statements upon the acquisition of effective control by the Company up to the date on which such control is transferred out of the Group.

On combination, reporting years and accounting policies consistent with those adopted by the parent will be adopted in respect of the financial statements of subsidiaries. All intra-group transactions and balances (including any unrealized profit) are eliminated in full on combination.

Please refer to Note IV to these financial statements for details of subsidiaries consolidated on 31 December 2005.

NOTES TO FINANCIAL STATEMENTS

(Prepared under PRC GAAP)

(All amounts in RMB'000 unless otherwise stated)

III. TAXATION

The principal tax items and tax rates applicable to the Group are as follows:

Value-added tax	Payable on income generated from domestic sales of products and equipment repair services at a tax rate of 17% after deducting the current balance of tax credit available for offsetting
Business tax	In accordance with relevant PRC tax regulations, business tax is payable by the Group at tax rates of 3% and 5%, respectively, on its sales income and service income which are subject to business tax.
City maintenance and construction tax	In accordance with relevant PRC tax regulations and local regulations, city maintenance and construction tax is payable according to rates stipulated by the State based on individual situations of the branches and subsidiaries of the Group
Education surcharge	In accordance with relevant PRC tax regulations and local regulations, education surcharge is payable according to rates stipulated by the State based on individual situations of the branches and subsidiaries of the Group.
Individual income tax	In accordance with relevant PRC tax regulations, the Group withhold income tax from its salary payments to employees based on progressive tax rates
Overseas tax	Overseas taxes are payable in accordance with tax laws of various countries and regions.
Enterprise income tax	In accordance with the PRC Provisional Regulations on Enterprise Income Tax, enterprise income tax is payable by the Group on its taxable income.

The Company is registered in Shenzhen Special Economic Zone, hence its enterprise income tax rate is 15%.

Taxation policy of parts of the company's subsidiaries is as follows:

Pursuant to the Approval Notice for Deduction and Exemption of Tax (Document Shen Guo Yan Jian Mian (2005) No. 004) issued by the Shenzhen State Tax Bureau, it is agreed that ZTE Microelectronics Technology Co. Ltd., as a enterprise, is entitled to enterprise income tax exemption in the first and second profitable year and is entitled to 50% reduction in enterprise income tax from the third to fifth year. The current year is the second profitable year and is exempted for enterprise income tax.

Wuxi Zhongxing Optoelectronics Technologies Company, Limited was registered at Wuxi State's High-tech Industrial Development Zone, it is subject to an enterprise income tax rate of 15%.

Pursuant to the Approval Notice for Deduction and Exemption of Tax (Document Shen Guo Shui Nan Jian Mian (2005) No. 0098) issued by the Nanshan State Tax Bureau in Shenzhen, Shenzhen Zhongxing Telecom Equipment Technology & Service Company, Limited, as a SEZ enterprise engaged in the servicing industry, is entitled to enterprise income tax exemption in the first profitable year and a 50% reduction of enterprise income tax in the second and third years. As the company had not yet to record a profitable year, it was exempted from enterprise income tax.

Pursuant to the Document Shen Di Shui San Han (2003) No. 199 issued by the Local Tax Bureau of Shenzhen, ZTE Mobile Tech Co., Ltd., as a manufacturing enterprise, is entitled to enterprise income tax exemption in the first and second profitable years and a 50% reduction of enterprise income tax in the third to fifth years. As the current year was the first profitable year for the company, it was exempted from enterprise income tax.

(All amounts in RMB'000 unless otherwise stated)

III. TAXATION (continued)

Pursuant to the Approval Notice for Deduction and Exemption of Tax (Document Shen Guo Shui Nan Jian Mian (2004) No. 0372) issued by the Nanshan State Tax Bureau in Shenzhen, ZTE Integration Telecom Ltd, as a manufacturing enterprise, is entitled to enterprise income tax exemption in the first and second profitable years and a 50% reduction of enterprise income tax in the third to fifth years. As the current year was the first profitable year for the company, it was exempted from enterprise income tax.

Pursuant to the Income Tax Concession Approval Notice (Document Pu Shui Suo (2005) No. 672) issued by the Shanghai Pudong New Area State Tax Bureau and the Shanghai Pudong New Area Local Tax Bureau, Shanghai Zhongxing Telecom Equipment Technology & Service Company, Limited, as a hi-tech enterprise, was exempted from domestic enterprise income tax for the period commencing 1 January 2005 and ending 31 December 2006.

Pursuant to the document Ke Gao (2002) No. 21 issued by the Science and Technology Department of Anhui, the Finance Department of Anhui, the Regional Tax Bureau of Anhui, Anhui Wantong Posts and Telecommunications Company, Limited is entitled to the enterprise income tax preferential treatment as enjoyed by high-tech enterprises. The enterprise income tax is subject to refund and the tax rate and the refund rate of which are 33% and 18% respectively and the actual tax rate is 15%.

Pursuant to the Approval Notice for Deduction and Exemption of Tax (Document Shen Guo Shui Nan Zi (2005) No. 0034) issued by the Nanshan State Tax Bureau in Shenzhen, it is agreed that Shenzhen Zhongxing Software Company, Limited, as a software enterprise, is entitled to enterprise income tax exemption in the first and second profitable year and is entitled to 50% reduction in enterprise income tax from the third to fifth year. The current year is the third profitable year and is subject to a reduced enterprise income tax of 7.5%.

Guangdong New Pivot Technology & Service Company, Limited was entitled to enterprise income tax exemption for 2005 pursuant to Document Sui Tian Guo Shui Suo Mian A (2005) No. 373 issued by Guangzhou Tianhe District State Tax Bureau.

Pursuant to the Document Shen Guo Shui Nan Jian Mian (2004) No. 0217 issued by the Nanshan State Tax Bureau in Shenzhen, 深圳中興力維技術有限公司 is entitled to enterprise income tax exemption in the first and second profitable years and a 50% reduction of enterprise income tax in the third to fifth years. As the current year was the first profitable year for the company, it was exempted from enterprise income tax.

Pursuant to the Document Shen Guo Shui Nan Jian Mian (2006) No. 0002 issued by the Nanshan State Tax Bureau in Shenzhen, Shenzhen Zhongxing Special Equipment Company, Limited is entitled to enterprise income tax exemption in the first and second profitable years and a 50% reduction of enterprise income tax in the third to fifth years. As the current year was the first profitable year for the company, it was exempted from enterprise income tax.

Yangzhou Zhongxing Mobile Telecom Equipment Co., Limited is subject to an enterprise income tax rate of 33%.

Shenzhen Guoxin Electronics Development Company Limited, Shenzhen Changfei Investment Company, Limited and Shenzhen Zhongxing Mobile Telecom Equipment Co., Ltd. are subject to an enterprise income tax rate of 15%.

NOTES TO FINANCIAL STATEMENTS

(Prepared under PRC GAAP)

(All amounts in RMB'000 unless otherwise stated)

IV. CONTROLLING SUBSIDIARIES AND JOINTLY-CONTROLLED ENTITIES

Except for the notes (1) and (2) below, the scope of consolidated financial statements is same as the previous year.

(1) Subsidiaries acquired during the year

Name of investee company	Registered Capital '000	Scope of business	Investment by the Company	Percentage of equity interests
Anhui Yalong Communications Technology Company, Ltd.	RMB6,000	Manufacturing, installation, maintenance of telecommunication equipment and design and construction and telecommunication projects	RMB5,400	90%
深圳市興飛科技有限公司	RMB5,000	Four technical services of electronic products, manufacturing, sales and after-sales services of electronic products and corporate management consultancy	RMB4,000	80%
ZTE Istanbul Trading Ltd. Co.	USD50	Sales of telecommunication products and provision of after-sales services and technical support	USD49.5	100%
ZTE Hrvatska D.O.O.	EUR3	Sales of telecommunication products and provision of after	EUR3	100%
ZTE Corporation Bulgaria Ltd.	USD3.5	Sales of telecommunication products and provision of after	USD3.5	100%
ZTE Deutschland GmbH	EUR150	Sales of telecommunication products and provision of after	EUR150	100%
ZTE Poland Sp.zo.o.	USD50	Sales of telecommunication products and provision of after	USD50	100%
深圳中興力維技術有限公司	RMB20,000	Design and development of operating environment and status monitoring and management systems for network base station and electronic equipment and electronic system equipment, sales of proprietary products and provision of technical services	RMB16,000	80%
Newinfo Holdings Limited	USD50	Acquisition, shareholding and investment of telecom carriers	USD4.299	100%
WANAAG COMMUNICATIONS LIMITED	USD200	IDD forwarding for Africa	USD100	100%
ZTE Canada Inc.	CAD200	Sales of telecommunication products and provision of after	USD38	100%
ZTE NETHERLANDS B.V.	EUR90	Sales of telecommunication products and provision of after	EUR18	100%
Congo-Chine Telecom International Network (CCTNET)	USD100	Data products, provision of telecom services and manufacturing of telecom equipment	USD100	100%

(All amounts in RMB'000 unless otherwise stated)

IV. CONTROLLING SUBSIDIARIES AND JOINTLY-CONTROLLED ENTITIES (continued)

(1) Subsidiaries acquired during the year (continued)

Name of investee company	Registered Capital '000	Scope of business	Investment by the Company	Percentage of equity interests
ZTE GHANA LIMITED	USD300	Sales of telecommunication products and provision of after-sales services and technical support	USD300	100%
深圳中興無線通信有限公司	USD5,000	R&D, production and sales of GSM, PHS and other telecom equipment	USD750	100%
Shenzhen Hongde Battery Company, Limited	RMB15,000	Production and sales of batteries, sales of raw materials for batteries and electronic products (excluding products under exclusive rights); import and export trade	RMB12,500	83%
ZTE Nigeria Investment Limited	USD39	Import and export trade, manufacturing, testing, sales, installation, development of raw materials for telecom products, user training and after-sales services	USD540	100%
ZTE (HK) Ltd. Saudi Arabia	USD534.76	Sales of telecommunication products and provision of after	USD534.76	100%
ZTE Sweden AB	USD360	Sales of telecommunication products and provision of after	USD360	100%
PT ZTE Indonesia	USD200	Sales of telecommunication products and provision of after	USD200	100%
西安中興精誠通訊有限公司 ("Xi'an Zhongxing") (Note 1)	RMB15,000	Installation, testing and technical services; development and sales of computer application software and systems integration, technical protection works and the development, production and sales of security products	RMB11,390	70%
ZiMax Technologies Inc (Note 2)	USD20,000	Wireless communication technology research	USD5,379.7	100%
Guangzhou Nanfang Telecommunications System Software Co., Ltd. (Note 3)	RMB12,430	Development, manufacturing, sales and services for software products, telecom equipment and data equipment	RMB11,500	84%

Note (1): In May 2005, the Group acquired a 34% equity interest in Xi'an Zhongxing for injection of assets received from the deregistration of Shanxi Zhongxing Telecom Equipment Company, Limited ("Shanxi Zhongxing"). In November 2005, the Company entered into a share transfer agreement with a third party to acquire from it a 36% equity interest in Xi'an Zhongxing. As at 31 December 2005, the Company held a 70% interest in Xi'an Zhongxing, whose results were consolidated by the Group.

Note (2): In September 2005, Zimax (Cayman) Holdings Ltd, a subsidiary of the Group, entered into a share transfer agreement with a third party to acquire a 100% equity interest in ZiMax Technologies Inc. Accordingly, the results of ZiMax Technologies Inc. were consolidated as from 1 October 2005.

Note (3): ZTE Soft Development Technology Co., Ltd ("ZTE Soft"), a subsidiary of the Group, entered into a share transfer agreement with 廣東國智投資有限公司, a third party, in March 2005 to acquire a 54% equity interest in Guangzhou Nanfang Telecommunications System Software Co., Ltd. ("Nanfang Telecom"). Accordingly, Nanfang Telecom's results were consolidated as from 1 April 2005. ZTE Soft entered into another share transfer agreement with a third party in September 2005 to acquire a further 30% equity interest in Nanfang Telecom. Since 1 October 2005, ZTE Soft had been holding an 84% interest in Nanfang Telecom.

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(All amounts in RMB'000 unless otherwise stated)

IV. CONTROLLING SUBSIDIARIES AND JOINTLY-CONTROLLED ENTITIES (continued)

(1) Subsidiaries acquired during the year (continued)

Assets and liabilities of subsidiaries described in Notes (1), (2) and (3) as at the date of consolidation.

Date of consolidation	Note (1) Xi'an Zhongxing 1 December 2005	Note (2) ZiMax Technologies Inc. At 1 October 2005	Note (3) Nanfang Telecom 1 April 2005
Current assets	22,920	6,321	53,107
Fixed assets	1,070	10,641	1,109
Intangible assets	47	—	—
Other assets	—	—	—
TOTAL ASSETS	24,037	16,962	54,216
Current Liabilities	(7,416)	(24,130)	(23,501)
Long-term liabilities	—	—	—
TOTAL LIABILITIES	(7,416)	(24,130)	(23,501)

Operating results of subsidiaries acquired during the year from the date of consolidation to 31 December 2005 are as follows:

Date of consolidation	Note (1) Xi'an Zhongxing 1 December 2005	Note (2) ZiMax Technologies Inc. At 1 October 2005	Note (3) Nanfang Telecom 1 April 2005
Revenue from principal operations	7,753	—	20,463
Profit from principal operations	1,787	—	5,558
Profit from other operations	—	11,928	—
Total profit	947	(10,639)	(32,131)
Income tax	—	—	—
Net profit	947	(10,639)	(32,131)

(All amounts in RMB'000 unless otherwise stated)

IV. CONTROLLING SUBSIDIARIES AND JOINTLY-CONTROLLED ENTITIES (continued)

(2) Disposal of Subsidiaries during the year

Name of investee company	Registered Capital '000	Scope of business	Investment by the Company	Percentage of equity interests
ZTE Future Tel Co. Ltd (Note 1)	KRW427,550	Development of handset products and design R&D of integrated circuits ("IC")	USD3,250	54.14%
Shanxi Zhongxing Telecom Equipment Company, Limited (Note 2)	RMB8,000	Technology R&D, development of computer soft/hardware; systems integration of computer network; technical services, maintenance and training services, manufacturing and sales of telecom equipment	RMB4,080	51%
ZTE IC Design Co., Ltd (Note 3)	RMB50,000	Design, development, production and operation of various ICs and related electronic application products	RMB30,000	60%

Note (1): In May 2005, the Board of Directors of the Company approved the transfer of an 54.14% equity interest in ZTE Future Tel Co. Ltd to a third party. The transfer had subsequently been completed.

Note (2): In April 2005, the Board of Directors of the Company approved the deregistration of Shanxi Zhongxing and re-invest the assets into Xi'an Zhongxing. The deregistration of Shanxi Zhongxing was completed in May 2005 and the additional investment in Xi'an Zhongxing was completed in June 2005.

Note (3): In January 2005, the Board of Directors of the Company approved the additional investment in ZTE IC Design Co., Ltd. The Company sold the 17.6% shareholdings in ZTE IC Design Co., Ltd for a consideration of 4.40 million, which was invested in the company as additional capital. The Company's shareholding in ZTE IC Design Co., Ltd was reduced to 40% in May 2005 following the completion of the capital increase.

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(All amounts in RMB'000 unless otherwise stated)

IV. CONTROLLING SUBSIDIARIES AND JOINTLY-CONTROLLED ENTITIES (continued)

(2) Disposal of Subsidiaries during the year (continued)

Operating results of subsidiaries disposed of during the year were included in the Group's consolidated statements from 1 January 2005 to the date of disposal/deregistration, as shown in the following:

	ZTE Future Tel Co. Ltd. 1 January to 30 April 2005	Shanxi Zhongxing 1 January to 13 April 2005	ZTE IC 1 January to 31 January 2005
Revenue from principal operations	—	—	4,097
Profit from principal operations	—	(231)	407
Total profit	—	—	407
Income tax	—	—	—
Net profit	—	(231)	407

Assets and liabilities of subsidiaries disposed of during the year as at the date of disposal/deregistration were as follows:

	ZTE Future Tel Co. Ltd. 1 January to 30 April 2005	Shanxi Zhongxing 1 January to 13 April 2005	ZTE IC 1 January to 31 January 2005
Current assets	1,958	14,450	58,436
Long-term investments	1,582	—	—
Fixed assets	2,509	1,313	2,306
Intangible assets	—	—	3,709
Total assets	6,049	15,763	64,451
Current liabilities	(2,454)	(5,217)	(52,669)
Total liabilities	(2,454)	(5,217)	(52,669)

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(Prepared under PRC GAAP)

(All amounts in RMB'000 unless otherwise stated)

IV. CONTROLLING SUBSIDIARIES AND JOINTLY-CONTROLLED ENTITIES (continued)

(3) Subsidiaries included in the scope of consolidation

Full name of subsidiaries	Place of registration	Registered capital '000	Shareholding percentage of the Company			Investment of the Group	Principal operations
			Direct	Indirect	Effective		
ZTE Kangxun Telecom Co., Ltd.	Shenzhen	RMB50,000	90%	—	90%	RMB45,000	Manufacture of electronics products and related parts (excluding restricted items)
ZTE Microelectronics Technology Co. Ltd.	Shenzhen	RMB15,000	—	90%	90%	RMB13,500	Design, manufacture and sale of integrated circuit products
Zhongxing Telecom Pakistan (Private) Limited	Islamabad, Pakistan	PKR37,919	93%	—	93%	USD654.7	Assembling and manufacture of digital remote control switch
Shenzhen Zhongxing Mobile Telecom Equipment Co., Ltd.	Shenzhen	RMB10,000	90%	10%	100%	RMB10,000	Research, manufacture and sale of CDMA digital mobile communications system equipment and related products
Yangzhou Zhongxing Mobile Telecom Equipment Co., Limited	Yangzhou	RMB6,000	65%	—	65%	RMB3,900	R&D, manufacture and sale of electronics, computer and communications products
ZTE Mobile Tech Co., Limited	Shenzhen	RMB33,333	95%	—	95%	RMB31,666	Technical development and sale of communications products; manufacture of handset batteries, hands-free ear piece; manufacture of handset charger
Congo-Chine Telecom S.A.R.L.	The Democratic Republic of Congo	USD9,800	51%	—	51%	USD5,000	Construction of telephone network in Congo, provision of telecom services and manufacture of communications equipment
Congo-Chine Telecom International Network (CCTNET)	The Democratic Republic of Congo	USD100	—	100%	100%	USD100	Data products, provision of telecom services, production of telecom equipment

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(All amounts in RMB'000 unless otherwise stated)

IV. CONTROLLING SUBSIDIARIES AND JOINTLY-CONTROLLED ENTITIES (continued)

(3) Subsidiaries included in the scope of consolidation (continued)

Full name of subsidiaries	Place of registration	Registered capital '000	Shareholding percentage of the Company			Investment of the Group	Principal operations
			Direct	Indirect	Effective		
ZTE Soft Technology Co., Ltd.	Nanjing	USD7,231	76%	—	76%	RMB45,040	Development, manufacture and sale of software products, communications equipment, data equipment and provision of related services
Guangzhou Nanfang Telecommunications System Software Co., Ltd.	Guangzhou	RMB12,430	—	84%	84%	RMB11,500	Development, manufacturing, sale and servicing of software products, telecommunication equipment, data equipment
Shenzhen Zhongxing Software Company, Limited	Shenzhen	RMB50,000	70%	25%	95%	RMB47,500	Development, manufacture and sale of all kinds of communications equipment system drivers, software for the service sector, and provision of technical consultation
Shenzhen Guoxin Electronics Development Company, Limited	Shenzhen	RMB13,000	90%	10%	100%	RMB33,000	Purchase and sale of electronics components; domestic businesses, supply and sale of materials; promotion of a variety of industries
Wuxi Zhongxing Optoelectronics Technologies Company, Limited	Wuxi	RMB10,000	65%	—	65%	RMB6,500	Development of optoelectronics technologies and manufacture and sale of related products and provision of technical services
Shenzhen Force Science and Technology Company, Limited	Shenzhen	RMB3,000	—	80%	80%	RMB2,400	Development of optoelectronics technologies and manufacture and sale of related products and provision of technical services

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(All amounts in RMB'000 unless otherwise stated)

IV. CONTROLLING SUBSIDIARIES AND JOINTLY-CONTROLLED ENTITIES (continued)

(3) Subsidiaries included in the scope of consolidation (continued)

Full name of subsidiaries	Place of registration	Registered capital '000	Shareholding percentage of the Company			Investment of the Group	Principal operations
			Direct	Indirect	Effective		
Anhui Wantong Posts and Telecommunications Company, Limited	Hefei	RMB22,214.4	51%	—	51%	RMB15,697.7	Manufacture of communications wireline equipment and accessories, PDF and switch equipment, manufacture and installation of towers, and design and installation of communications projects
Anhui Wantong Information System Integration Company, Limited	Hefei	RMB3,000	—	95%	95%	RMB1,530	Design and installation of communications projects
Anhui Wantong Tower Installation Company, Limited	Hefei	RMB2,000	—	90%	90%	RMB1,800	Installation of towers
Anhui Yalong Communications Technology Company, Ltd.	Hefei	RM6,000	—	90%	90%	RMB5,400	Manufacturing, installation, maintenance of telecommunication equipment and design and construction and telecommunication projects
ZTE (H.K.) Limited	Hong Kong	HKD50,000	100%	—	100%	HKD50,000	Procurement and sale of communications products and provision of technical services
ZTE Portugal Co.,Ltd-Projectos de Telecomunicacoes, Unipessoal, Lda	Portugal	EUR50	—	100%	100%	EUR50	Sale of communications products and provision of after-sale services
ZTE (USA) Inc.	Edison, United States of America	USD20	100%	—	100%	USD650	Sale of communications products
Shenzhen Special Equipment Company, Limited	Shenzhen	RMB1,000	54%	—	54%	RMB540	Technical development, services, consultation and purchase and sale of communications products
Telrise (Cayman) Telecom Co., Ltd.	Cayman Islands	USD50	52.85%	—	52.85%	USD2,550	R&D of softswitch technologies

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IV. CONTROLLING SUBSIDIARIES AND JOINTLY-CONTROLLED ENTITIES (continued)

(3) Subsidiaries included in the scope of consolidation (continued)

Full name of subsidiaries	Place of registration	Registered capital '000	Shareholding percentage of the Company			Investment of the Group	Principal operations
			Direct	Indirect	Effective		
Telrise INC.	Cayman Islands	USD1,609	—	100%	100%	USD1,609	R&D of softswitch technologies
Telrise Nanjing Telecom Limited	Nanjing	USD100	—	100%	100%	USD100	R&D of softswitch technologies
ZTE (UK) Ltd.	London, United Kingdom	GBP604	51%	—	51%	USD372.3	Sale of communications products and provision of after-sale services and technical support
ZTE Do Brasil LTDA.	Brazil	USD200	100%	—	100%	USD900	Sale of communications products and provision of after-sale services and technical support
ZTE Holdings (Thailand) Co., Ltd	Thailand	THB100	49%	—	49%	THB49	Investment holding
ZTE (Thailand) CO., Ltd	Thailand	THB2,000	49%	51%	100%	THB980	Sale of communications products and provision of after-sale services and technical support
ZTE Corporation Mexico S.DE.R.L.DE.C.V.	Mexico	USD5	100%	—	100%	USD28.115	Sale of communications products and provision of after-sale services and technical support
ZTE Integration Telecom Ltd.	Shenzhen	RMB55,000	75%	5%	80%	RMB41,250	Research and manufacture, production and sale of digital integrated system products and provision of related consultation services
ZTEIT USA Inc.	United States of America	USD950	—	100%	100%	USD475	Design and development of all kinds of communications products
OOO ZTE Russia Co., Limited	Russia	USD760	100%	—	100%	USD760	Sales of telecommunication products, provision of after-sales services and technical support
ZTE Wistron Telecom AB	Sweden	SEK1,000	100%	—	100%	USD3,137.4	Operation of telecommunications related businesses as R&D base and technical support platform of the sector

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(All amounts in RMB'000 unless otherwise stated)

IV. CONTROLLING SUBSIDIARIES AND JOINTLY-CONTROLLED ENTITIES (continued)

(3) Subsidiaries included in the scope of consolidation (continued)

Full name of subsidiaries	Place of registration	Registered capital '000	Shareholding percentage of the Company			Investment of the Group	Principal operations
			Direct	Indirect	Effective		
Shenzhen Changfei Investment Company, Limited	Shenzhen	RMB30,000	51%	—	51%	RMB15,300	Investment and promotion of industries, and sale of electronics and communications parts and components
Shenzhen Lead Communications Company, Limited	Shenzhen	RMB10,000	—	62.5%	62.5%	RMB6,250	Sale of electronics products, communications products, apparatus and instruments and related accessories
Shenzhen Ruide Electronic Industrial Company, Limited	Shenzhen	RMB8,700	—	57.47%	57.47%	RMB5,500	Manufacture and sale of handset accessories; sale of electronics products; operation of I/E businesses
Shenzhen Kangquan Electromechanical	Shenzhen	RMB16,000	—	57.5%	57.5%	RMB9,200	Manufacture and sale of handset case and accessories; purchase and sale of electromechanical products; self operation of I/E businesses
Shanghai Xingfei Science and Technology Company, Limited	Shanghai	RMB1,000	—	80%	80%	RMB800	Four skill services of the electronics products sector, manufacture, sale and after-sale services of electronics products, and corporate management consultation (subject to license where a license is required)
深圳市興飛科技有限公司	Shenzhen	RMB5,000	—	80%	80%	RMB4,000	Four technical services of electronic products, manufacturing, sales and after-sales services of electronic products and corporate management consultancy

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IV. CONTROLLING SUBSIDIARIES AND JOINTLY-CONTROLLED ENTITIES (continued)

(3) Subsidiaries included in the scope of consolidation (continued)

Full name of subsidiaries	Place of registration	Registered capital '000	Shareholding percentage of the Company			Investment of the Group	Principal operations
			Direct	Indirect	Effective		
Shenzhen Zhongxing Telecom Equipment Technology & Service Company, Limited	Shenzhen	RMB50,000	90%	10%	100%	RMB50,000	Technical development of computer networks, software, electronics equipment and communications products; domestic supply and sale of materials and resources; information consultancy
Shanghai Zhongxing Telecom Equipment Technology & Service Company, Limited	Shanghai	RMB10,000	51%	—	51%	RMB5,100	R&D of communications technologies, design, research, development, manufacture and sale of software and hardware for communications products and provision of related technical services
Guangdong New Pivot Technology & Service Company, Limited	Guangzhou	RMB5,000	90%	—	90%	RMB4,500	Development, design and integration of computer software and hardware and data equipment, and sale and technical assignment of related products and provision of related services
Closed Joint Stock Company TK Mobile	Tadjikistan	USD4,000	51%	—	51%	RMB16,870.8	Manufacture of CDMA800 mobile voice and related value-added services, maintenance of CDMA telecom networks and provision of consultation services
ZTE Kangxun Telecom Company India (Private) Ltd.	India	USD22.2	99.99%	0.01%	100%	RMB1,654	Assembling and integration of telecom systems equipment and terminal equipment in India; investment in and establishment of local manufacturing joint-venture

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IV. CONTROLLING SUBSIDIARIES AND JOINTLY-CONTROLLED ENTITIES (continued)

(3) Subsidiaries included in the scope of consolidation (continued)

Full name of subsidiaries	Place of registration	Registered capital '000	Shareholding percentage of the Company			Investment of the Group	Principal operations
			Direct	Indirect	Effective		
ZTE Romania SRL	Romania	USD100	100%	—	100%	RMB827	Sale and marketing of the Company's products in Romania and provision of corresponding engineering, after-sale services, technical support, consultation and trainings
ZTE Malaysia Corporation SDN. BHD.	Malaysia	USD60	100%	—	100%	RMB496.2	Sale and marketing of the Company's products in Malaysia and provision of corresponding engineering, after-sale services, technical support, consultation and trainings
ZiMax (Cayman) Holding Ltd.	Cayman Islands	USD5,500	100%	—	100%	RMB45,485	R&D investment in all kinds of communications products
Shenzhen Hongde Battery Company, Limited	Shenzhen	RMB15,000	—	83%	83%	RMB12,500	Manufacture and sale of batteries, sale of battery raw materials and electronics products (excluding franchised, state-controlled and monopolized merchandises and restricted items); operate import and export business
ZTE (HK) Ltd. Saudi Arabia	Saudi Arabia	USD534.76	—	100%	100%	USD534.76	Sale of communications products, provision of aftersale services and technical support
ZTE Nigeria Investment Limited	Nigeria	USD39	—	100%	100%	USD540	Import and export of raw materials, manufacture, testing, sale, installation, development, user training and after-sale services of telecommunications products

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IV. CONTROLLING SUBSIDIARIES AND JOINTLY-CONTROLLED ENTITIES (continued)

(3) Subsidiaries included in the scope of consolidation (continued)

Full name of subsidiaries	Place of registration	Registered capital '000	Shareholding percentage of the Company			Investment of the Group	Principal operations
			Direct	Indirect	Effective		
ZTE Sweden AB	Sweden	USD360	—	100%	100%	USD360	Sale of communications products, provision of aftersale services and technical support
PT ZTE Indonesia	Indonesia	USD200	99.5%	0.5%	100%	USD200	Sale of communications products, provision of aftersale services and technical support
ZTE Istanbul Trading Ltd. Co.	Turkey	USD50	—	100%	100%	USD49.5	Sale of communications products, provision of aftersale services and technical support
ZTE Hrvatska D.O.O	Croatia	EUR3	—	100%	100%	EUR3	Sale of communications products, provision of aftersale services and technical support
ZTE Corporation Bulgaria Ltd	Bulgaria	USD3.5	—	100%	100%	USD3.5	Sale of communications products, provision of aftersale services and technical support
ZTE Deutschland GmbH i.Gr.	Germany	EUR150	—	100%	100%	EUR150	Sale of communications products, provision of aftersale services and technical support
ZTE Poland Sp.zo.o.	Poland	USD50	—	100%	100%	USD50	Sale of communications products, provision of aftersale services and technical support
深圳中興力維技術有限公司	Shenzhen	RMB20,000	30%	50%	80%	RMB16,000	Design and development of operating environment and status monitoring and management systems for network base station and electronic equipment and electronic system equipment, sales of proprietary products and provision of technical services
西安中興精誠通訊有限公司	Xi'an	RMB15,000	70%	—	70%	RMB11,390	Installation, testing and technical services; development and sales of computer application software and systems integration, technical protection works and the development, production and sales of security products

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(All amounts in RMB'000 unless otherwise stated)

IV. CONTROLLING SUBSIDIARIES AND JOINTLY-CONTROLLED ENTITIES (continued)

(3) Subsidiaries included in the scope of consolidation (continued)

Full name of subsidiaries	Place of registration	Registered capital '000	Shareholding percentage of the Company			Investment of the Group	Principal operations
			Direct	Indirect	Effective		
ZiMax Technologies Inc	United States	USD20,000	—	100%	100%	USD5,379.7	R&D of wireless communication technology
Newinfo Holdings Limited	Hong Kong	USD50	—	100%	100%	USD4.299	Acquisition, shareholding and investment of telecom carriers
WANAAG Communications Limited	Hong Kong	USD200	—	100%	100%	USD100	IDD forwarding for Africa
ZTE Canada Inc	Canada	USD200	—	100%	100%	USD38	Sale of communications products, provision of after sales service and technical support
ZTE Netherlands B.V.	Holland	EUR90	—	100%	100%	EUR18	Sale of communications products, provision of after sales service and technical support
ZTE Ghana Limited	Ghana	USD300	—	100%	100%	USD300	Sale of communications products, provision of after sales service and technical support
ZTE (Australia) Pty Ltd.	Australia	USD200	—	100%	100%	USD200	Sale of communications products, provision of after sales service and technical support
深圳中興無線通信有限公司	Shenzhen	USD5,000	—	100%	100%	USD750	Development, production and sales of GSM and PHS telecommunication equipment

(4) Jointly-controlled entities

Full name of jointly-controlled entities	Place of registration	Registered capital	Shareholding percentage of the Company			Investment of the Group	Principal operations
			Direct	Indirect	Effective		
Bestel Communications Ltd.	Republic of Cyprus	CYP600	—	50%	50%	CYP150	Sale of communications products and provision of after-sale services
Beijing Zhongxingxin Communication Equipment Company, Limited	Beijing	RMB5,000	50%	—	50%	RMB2,500	Sale of communications equipment (excluding radio transmitter), electronics computer and related external devices, and provision of technical consultation services

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(All amounts in RMB'000 unless otherwise stated)

IV. CONTROLLING SUBSIDIARIES AND JOINTLY-CONTROLLED ENTITIES (continued)

(5) Associates

Full name of associates	Place of registration	Registered capital '000	Shareholding percentage of the Company			Investment of the Group	Principal operations
			Direct	Indirect	Effective		
ZTE IC Design Co., Ltd	Shenzhen	RMB64,000	40%	—	40%	RMB34,400	Design, development, production and marketing of various ICs and related electronic applications
WuXi Kaier Technology Co., Ltd	Wuxi	RMB10,000	—	30.88%	30.88%	RMB3,500	R&D and manufacture of optoelectronics products, development of optoelectronics technologies, sale of self-produced products and provision of related services
Shenzhen Zhongxing Xinyu FPC Company, Limited	Shenzhen	RMB11,000	—	22.7%	22.7%	RMB2,500	Development, manufacture and sale of single-layered, double-layered, multi-layered and rigid-flexible relexible printed integrated circuits; I/E of goods and technologies (excluding items prohibited and restricted under the laws, constitutions and as decided by the State Council)
Shenzhen Weigao Semiconductor Company, Limited	Shenzhen	RMB10,000	—	40%	40%	RMB4,000	Development, design and sale of semi-conductor circuit package; domestic business and supply of materials and resources (excluding franchised, state-controlled and monopolized merchandises and restricted items); promotion of industries (separate declaration is required for specific items)
Beijing Zhongxing Yuanjing Technology Co., Ltd.	Beijing	RMB10,000	30%	—	30%	RMB3,000	Development and research No Technology Co., Ltd. manufacture of data centre and metropolitan/Campus networks integrated core software products

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(All amounts in RMB'000 unless otherwise stated)

IV. CONTROLLING SUBSIDIARIES AND JOINTLY-CONTROLLED ENTITIES (continued)

(5) Associate companies (continued)

Full name of associates	Place of registration	Registered capital '000	Shareholding percentage of the Company			Investment of the Group	Principal operations
			Direct	Indirect	Effective		
KAZNURTEL Limited Liability Company	Kazakstan	USD3,000	49%	—	49%	RMB3,988.4	Manufacture and sale of telecom equipment and provision of corresponding technical support, after-sale services, trainings and consultation; installation and construction of CDMA450MWWLL and provision of corresponding telecom services and value-added services
深圳思碼特電子有限公司	Shenzhen	HKD15,000	—	32%	32%	HKD3,200	Development and production of parts and components for novel instruments
中興軟件技術(南昌)有限公司	Nanchang	RMB15,000	30%	—	30%	RMB4,500	Development and application of software technology, systems integration, network engineering, technology consultancy and services
深圳市聚飛光電有限公司	Shenzhen	RMB15,000	—	30%	30%	RMB4,500	Development, production and sales of optoelectronic components, sensitive components, sensors, diodes, SM DLED, LED and optoelectronic component application products; sales of electronic components; export and import of goods and technology
Shenzhen Decang Technology Company Limited	Shenzhen	RMB2,500	—	40%	40%	RMB1,000	Technology development of optoelectronic products; production and sales of blue light source products and light guide plates; sales of electronic products, telecommunication products and optoelectronic products; import and export of goods and technologies

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(All amounts in RMB'000 unless otherwise stated)

V. EXPLANATORY NOTES TO MAJOR ITEMS IN THE CONSOLIDATED FINANCIAL STATEMENTS (THE FOLLOWING REPRESENTS GROUP FIGURES UNLESS OTHERWISE STATED)

1. Cash in banks and on hands

Item		2005			2004		
		Original currency	Exchange rate	RMB equivalent	Original currency	Exchange rate	RMB equivalent
Cash	RMB	387	1.0000	387	366	1.0000	366
	HKD	125	1.0403	130	353	1.0603	389
	USD	1,138	8.0702	9,184	1,625	8.2705	13,481
	BRL	1	3.4522	3	72	2.8899	224
	THB	1,540	0.1968	303	—	—	—
	FEC	69	7.3633	508	—	—	—
	GBP	—	—	—	2	15.91	27
	JPY	—	—	—	151	0.0807	11
	CDF	—	—	—	15,018	0.0157	282
	PKR	574	0.1350	77	456	0.1495	68
	SAR	92	2.1521	198	—	—	—
	SOS	42	2.5225	106	—	—	—
	Others			150			16
	Sub-total			11,046			14,864

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V. EXPLANATORY NOTES TO MAJOR ITEMS IN THE CONSOLIDATED FINANCIAL STATEMENTS (THE FOLLOWING REPRESENTS GROUP FIGURES UNLESS OTHERWISE STATED) (continued)

1. Cash in banks and on hands (continued)

Item	2005			2004		
	Original currency	Exchange rate	RMB equivalent	Original currency	Exchange rate	RMB equivalent
Bank deposits RMB	3,609,771	1.0000	3,609,771	2,081,252	1.0000	2,081,252
HKD	33,408	1.0403	34,754	2,910,758	1.0603	3,086,167
USD	154,588	8.0702	1,247,556	219,675	8.2750	1,815,532
BRL	8,858	3.4522	30,580	41,913	2.8899	130,768
PKR	651,989	0.1350	88,019	215,941	0.1495	32,278
EGP	65,376	1.4035	91,755	12,947	1.3482	17,454
GBP	945	14.1349	13,357	170	15.91	2,496
SEK	2,442	1.0154	2,480	1,640	1.1290	1,852
DZD	35,070	0.0897	3,146	—	—	—
COP	5,334,654	0.0035	18,671	—	—	—
CEDI	3,509,473	0.0008	2,808	—	—	—
EUR	19,778	9.5797	189,467	6,696	11.2627	74,380
NGN	334,439	0.0576	19,264	—	—	—
RUR	—	—	—	1,928	0.2996	578
THB	2,747	0.1968	541	2,088	0.2068	432
JPY	—	—	—	308,288	0.0807	22,380
INR	—	—	—	23,129	0.1861	4,305
ROL	—	—	—	121,142	0.0066	794
CDF	—	—	—	85,935	0.0157	1,615
SAR	1,514	2.1521	3,258	—	—	—
SOS	613	2.5225	1,546	—	—	—
RUB	38,287	0.2803	10,732	—	—	—
Others	—	—	1,452	—	—	1,384
Sub-total	—	—	5,369,157	—	—	7,273,667

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V. EXPLANATORY NOTES TO MAJOR ITEMS IN THE CONSOLIDATED FINANCIAL STATEMENTS (THE FOLLOWING REPRESENTS GROUP FIGURES UNLESS OTHERWISE STATED) (continued)

1. Cash in banks and on hands (continued)

Item	Original currency	2005		RMB equivalent	Original currency	2004		RMB equivalent
		Exchange rate				Exchange rate		
Other								
currencies	RMB	79,435	1.0000	79,435	304,656	1.0000	304,656	
	USD	1,400	8.0702	11,298	118	8.2705	977	
	HKD	14,700	1.0403	15,292	—	—	—	
	PKR	54,131	0.1350	7,308	24,741	0.1495	3,698	
	XOF	5,543,000	0.0143	79,265	—	—	—	
	SEK	—	—	—	320	1.1290	361	
	Others			331				
	Sub-total			192,929				309,692
Total				5,573,132				7,598,223

Cash in banks and on hands of the Group at the end of the period comprised a bank guarantee deposit of RMB175,899,000.

2. Notes receivable

	2005	2004
Bank acceptance bills	448,693	743,356
Commercial acceptance bills	796,160	1,514,732
	1,244,853	2,258,088

No outstanding amount due from shareholders holding 5% or more in the shares as at the end of the year.

The balance of notes receivable at year-end decreased by 44.87% compared to the balance at the beginning of the year mainly as a result of cash settlement of certain notes receivable during the year.

(All amounts in RMB'000 unless otherwise stated)

V. EXPLANATORY NOTES TO MAJOR ITEMS IN THE CONSOLIDATED FINANCIAL STATEMENTS (THE FOLLOWING REPRESENTS GROUP FIGURES UNLESS OTHERWISE STATED) (continued)

3. Trade receivables

Ageing analysis of trade receivables is as follows:

The Group

	2005				2004			
	Amount	Percentage of the total amount	Provision for bad debts	Percentage of provision	Amount	Percentage of the total amount	Provision for bad debts	Percentage of provision
Within one year	3,535,496	84.28%	109,961	3.11%	3,513,954	86.08%	124,909	3.55%
Between one to two years	545,333	13.00%	232,046	42.55%	420,742	10.31%	224,275	53.3%
Between two to three years	47,377	1.13%	36,826	77.73%	113,999	2.79%	67,346	59.08%
Over three years	66,628	1.59%	66,413	99.68%	33,416	0.82%	13,075	39.13%
	4,194,834	100%	445,246		4,082,111	100%	429,605	
Less: accounts due within one year	3,887,168	92.67%	445,246		4,082,111	100%	429,605	
Long-term portion	307,666	7.33%	—		—	—	—	

Of the balance of trade receivables as at the end of the year, RMB177,000 was due from shareholders holding 5% or more in the shares. Please refer to Note VII to the financial statements — Relationship and transactions with connected parties.

The top five amounts amounted to RMB2,018,544,000, accounting for 48.12% of the total amount of trade receivable.

Bad debt provision of trade receivables is as follows:

	2005	2004
Balance at the beginning of the year	429,605	77,470
Provided for the year	217,537	352,135
Reversed for the year	(201,896)	—
Balance at the end of the year	445,246	429,605

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V. EXPLANATORY NOTES TO MAJOR ITEMS IN THE CONSOLIDATED FINANCIAL STATEMENTS (THE FOLLOWING REPRESENTS GROUP FIGURES UNLESS OTHERWISE STATED) (continued)

3. Trade receivables (continued)

The Company

	2005				2004			
	Amount	Percentage	Provision for bad debts	Percentage of provision	Amount	Percentage	Provision for bad debts	Percentage of provision
Within one year	4,426,106	84.78%	97,303	2.20%	3,887,109	87.61%	123,773	3.18%
Between one to two years	648,024	12.42%	219,505	33.87%	410,416	9.25%	216,698	52.80%
Between two to three years	46,038	0.88%	34,166	74.21%	110,457	2.49%	67,244	60.88%
Over three years	100,487	1.92%	60,763	60.47%	28,946	0.65%	12,883	44.51%
	5,220,655	100%	411,737		4,436,928	100%	420,598	
Less: accounts due within one year	4,893,533	93.73%	411,737		4,436,928	100%	420,598	
Long-term portion	327,122	6.27%	—		—	—	—	

The top five amounts of trade receivables amounted to RMB3,097,760,000, accounting for 59.34% of the total trade receivables at the end of the year.

Bad debt provision of trade receivables is as follows:

	2005	2004
Balance at the beginning of the year	420,598	76,076
Provided for the year	193,035	344,522
Reversed for the year	(201,896)	—
Balance at the end of the year	411,737	420,598

Of the balance of trade receivables, RMB8,000 was due from shareholders holding 5% or more in the shares as at the end of the year.

4. As at 31 December 2005, the Company and one of its subsidiaries entered into an agreement with a bank during the year, trade receivables amounting to RMB724,181,000 were factored to obtain bank advances. According to the factoring agreement, if the client delays repayment, the Company and its subsidiary will be obliged to pay interests in respect of the delayed repayment. In accordance with the Provision Regulation on Accounting Treatment of Creditor Financing between Enterprises and Banks/Financial Institutions issued by the Ministry of Finance, the factored trade receivables and bank advances on factored trade receivables of the Group were reflected in the balance sheet based on the principle that "essence should prevail over form," as the risks and rewards associated with the creditor rights had not been fully transferred.

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V. EXPLANATORY NOTES TO MAJOR ITEMS IN THE CONSOLIDATED FINANCIAL STATEMENTS (THE FOLLOWING REPRESENTS GROUP FIGURES UNLESS OTHERWISE STATED) (continued)

5. Other receivables

Ageing analysis of other receivables is as follows:

The Group

	2005				2004			
	Amount	Percentage	Provision for bad debts	Percentage of provision	Amount	Percentage	Provision for bad debts	Percentage of provision
Within one year	712,063	70.65%	487,678	68.49%	291,783	39.69%	175,946	60.3%
Between one to two years	122,012	12.10%	82,721	67.80%	271,113	36.88%	137,116	50.58%
Between two to three years	83,238	8.26%	71,825	86.29%	42,628	5.80%	41,418	97.16%
Over three years	90,627	8.99%	85,741	94.61%	129,564	17.63%	123,013	94.94%
	1,007,940	100%	727,965		735,088	100%	477,493	

Bad debt provision for other receivables is as follows:

	2005	2004
Balance at the beginning of the year	477,493	271,161
Provide for the year	487,678	206,332
Reverse for the year	(237,206)	—
Balance at the end of the year	727,965	477,493

The top five amounts of other receivables amounted to RMB91,186,000, accounting for 9.05% of the total other receivables of the Group at the end of the year.

No outstanding amount due from shareholders holding 5% or more in the shares as at the end of the year.

The balance of other receivables included two loan receivables amounting to RMB46,165,000 to potential customers granted by Group. A loan of SEK43,000,000 bears an annual interest of STIBOR + 3% to 8%, repayable in March 2006 and are secured by certain properties. Another loan of EUR3,150,000 bears an annual interest of three months EURIBOR + 1% to 3%, repayable in 4 installments which will be fully repaid by February 2007 and are secured by shares of the customer's immediate holding company and ultimate holding company. Subsequent to the balance sheet date, SEK loan of approximately SEK14,940,000 and the first installment payment of EURO dollar loan were both overdue in March 2006 and February 2006, respectively, and the respective borrowers are in the process of negotiating with the management for a two months deferred payment. The executive directors had taken necessary measures with the potential customers to recover the loans receivables and in view of the securities on hand, are of the opinion that no provision is necessary for these loans receivable.

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V. EXPLANATORY NOTES TO MAJOR ITEMS IN THE CONSOLIDATED FINANCIAL STATEMENTS (THE FOLLOWING REPRESENTS GROUP FIGURES UNLESS OTHERWISE STATED) (continued)

5. Other receivables (continued)

The Company

	2005				2004			
	Amount	Percentage	Provision for bad debts	Percentage of provision	Amount	Percentage	Provision for bad debts	Percentage of provision
Within one year	1,058,754	54.55%	481,644	45.49%	794,686	65.30%	166,872	21.00%
Between one to two years	656,484	33.83%	82,103	12.51%	257,046	21.12%	135,531	52.73%
Between two to three years	102,262	5.27%	62,013	60.64%	41,667	3.42%	41,156	98.77%
Over three years	123,248	6.35%	84,636	68.67%	123,527	10.16%	121,808	98.61%
	1,940,748	100%	710,396		1,216,926	100%	465,367	

Bad debt provision for other receivables is as follows:

	2005	2004
Balance at the beginning of the year	465,367	271,161
Increase for the year	481,644	194,206
Reverse for the year	(236,615)	—
Balance at the end of the year	710,396	465,367

The top five amounts of other receivables amounted to RMB91,186,000, accounting for 4.70% of the total other receivables of the Company at the end of the year.

No outstanding amount due from shareholders holding 5% or more in the shares as at the end of the year.

6. Accounts prepaid

Ageing analysis of accounts prepaid is as follows:

	2005		2004	
	Amount	Percentage	Amount	Percentage
Within one year	150,991	99.88%	145,151	99.83%
Between one to two years	53	0.03%	247	0.17%
Between two to three years	130	0.09%	—	—
	151,174	100%	145,398	100%

No outstanding amount due from shareholders holding 5% or more in the shares as at the end of the year.

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V. EXPLANATORY NOTES TO MAJOR ITEMS IN THE CONSOLIDATED FINANCIAL STATEMENTS (THE FOLLOWING REPRESENTS GROUP FIGURES UNLESS OTHERWISE STATED) (continued)

7. Inventories

	2005	2004
Raw materials	1,221,858	1,146,676
Materials under sub-contract processing	102,958	—
Work-in-progress	538,703	356,899
Finished goods	892,766	641,265
Science and technology R&D cost*	279,220	146,700
Less: impairment provision	515,958	419,773
	2,519,547	1,871,767

* Pursuant the Reply on Accounting for Expenses by Technology Research and Development Projects Designated by the State (Cai Kuai Bian [2002] No. 36) issued by the Accounting Department of the Ministry of Finance, expenses incurred by the Company in the research and development of products designated by the State using government grants shall be deemed as pooling of costs and expenses of products manufactured by the Company and accounted for as technology development costs. The balance of technology development at the end of the period represented costs and expenses pooled in respect of designated projects funded by the State prior to the completion or inspection for acceptance of such projects. Upon completion of the project designated by the state using government grants, science and technology R&D costs will be set off against specific payables in respect of the project.

An analysis of inventories provision is as follows:

	2005	2004
Balance at the beginning of year	419,773	282,187
Increase for the year	96,185	137,586
Reverse for the year	—	—
Balance at the end of the year	515,958	419,773

8. Construction contracts

	2005	2004
Amount due from customers for contract work (Note 1)	4,689,157	2,752,024
Amount due to customers for contract work	(733,455)	(2,318,731)
	3,955,702	433,293
Cost of contract construction in progress to date and gross profit (loss) of contract construction in progress recognized to date	19,420,235	15,327,336
Less: progress billings	(15,464,533)	(14,894,043)
	3,955,702	433,293

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V. EXPLANATORY NOTES TO MAJOR ITEMS IN THE CONSOLIDATED FINANCIAL STATEMENTS (THE FOLLOWING REPRESENTS GROUP FIGURES UNLESS OTHERWISE STATED) (continued)

8. Construction contracts (continued)

Note 1:

Category	2005	2004
Construction work	2,420,118	(1,695,270)
Dispatch of goods	1,535,584	2,128,563
	3,955,702	433,293

The balance of amount due from customers for contract work at year-end increased by 70.39% compared to that at the beginning of the year mainly as a result of the speeding up of the completion of the Group's telecommunication system construction works ahead of the payment of progress billings.

9. Long-term investments

The Group

		2005	2004
Long-term equity investments			
Equity investments under cost method	(1)	43,288	44,346
Equity investments under equity method			
Equity interest in associates	(2)	35,583	8,841
Equity interest in jointly-controlled entities	(3)	6,588	8,304
Differences in equity investment	(4)	13,036	18,721
		98,495	80,212
Less: Provision for impairment of long-term investments	(5)	13,036	13,036
		85,459	67,176

(1) Equity investments under cost method

Name of investee	Share of registered capital	Initial investment	Balance at the beginning	Increase during the period	Decrease during the period	Balance at year-end	
深圳市創新科技投資集團有限公司	0.33%	5,000	5,000	—	—	5,000	
北京中視聯數字系統有限公司	7.59%	3,240	3,240	—	—	3,240	
Spread Telecom	4.5%	176	176	—	(176)	—	
Edmotech Co. Ltd	18%	1,406	1,406	—	(1,406)	—	
Shenzhen Zhongxing Xinyu FPC Company, Limited	22.73%	2,500	2,500	—	(2,500)	—	
中移鼎訊通訊股份有限公司	16%	32,000	32,000	—	—	32,000	
Beijing Zhongxing Intelligent Transportation Systems Ltd.	19%	1,024	—	1,024	—	1,024	
SunTop Technologies Ltd	26.54%	24	24	—	—	24	
杭州中興發展有限公司	10%	2,000	—	2,000	—	2,000	
			47,370	44,346	3,024	(4,082)	43,288

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V. EXPLANATORY NOTES TO MAJOR ITEMS IN THE CONSOLIDATED FINANCIAL STATEMENTS (THE FOLLOWING REPRESENTS GROUP FIGURES UNLESS OTHERWISE STATED) (continued)

9. Long-term investments (continued)

The Group (continued)

(2) Equity interest in associates

Name of investee	Share of registered capital	Initial investment	Balance at the beginning	Increase/decrease of investment cost during the period	Increase/decrease of equity during the period	Balance at year-end
ZTE IC Design Co., Ltd	40%	30,000	—	10,899	2,319	13,218
Beijing Zhongxing Yuanjing Technology Co., Ltd	30%	3,000	329	—	(46)	283
Kaznurte Limited Liability Company	49%	1,012	1,012	2,976	(1,511)	2,477
WuXi KaiEr Technology Company, Limited	30.88%	3,500	3,500	—	98	3,598
Shenzhen Zhongxing Xinyu FPC Company, Limited	22.73%	2,500	—	2,500	(125)	2,375
Shenzhen Weigao Semiconductor Company, Limited	40%	4,000	4,000	—	(1,024)	2,976
Shenzhen Decang Technology Company Limited	40%	1,000	—	1,000	(189)	811
深圳市聚飛光電有限公司	30%	4,500	—	4,500	(152)	4,348
中興軟件技術(南昌)有限公司	30%	4,500	—	4,500	(2,146)	2,354
深圳思碼特電子有限公司	32%	3,335	—	3,335	(192)	3,143
		57,347	8,841	29,710	(2,968)	35,583

(3) Equity interest in jointly-controlled entities

Name of investee	Share of registered capital	Initial investment	Balance at the beginning	Increase/decrease of investment cost during the period	Increase/decrease of equity during the period	Balance at year-end
Beijing Zhongxingxin Communication Equipment Company Limited	50.00%	2,500	6,311	—	(1,698)	4,613
Bestel Communications Ltd.	50.00%	2,050	1,993	—	(18)	1,975
		4,550	8,304	—	(1,716)	6,588

(4) Differences in equity investments

Name of investee	Balance at the beginning	Increase during the year	Amortized during the year	Impairment during the year	Remaining value
Shenzhen Guoxin Electronics Development Company, Limited	13,036	—	—	—	13,036
ZTE Mobile Tech Co., Ltd	5,685	—	(812)	(4,873)	—
ZiMax Technologies Inc	—	50,583	—	(50,583)	—
	18,721	50,583	(812)	(55,456)	13,036

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9. Long-term investments (continued)

The Group (continued)

(5) Provision for impairment of long-term investment:

Item	Balance at the beginning and year-end
Shenzhen Guoxin Electronics Development Company, Limited	13,036

The Company

		2005	2004
Long-term equity investment			
Equity investment under equity method			
Subsidiaries	(1)	2,779,384	2,951,428
Jointly-controlled entities	(2)	4,613	6,311
Associates	(3)	18,336	1,342
Equity investment under cost method	(4)	41,288	40,264
Difference in equity investment	(5)	2,720	6,686
		2,846,341	3,006,031
Less: Provision for impairment of long-term investment	(6)	13,036	13,036
		2,833,305	2,992,995

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V. EXPLANATORY NOTES TO MAJOR ITEMS IN THE CONSOLIDATED FINANCIAL STATEMENTS (THE FOLLOWING REPRESENTS GROUP FIGURES UNLESS OTHERWISE STATED) (continued)

9. Long-term investments (continued)

The Company (continued)

(1) Subsidiaries

Investee	Share of registered capital	Balance at the beginning	Increase/ decrease of investment cost during the year	Increase/ decrease of equity during the year	Cash bonus for the year	Balance at year-end
ZTE Kangxun Telecom Co., Ltd.	90%	1,036,766	—	266,348	—	1,303,114
Shenzhen Zhongxing Mobile Telecom Equipment Co., Ltd	90%	9,340	—	74	—	9,414
Shanxi Zhongxing Telecom Equipment Co., Ltd.	51%	5,587	(5,587)	—	—	—
ZTE (USA) Inc.	100%	4,173	—	(13,463)	—	(9,290)
Wuxi Zhongxing Optoelectronics Technologies Company, Limited	65%	29,487	—	4,210	(2,080)	31,617
ZTE IC Design Co., Ltd	40%	6,808	(10,899)	4,091	—	—
ZTE (H.K) Limited	100%	400,368	—	54,359	—	454,727
Anhui Wantong Posts and Telecommunications Company, Limited	51%	18,617	—	5,303	(1,133)	22,787
Telrise (Cayman) Telecom Co., Ltd.	52.85%	5,965	—	(3,042)	—	2,923
ZTE Future Tel Co. Ltd.	54.14%	561	(561)	—	—	—
Shenzhen Guoxin Electronics Development Company Limited	90%	3,292	—	64	—	3,356
Congo-Chine Telecom S.A.R.L.	51%	32,155	—	(7,422)	(477)	24,256
Yangzhou Zhongxing Mobile Telecom Equipment Co., Limited	65%	(9,890)	—	(19,022)	—	(28,912)
ZTE Mobile Tech Co., Limited	95%	9,034	—	20,095	—	29,129
ZTE Soft Development Technology Co., Ltd	76%	55,705	(4,298)	52,269	—	103,676
ZTE(UK) Limited	51%	(6,876)	—	(9,771)	—	(16,647)
ZTE do Brasil Ltda	100%	(1,138)	—	(9,207)	—	(10,345)
Shenzhen Zhongxing Software Company, Limited	70%	1,175,302	(28,058)	644,262	(1,093,925)	697,581
ZTE Integration Telecom Ltd	75%	36,922	—	41,336	—	78,258
ZTE Wistron Telecom AB	100%	1,714	—	902	—	2,616
OOO ZTE Russia Co. Ltd	100%	5,563	—	(453)	—	5,110
ZTE Corporation Mexico S.DER.L PE C.V.	100%	(5,775)	—	(7,550)	—	(13,325)
Shenzhen Changfei Investment Company, Limited	51%	42,885	—	19,010	(12,240)	49,655
Zhongxing Telecom Pakistan (Private) Limited	93%	3,468	3,729	(41,099)	—	(33,902)
Guangdong New Pivot Technology & Service Company, Limited	90%	4,774	2,700	1,806	—	9,280
Shenzhen Zhongxing Telecom Equipment Technology & Service Company Limited	90%	44,931	—	(10,553)	—	34,378
Shanghai Zhongxing Telecom Equipment Technology & Service Company Limited	51%	5,431	—	6,943	(1,785)	10,589
ZTE Holdings (Thailand) Co., Ltd	49%	(6)	—	(6)	—	(12)
ZTE (Thailand) Co. Ltd	49%	(1,745)	—	723	—	(1,022)
Shenzhen Zhongxing Special Equipment Company Limited	54%	488	—	1,362	—	1,850
ZTE Kangxun Telecom Company India Private Ltd.	100%	1,599	—	(53,741)	—	(52,142)
ZTE Romania SRL	100%	449	—	(7,932)	—	(7,483)
ZTE Malaysia Corporation SDH.BHD	100%	(134)	—	(2,445)	—	(2,579)
ZiMAX(Cayman) Holdings Co. Ltd	100%	20,673	24,810	(12,316)	—	33,167
西安中興精誠通訊有限公司	70%	—	11,396	902	—	12,298
Closed Joint Stock Company TK Mobile	51%	14,935	—	(606)	—	14,329
PT ZTE Indonesia	99.5%	—	1,654	3,923	—	5,577
深圳中興力維技術有限公司	30%	—	6,000	9,356	—	15,356
		2,951,428	886	938,710	(1,111,640)	2,779,384

* RMB925,116,000 included in Increase/decrease of equity during the year was current year's equity.

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9. Long-term investments (continued)

The Company (continued)

(2) Jointly-controlled entities

Investee	Share of registered capital	Balance at the beginning	Increase/ decrease of equity during the year	Dividends of cash during the year	Balance at year-end
Beijing Zhongxingxin Communication Equipment Company Limited	50%	6,311	(1,698)	—	4,613

(3) Associates

Investee	Share of registered capital	Balance at the beginning	Increase/ decrease of investment cost during the year	Increase/ decrease of equity during the year	Balance at year-end
Beijing Zhongxing Yuanjing Technology Co., Ltd.	30%	329	—	(43)	286
KAZNURTEL Limited Liability Company	49%	1,013	2,976	(1,511)	2,478
中興軟件技術(南昌)有限公司	30%	—	4,500	(2,146)	2,354
ZTE IC Design Co., Ltd	40%	—	10,899	2,319	13,218
		1,342	18,375	(1,381)	18,336

(4) Equity investments under cost method

Investee	Share of registered capital	Balance at the beginning	Increase/decrease of investment cost during the year	Balance at year-end
深圳市創新科技投資集團有限公司	0.33%	5,000	—	5,000
北京中視聯數字系統有限公司	7.59%	3,240	—	3,240
SunTop Technologies Ltd.	26.54%	24	—	24
Beijing Zhongxing Intelligent Transportation Systems Ltd	19%	—	1,024	1,024
中移鼎訊通訊股份有限公司	16%	32,000	—	32,000
		40,264	1,024	41,288

(All amounts in RMB'000 unless otherwise stated)

V. EXPLANATORY NOTES TO MAJOR ITEMS IN THE CONSOLIDATED FINANCIAL STATEMENTS (THE FOLLOWING REPRESENTS GROUP FIGURES UNLESS OTHERWISE STATED) (continued)

9. Long-term investments (continued)

The Company (continued)

(5) Difference in equity investments

Investee	Balance at the beginning	Amortization in current year	Increase/ decrease of equity during the year	Balance at year-end
Congo-Chine Telecom S.A.R.L.	(12,035)	1,719	—	(10,316)
Shenzhen Guoxin Electronics Development Company Limited	13,036	—	—	13,036
ZTE Mobile Tech Co., Ltd	5,685	(812)	(4,873)	—
	<u>6,686</u>	<u>907</u>	<u>(4,873)</u>	<u>2,720</u>

(6) Provision for impairment of long-term investment:

	Balance at the beginning and year-end
Shenzhen Guoxin Electronics Development Company Limited	<u>13,036</u>

There is no significant restriction relating to the Group's realization of investment.

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V. EXPLANATORY NOTES TO MAJOR ITEMS IN THE CONSOLIDATED FINANCIAL STATEMENTS (THE FOLLOWING REPRESENTS GROUP FIGURES UNLESS OTHERWISE STATED) (continued)

10. Fixed Assets (continued)

	Buildings	Leasehold improvement	Motor Vehicles	Machinery equipment	Electronic equipment	Other equipment	Total
Cost:							
At the beginning of the year	692,156	60,020	177,271	879,133	898,749	78,460	2,785,789
Additions	4,537	12,949	47,437	133,908	557,165	4,180	760,176
Acquisition of subsidiaries	—	—	475	11,145	5,446	—	17,066
Transferred from Construction in progress	221,000	—	—	—	11,594	—	232,594
Disposal and retirement	(11)	(21,338)	(14,037)	(14,320)	(32,399)	(68,514)	(150,619)
Disposal of subsidiaries	—	—	(927)	(331)	(20,815)	—	(22,073)
Exchange realignments	(59)	—	150	407	138	371	1,007
At year-end	917,623	51,631	210,369	1,009,942	1,419,878	14,497	3,623,940
Accumulated depreciation:							
At the beginning of the year	81,452	37,550	24,839	250,080	432,085	4,867	830,873
Provision	29,006	11,834	48,635	87,887	214,437	3,185	394,984
Acquisition of subsidiaries	—	—	—	2,116	2,130	—	4,246
Transfer	(4)	(21,338)	(8,867)	(8,214)	(25,862)	(1,135)	(65,420)
Disposal of subsidiaries	—	—	(387)	(210)	(15,348)	—	(15,945)
Exchange realignments	(3)	—	9	26	(6)	25	51
At year-end	110,451	28,046	64,229	331,685	607,436	6,942	1,148,789
Fixed assets, net:							
At year-end	807,172	23,585	146,140	678,257	812,442	7,555	2,475,151
At the beginning of the year	610,704	22,470	152,432	629,053	466,664	73,593	1,954,916
Provision for impairment:							
At the beginning and year end	7,708	—	—	1,475	85,797	—	94,980
Fixed assets, net:							
At year-end	799,464	23,585	146,140	676,782	726,645	7,555	2,380,171
At the beginning of the year	602,996	22,470	152,432	627,578	380,867	73,593	1,859,936

Book value of currently idle fixed assets was RMB911,000. Book value at cost of fixed assets in continued use for which full depreciation had been made was RMB150,503,000. Book value of retired fixed assets or fixed assets pending disposal was RMB607,000.

NOTES TO FINANCIAL STATEMENTS

(Prepared under PRC GAAP)

(All amounts in RMB'000 unless otherwise stated)

V. EXPLANATORY NOTES TO MAJOR ITEMS IN THE CONSOLIDATED FINANCIAL STATEMENTS (THE FOLLOWING REPRESENTS GROUP FIGURES UNLESS OTHERWISE STATED) (continued)

11. Construction in progress

Name of construction project	Budget	Amount	Increase/	Transfer to fixed	Other	Amount at the	Source of funds	Status of project
		at the beginning of the year	(decrease) during the year	assets during the year				
Science and Technology Park R&D Center	300,000	71,269	161,926	221,000	—	12,195	Internal resources	Partially completed
Liuxiandong ZTE Industrial Park	1,300,000	24,446	22,219	—	—	46,665	Internal resources	Work in progress
Network expansion phase IV	—	11,407	—	11,407	—	—	Internal resources	Completed
New plant in Wuxi	—	5,169	9,420	—	—	14,589	Internal resources	Work in progress
IT chamber of R&D complex	—	—	9,440	—	—	9,440	Internal resources	Work in progress
TK Phase II expansion	—	—	33,955	—	—	33,955	Internal resources	Work in progress
Others	—	2,386	22,236	187	14,538	9,897	Internal resources	Work in progress
	1,600,000	114,677	259,196	232,594	14,538	126,741		

12. Intangible assets

	Initial amount	Method of possession	Amount at the beginning of the year	Increase (decrease) during the year	Acquisition of subsidiaries	Disposal of subsidiaries	Amortization in the year	Accumulated amortization	Amount at the end of the year	Remaining years for amortization
Software	240,736	Acquisition	116,587	40,639	—	(3,709)	44,524	131,743	108,993	5
Patent technology	2,396	Acquisition	5,877	(4,129)	47	—	441	1,042	1,354	1-10
Land use rights	19,844	Acquisition	10,741	2,442	—	—	324	6,985	12,859	48
Operating concession	77,364	Acquisition	39,630	29,771	—	—	5,387	13,350	64,014	20
Other intangible assets	444	Investment	333	—	—	—	333	444	—	—
			173,168	68,723	47	(3,709)	51,009	153,564	187,220	

Provision for impairment of intangible assets:

	Amount at the beginning of the year	Addition in the year	Diminution in the year		Amount at the end of the year
			Increase in value	Other transfer	
Software	12,882	2	—	—	12,884
Land use rights	6,322	—	—	—	6,322
Operating concession	7,750	—	—	—	7,750
	26,954	2	—	—	26,956

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(All amounts in RMB'000 unless otherwise stated)

V. EXPLANATORY NOTES TO MAJOR ITEMS IN THE CONSOLIDATED FINANCIAL STATEMENTS (THE FOLLOWING REPRESENTS GROUP FIGURES UNLESS OTHERWISE STATED) (continued)

13. Long-term prepaid expenses

	Initial amount	Amount at the beginning of the year	Addition in the year	Amortization in the year	Accumulated amortization	Amount at the end of the year
Modules	2,174	1,315	301	1,616	2,174	—
		1,315	301	1,616	2,174	—

14. The Group entered into an international construction contract with Algeria Telecom for the provision of telecommunications equipment. Pursuant to the agreement, a subsidiary of the Group will share certain portion of the operating revenue of Algeria Telecom for the five years after the commissioning of the project, and the ownership of these telecommunications equipments shall be transferred to Algeria Telecom after 5 years at nil consideration. As at 31 December 2005, the project was not completed and the equipment supplied by the Group was accounted for as long-term deferred assets. Such assets will be amortized over a period of 5 years after the commissioning of the project.

15. Deferred tax debit

	2005	2004
Unrealized profit of stock	4,474	25,827
Provision for maintenance	37,350	33,934
Inventories provision	39,069	44,864
Deferred tax debit	80,893	104,625

16. Short-term loans

	2005		2004	
	Original currency	RMB equivalent	Original currency	RMB equivalent
Credit loans	RMB52,000	52,000	RMB12,000	12,000
	—	—	USD5,000	41,340
Mortgage loans	—	—	RMB2,021	2,021
Pledged loans	PKR353,300	47,695	RMB350,334	350,334
		99,695		405,695

The balance of short-term loans at year-end decreased by 75.43% compared to that at the beginning of the year. The decrease reflected repayment of loans during the year.

(All amounts in RMB'000 unless otherwise stated)

V. EXPLANATORY NOTES TO MAJOR ITEMS IN THE CONSOLIDATED FINANCIAL STATEMENTS (THE FOLLOWING REPRESENTS GROUP FIGURES UNLESS OTHERWISE STATED) (continued)

17. Notes payable

No outstanding amount due to shareholders holding 5% or more in the shares as at the year end.

The balance of notes payable at year-end increased by 39.03% compared to that at the beginning of the year. The increase mainly reflected increased settlement of payment by bills.

18. Accounts payable

Included in the balance of the account, such amount of shareholders holding 5% or more in the shares of the Company was RMB104,563,000. Please refer to Note VII to the financial statements-Relationship and transactions with connected parties.

The balance of accounts payable at year-end increased by 47.02% compared to that at the beginning of the year. The increase mainly reflected increased credit amount granted to the Group by suppliers allowing deferred payments.

19. Advances from customers

No outstanding amount of shareholders holding 5% or more in the shares of the Company.

The balance of accounts payable at year-end increased by 194.85% compared to that at the beginning of the year, reflecting mainly an increased number of construction contracts for which deposits were paid by customers.

20. Dividends payable

	2005	2004
Holders of State-owned corporate shares	3,186	936
Holders of domestic corporate shares/domestic investors	159,822	39,985
	163,008	40,921

The balance of dividends payable at year-end increased by RMB122,087,000 compared to that at the beginning of the year. The increase mainly reflected dividend due to minority shareholders by subsidiaries of the Company.

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(All amounts in RMB'000 unless otherwise stated)

V. EXPLANATORY NOTES TO MAJOR ITEMS IN THE CONSOLIDATED FINANCIAL STATEMENTS (THE FOLLOWING REPRESENTS GROUP FIGURES UNLESS OTHERWISE STATED) (continued)

21. Taxes payable

	2005	2004
Value-added tax ("VAT")	(802,209)	(223,852)
Business tax	5,508	13,815
City maintenance and construction tax	(794)	2,763
Income tax		
PRC tax	42,020	228,648
Overseas tax	72,652	—
Property tax	18	10
Individual income tax	12,523	31,075
	(670,282)	52,459

The bases of taxes calculation and tax rate of taxes payable are set out in Note III "Tax" to the financial statements.

The balance of taxes payable decreased by RMB722,741,000, reflecting mainly the increase in VAT credit that have not been deducted and the increase in refundable export VAT.

22. Other payables

The balance of the account comprised RMB313,000 payable to shareholders holding 5% or more in the shares of the Company.

23. Accrued expenses

	2005	2004
Interest expenses	395	3,072
Rent and water and electricity charges	4,541	3,966
Work installation expenses	14,972	1,063
Product maintenance fee	248,998	186,227
Commission	—	26,336
Others	77,762	47,870
	346,668	268,534

24. Provision

	2005	2004
Provision of guarantees for external parties	4,035	—
Guarantees for quality of products	16,000	20,000
	20,035	20,000

NOTES TO FINANCIAL STATEMENTS

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(All amounts in RMB'000 unless otherwise stated)

V. EXPLANATORY NOTES TO MAJOR ITEMS IN THE CONSOLIDATED FINANCIAL STATEMENTS (THE FOLLOWING REPRESENTS GROUP FIGURES UNLESS OTHERWISE STATED) (continued)

25. Long-term loans due within one year

	Notes	2005	2004
Long-term loans	26	500,000	16,900

26. Long-term loans

Category of loans	2005		2004	
	Original currencies	RMB equivalent	Original currencies	RMB equivalent
Pledged loans	—	—	EUR1,000	11,263
Credit loans	—	—	RMB450,900	450,900
Guaranteed loans	USD9,648	80,000	USD9,648	80,000
	RMB500,000	500,000	RMB500,000	500,000
Less: long-term loans due within one year		500,000		16,900
		80,000		1,025,263

27. Specific payables

	2005	2004
Technology appropriations	405,511	227,320

The balance at year-end increased by 78.39% as compared to that at the beginning of the year, mainly as a result of the increase in technology research grants received during the year.

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(Prepared under PRC GAAP)

(All amounts in RMB'000 unless otherwise stated)

V. EXPLANATORY NOTES TO MAJOR ITEMS IN THE CONSOLIDATED FINANCIAL STATEMENTS (THE FOLLOWING REPRESENTS GROUP FIGURES UNLESS OTHERWISE STATED) (continued)

28. Share capital

The Company has registered and paid-in capital of RMB959,521,650 with a par value of RMB1 each. Shares are classified and structured as follows:

	Balance at the beginning		Increase (decrease) during the year			Balance at year-end	
	Number of Shares	Percentage	Bonus issue	Others	Sub-total	Number of Shares	Percentage
I. Non-circulating shares							
(I) Promoters' shares							
1. State owned corporate shares	462,273	48.18%	—	(462,273)	(462,273)	—	—
2. Domestic corporate shares	13,478	1.40%	—	(13,478)	(13,478)	—	—
(II) Non-promoters' shares							
Domestic corporate shares	21,566	2.25%	—	(21,566)	(21,566)	—	—
Total non-circulating shares	497,317	51.83%	—	(497,317)	(497,317)	—	—
II. Circulating shares							
(I) Restricted Shares							
1. State owned corporate shares	—	—	—	392,080	392,080	392,080	40.86%
2. Other domestic shares	1,025	0.11%	256	11,433	11,689	12,714	1.32%
Including:							
Domestic corporate shares	—	—	—	11,433	11,433	11,433	1.19%
Domestic natural person shares	1,025	0.11%	256	—	256	1,281	0.13%
3. Foreign shares							
Foreign corporate shares	—	—	—	18,291	18,291	18,291	1.91%
Total number of restricted shares	1,025	0.11%	256	421,804	422,060	423,085	44.09%
(II). Unrestricted shares							
1. RMB ordinary shares	301,029	31.37%	75,257	—	75,257	376,286	39.22%
2. Overseas listed foreign shares	160,151	16.69%	—	—	—	160,151	16.69%
Total number of unrestricted shares	461,180	48.06%	75,257	—	75,257	536,437	55.91%
Total circulating shares	462,205	48.17%	75,513	421,804	497,317	959,522	100.00%
III. Total of shares	959,522	100.00%	75,513	(75,513)	—	959,522	100.00%

(All amounts in RMB'000 unless otherwise stated)

V. EXPLANATORY NOTES TO MAJOR ITEMS IN THE CONSOLIDATED FINANCIAL STATEMENTS (THE FOLLOWING REPRESENTS GROUP FIGURES UNLESS OTHERWISE STATED) (continued)

29. Capital reserve

	Amount at the beginning of the year	Increase in the period	Decrease in the period	Amount at the end of the year
Share premium	5,462,657	—	—	5,462,657
Provision for equity investments*	28,939	9,459	—	38,398
Provision for acceptance of non-cash asset donation	62	—	—	62
Other capital reserve**	—	5,307	—	5,307
	<u>5,491,658</u>	<u>14,766</u>	<u>—</u>	<u>5,506,424</u>

* The increase in equity investment provision was attributable to the acquisition of Nanfang Telecom by ZTE Soft, a subsidiary of the Group.

** Other capital reserve represented the disposal of accounts payable overdue for 3 years by the Group.

30. Surplus reserves

	Amount at the beginning of the year	Increase in the period	Decrease in the period	Amount at the end of the year
Statutory surplus reserve	733,350	185,802	—	919,152
Statutory public welfare fund	252,006	92,902	—	344,908
	<u>985,356</u>	<u>278,704</u>	<u>—</u>	<u>1,264,060</u>

In accordance with Article 177 of the Company Law and the Company's articles of association, and as resolved by the board of directors on 6 April 2006, 10% of the net profit of the Company was appropriated to the statutory surplus reserve. Such appropriation will cease when the reserve balance has reached 50% of the registered capital of the Company.

In accordance with Article 177 of the Company Law and the Company's articles of association, and as resolved by the board of directors on 6 April, 2006, 5% of the net profit of the Company was appropriated to the statutory public welfare fund.

The Company may make appropriation to its discretionary surplus reserve fund after appropriations to the statutory surplus reserve and the statutory public welfare fund. Upon approval, the discretionary surplus reserve can be utilized to make up prior years' losses or to increase capital.

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V. EXPLANATORY NOTES TO MAJOR ITEMS IN THE CONSOLIDATED FINANCIAL STATEMENTS (THE FOLLOWING REPRESENTS GROUP FIGURES UNLESS OTHERWISE STATED) (continued)

31. Undistributed profit

	At the beginning of the year	Increase during the year	Decrease during the year	Balance at year-end
	1,495,431	1,194,343	518,584	2,171,190

The decrease during the year comprised the payment of RMB2.5 in cash for every 10 shares or an aggregate of RMB239,880,000 on the basis of the total share capital as at 31 December 2005 according to the 2005 profit distribution plan declared by the sixteen meeting of the third session of the Board of Directors of the Company and transfers to the statutory surplus reserve and the statutory public welfare fund.

32. Revenue and cost of sales

Revenue from principal operations refers to the revenue from sale of products and labor services. Segment information of the Group and the Company is set out in the business and geographical segments described in note VI.

Sale to the top five customers of the Group generated revenue of RMB10,124,082,000 and RMB15,163,377,000 in 2005 and 2004 respectively, accounting for 46.92% and 66.80% of the sales revenue of the Group respectively.

33. Taxes and surcharges

	2005	2004
Business tax	16,499	31,532
City maintenance and construction tax	20,260	10,272
Education surcharge	44,632	29,108
Others	24,269	—
	105,660	70,912

Taxes and surcharges increased by 49%. The increase mainly reflected increased overseas taxes in tandem with growth in overseas sales.

34. Profit from other operations

	2005	2004
Sales of raw materials	—	27,841
Technology service and consultation fee	15,379	12,678
Others	400	820
	15,779	41,339

Profit from other operations decreased by 61.83%. The decreased mainly reflected decreased of sales of raw materials.

(All amounts in RMB'000 unless otherwise stated)

V. EXPLANATORY NOTES TO MAJOR ITEMS IN THE CONSOLIDATED FINANCIAL STATEMENTS (THE FOLLOWING REPRESENTS GROUP FIGURES UNLESS OTHERWISE STATED) (continued)

35. Finance Expenses

	2005	2004
Interest expenses	175,884	113,661
Less: Interest income	54,870	22,578
Gain/losses on exchange	48,390	16,130
Cash discounts and interest subsidy	59,746	138,508
Bank charges	59,601	39,257
	288,751	284,978

36. Investment income

The Group

	2005	2004
Gain from stock investment	—	12,140
Share of net gain/losses of jointly-controlled entities	(2,968)	650
Share of net gain/losses of associates	(1,716)	—
Gain on transfer of equity investment	1,598	—
Dividends received from investee companies	—	250
Amortization of differences in equity investment	(812)	(3,673)
Provision for impairment of long-term investments	—	(13,036)
Written off of long-term investments	(55,456)	—
	(59,354)	(3,669)

As at the balance sheet date, the Group was not subject to significant restrictions in remitting its investment income.

Investment loss in current year increased by RMB55,685,000, which was mainly due to written off of investment impairment of Zimax Technologies Inc.

The Company

	2005	2004
Share of net gain/losses of subsidiaries	925,160	1,164,640
Share of net gain/losses of associates	(1,698)	—
Share of net gain/losses of jointly-controlled entities	(1,381)	—
Gain/losses on transfer of equity investment	1,598	—
Dividends received from investee companies	—	250
Amortization of differences in equity investment	907	(1,954)
Provision for impairment of long-term investment	—	(13,036)
Written-off of long-term investments	(4,873)	—
	919,713	1,149,900

As at the balance sheet date, the Group was not subject to significant restrictions in remitting its investment income.

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V. EXPLANATORY NOTES TO MAJOR ITEMS IN THE CONSOLIDATED FINANCIAL STATEMENTS (THE FOLLOWING REPRESENTS GROUP FIGURES UNLESS OTHERWISE STATED) (continued)

37. Subsidies income

Item	2005	2004
Refund of VAT on software products*	435,326	345,066
Financial subsidies on essential new products	8,900	20,254
Preferential financial subsidies on new products	3,500	3,052
Subsidies granted on export sales	—	4,631
Others	10,288	5,695
	458,014	378,698

* Refund of VAT on software products represented the refund upon payment of VAT paid according to the portion of any effective VAT rate in excess of 3% in respect of software product sales by a subsidiary of the Company, pursuant to the principles of Certain Policies to Encourage the Development of Software Enterprise and the IC Industry and the approval reply of the State taxation authorities in Shenzhen.

38. Non-operating income

	2005	2004
Gains from disposal of fixed assets	909	164
Income from penalty payment	9,367	5,155
Income from compensation payment	10,000	6,756
Reward income	5,107	—
Others	2,244	5,966
	27,627	18,041

Non-operating income increased by 53.13% mainly as a result of increased income from compensation and Reward income.

39. Non-operating expenses

	2005	2004
Provision for impairment of fixed assets	—	87,003
Provision for impairment of intangible assets	2	20,632
Net loss on written off of assets	7,072	43,785
Input VAT not offset in exports	—	3,447
Donations	2,218	—
Penalties	5,638	—
Others	1,792	5,770
	16,722	160,637

Non-operating expenses decreased by 89.59%. The decrease mainly reflected the decrease of fixed asset impairment provision, intangible asset impairment provision and written off of fixed assets.

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V. EXPLANATORY NOTES TO MAJOR ITEMS IN THE CONSOLIDATED FINANCIAL STATEMENTS (THE FOLLOWING REPRESENTS GROUP FIGURES UNLESS OTHERWISE STATED) (continued)

40. Other cash outflow from operating activities

Other cash outflow from operating activities in the consolidated cash flow statement at 31 December 2005 was RMB3,326,157,000, comprising mainly operating expenses and administrative expenses.

VI. SEGMENT INFORMATION BY INDUSTRY AND REGION

The Group

Items of principal operations	Revenue from principal operations		Costs of sales		Gross profit	
	2005	2004	2005	2004	2005	2004
Communication system construction income	17,016,057	16,540,980	10,208,099	9,119,506	6,807,958	7,421,474
Communication terminal equipment	4,333,082	6,014,967	3,574,985	5,150,790	758,097	864,177
Telecommunications service income	226,781	142,206	161,713	98,810	65,068	43,396
Total	21,575,920	22,698,153	13,944,797	14,369,106	7,631,123	8,329,047

Geographical segments	Revenue from principal operations		Cost of sales		Profits from principal operations	
	2005	2004	2005	2004	2005	2004
Domestic	13,874,309	17,803,600	9,364,085	11,796,644	4,510,224	6,006,956
Overseas	7,701,611	4,894,553	4,580,712	2,572,462	3,120,899	2,322,091
Total	21,575,920	22,698,153	13,944,797	14,369,106	7,631,123	8,329,047

The Company

Items of principal operations	Revenue from principal operations		Costs of sales		Gross profit	
	2005	2004	2005	2004	2005	2004
Communication system construction income	16,408,812	16,486,739	13,175,302	11,831,497	3,233,510	4,655,242
Communication terminal equipment	4,156,240	5,086,206	3,496,520	4,454,322	659,720	631,884
Total	20,565,052	21,572,945	16,671,822	16,285,819	3,893,230	5,287,126

Geographical segments	Revenue from principal operations		Cost of sales		Gross profit	
	2005	2004	2005	2004	2005	2004
Domestic	13,439,004	17,545,832	10,925,688	13,708,115	2,513,316	3,837,717
Overseas	7,126,048	4,027,113	5,746,134	2,577,704	1,379,914	1,449,409
Total	20,565,052	21,572,945	16,671,822	16,285,819	3,893,230	5,287,126

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(All amounts in RMB'000 unless otherwise stated)

VII. RELATIONSHIP WITH CONNECTED PARTIES AND CONNECTED TRANSACTIONS

1. Connected parties with controlling relationship

Name of corporation	Principal operations	Place of registration	Relationship with the Company	Percentage of Shares or equities	Economic nature or category	Legal representative
Shenzhen Zhongxingxin Telecommunications Equipment Company, Limited	production of programmed switchboard cabinets, telephones and related components, and electronic products; import and export operations	Shenzhen, Guangdong	Controlling shareholder of the Company	37.41%	State-owned	Zhang Taifeng

2. Registered capital of connected parties with controlling relationship and its movements

Name of corporation	At the beginning of the year RMB'000	Addition in the period RMB'000	Reduction in the period RMB'000	At the end of the year RMB'000
Shenzhen Zhongxingxin Telecommunications Equipment Company, Limited	10,000	—	—	10,000

The amount was RMB10,000,000 at the beginning and the end of the year. No movements were recorded during the year.

3. Movements in shares or equity held by connected parties with controlling relationship:

Name of corporation	At the beginning of the period		Addition in the period		Reduction in the period		At the end of the period	
	Amount	%	Amount	%	Amount	%	Amount	%
Shenzhen Zhongxingxin Telecommunications Equipment Company, Limited	423,222	44.11%	—	—	64,263	6.70%	358,959	37.41%

Changes in the shareholding of the controlling shareholders were attributable to the Group's share reform plan. Please refer to Note V.28 for details of the shareholding structure following the share reform plan.

(All amounts in RMB'000 unless otherwise stated)

VII. RELATIONSHIP WITH CONNECTED PARTIES AND CONNECTED TRANSACTIONS

(continued)

4. Relationship with connected parties with non-controlling relationship

Details for connected parties with non-controlling relationship are as follow:

Name of related companies	Relationship with the Company
Shenzhen Zhongxing WXT Equipment Company, Ltd.	Shareholder of the Company's controlling shareholder
Shenzhen Zhongxing Information Technology Co., Ltd.	Partially holding company of the shareholder of the Company's controlling shareholder
Shenzhen Lead Communications Company, Limited*	Under the same controlling shareholder as the Company
Beijing Yuanjing Technology Co., Ltd.	Associate
Shenzhen Zhongxing Xindi Telecommunications Equipment Company, Limited	Under the same controlling shareholder as the Company
Xi'an Microelectronics Technology Research Institute	Shareholder of the Company's controlling shareholder
Lishan Microelectronics Research Institute	Shareholder of the Company
Beijing Zhongxingxin Communication Equipment Company, Limited	Subsidiary jointly-controlled by the Company
Beijing Zhongxing Intelligent Transportation Systems Ltd.#	Entity in which the Company holds an equity interest
Shenzhen Zhongxing Xinyu FPC Company, Limited	Under the same controlling shareholder as the Company
Shenzhen Gaodonghua Communication Technology Co., Ltd.	Partially holding company of the shareholder of the Company's controlling shareholder
Beijing Xieli Chaoyue Science Technology Co., Ltd.	Controlling company of the shareholder of the Company's controlling shareholder
Shenzhen Zhongxing Development Co., Ltd.	Partially holding company of the shareholder of the Company's controlling shareholder
Chung Hing (Hong Kong) Development Limited	Company controlled by key management personnel of the Company
WuXi KaiEr Technology Company, Limited	Associate
Shenzhen Weigao Semiconductor Company, Limited	Associate
ZTE IC Design Co., Ltd	Associate
Shenzhen Decang Technology Company Limited	Associate

* Shenzhen Lead Communications Company, Limited has been acquired by Shenzhen Changfei Investment Company, Limited, the holding subsidiary of the Company in March 2004, and has been combined in the consolidated financial statements of the Company, rather than as a related company after the acquisition.

Beijing Zhongxing Intelligent Transportation Systems Ltd was no longer considered an associate as the Company no longer exercised significant influence over Beijing Zhongxing Intelligent Transportation Systems Ltd following a share transfer in July 2005 that reduced the Company's effective control over Beijing Zhongxing Intelligent Transportation Systems Ltd to less than 20%.

NOTES TO FINANCIAL STATEMENTS

(Prepared under PRC GAAP)

(All amounts in RMB'000 unless otherwise stated)

VII. RELATIONSHIP WITH CONNECTED PARTIES AND CONNECTED TRANSACTIONS (continued)

5. Major transactions between the Group and related companies during the year are as follow:

(1) Sales of goods to the connected parties:

Item	Names of companies	2005	2004
Sales of goods	Shenzhen Zhongxing Information Technology Co., Ltd.	7,910	3,435
	Shenzhen Zhongxingxin Telecommunications Equipment Company, Limited	545	1
	Beijing Zhongxingxin Communication Equipment Company Limited	3,248	10,904
	Beijing Zhongxing Yuanjing Technology Co., Ltd.	2,815	13,945
	Shenzhen Lead Communications Company, Limited*	—	43,577
	Beijing Zhongxing Intelligent Transportation Systems Ltd.	4,265	16,591
	Xi'an Microelectronics Technology Research Institute	6,478	52,547
	Beijing Xieli Chaoyue Science Technology Co., Ltd.	—	228
	Shenzhen Zhongxing Development Co., Ltd.	—	2,982
	ZTE IC Design Co., Ltd	9,025	—
	Shenzhen Zhongxing WXT Equipment Company, Ltd.	5,233	1,580
	Shenzhen Zhongxing Xindi Telecommunications Equipment Company, Limited	13	—

* The amount involved in related-party transactions between the Company and Shenzhen Lead Communications Company, Limited was the transaction amount before that company was consolidated in the Company in January to March of 2004.

(2) Purchase of raw materials from connected parties:

Item	Names of companies	2005	2004
Purchase of raw materials	Shenzhen Zhongxingxin Telecommunications Equipment Company, Limited	311,970	254,467
	Shenzhen Zhongxing WXT Equipment Company, Ltd.	184,326	107,842
	Shenzhen Zhongxing Xindi Telecommunications Equipment Company, Limited	84,327	145,659
	Shenzhen Zhongxing Information Technology Co., Ltd.	16,163	7,301
	Xi'an Microelectronics Technology Research Institute	7,718	12,103
	Shenzhen Zhongxing Xinyu FPC Company, Limited	41,623	6,686
	Beijing Zhongxingxin Communication Equipment Company Limited	89	266
	Shenzhen Lead Communications Company, Limited*	—	39,747
	Shenzhen Gaodonghua Communication Technology Co., Ltd.	—	12,034
	Chung Hing (Hong Kong) Development Limited	8,166	1,500
	ZTE IC Design Co., Ltd.	36,380	—
	WuXi KaiEr Science and Technology Company, Limited	11,957	—
	Shenzhen Decang Technology Company Limited	5,874	—

* The amount involved in connected transactions between the Company and Shenzhen Lead Communications Company, Limited was the transaction amount before that company was consolidated in the Company in January to March of 2004.

(3) Other major related transaction

Item	2005	2004
Conversion of equities	1,024	—

Notes:

- (1) Sales of goods to connected parties: Goods were sold to connected parties by the Company at the market price during the year.
- (2) Purchase of raw materials from connected parties: Raw materials, parts and ancillary materials were purchased by Company from connected parties at the market price during the year.
- (3) Other major connected transactions: During the year, the Company acquired from Beijing Zhongxingxin Communication Equipment Company Limited a 19% interest in Beijing Zhongxing Intelligent Transportation Systems Ltd at an agreed price.

NOTES TO FINANCIAL STATEMENTS

(Prepared under PRC GAAP)

(All amounts in RMB'000 unless otherwise stated)

VII. RELATIONSHIP WITH CONNECTED PARTIES AND CONNECTED TRANSACTIONS

(continued)

6. Amounts due from/to connected parties

Items	Name of connected parties	Amount at the end of the period	Amount at the beginning of the period
Accounts payable	Shenzhen Zhongxingxin Telecommunications Equipment Company, Limited	104,563	51,168
	Shenzhen Zhongxing WXT Equipment Company, Ltd.	65,870	31,325
	Shenzhen Zhongxing Information Technology Co., Ltd.	14,910	3,487
	Shenzhen Zhongxing Xinyu FPC Company, Limited	6,005	2,057
	Shenzhen Zhongxing Xindi Telecommunications Equipment Company, Limited	27,490	17,939
	Shenzhen Gaodonghua Communication Technology Co., Ltd.	1,408	5,046
	Beijing Zhongxingxin Communication Equipment Company Limited	182	93
	Xi'an Microelectronics Technology Research Institute	2,616	3,923
	Chung Hing (Hong Kong) Development Limited	954	—
	ZTE IC Design Co., Ltd	11,067	—
	Shenzhen Decang Technology Company Limited	3,156	—
Other payables	Shenzhen Zhongxingxin Telecommunications Equipment Company, Limited	313	313
	Lishan Microelectronics Research Institute	—	65
	Shenzhen Zhongxing WXT Equipment Company, Ltd.	—	12
	Beijing Zhongxingxin Communication Equipment Company Limited	1,024	—
	Shenzhen Zhongxing Xindi Telecommunications Equipment Company, Limited	132	—
Notes payables	Shenzhen Zhongxing WXT Equipment Company, Ltd.	3,040	—
	Shenzhen Gaodonghua Communication Technology Co., Ltd.	—	8,448
	Shenzhen Zhongxing Xinyu FPC Company, Limited	3,173	—
	Shenzhen Zhongxing Information Technology Co., Ltd.	401	—
	ZTE IC Design Co., Ltd	775	—
	Shenzhen Decang Technology Company Limited	559	—
Accounts prepaid	Shenzhen Zhongxing WXT Equipment Company, Ltd.	—	613
	Shenzhen Zhongxing Information Technology Co., Ltd.	3,464	2,663
Other receivables	Xi'an Microelectronics Technology Research Institute	—	65
	Lishan Microelectronics Research Institute	—	565
	Shenzhen Zhongxing Information Technology Co., Ltd.	1,038	1,038
	China Precision Machinery Import and Export Shenzhen Company	—	1,394
Trade receivables	Shenzhen Zhongxingxin Telecommunications Equipment Company, Limited	177	169
	Shenzhen Zhongxing WXT Equipment Company, Ltd.	9,053	2,930
	Beijing Zhongxing Yuanjing Technology Co., Ltd.	—	3,187
	Shenzhen Zhongxing Information Technology Co., Ltd.	3,062	1,246
	Beijing Zhongxingxin Communication Equipment Company Limited	2,070	—
	ZTE IC Design Co., Ltd	2,150	—
Advances from customers	Xi'an Microelectronics Technology Research Institute	154	93
	Beijing Zhongxingxin Communication Equipment Company Limited	—	847
	Beijing Zhongxing Yuanjing Technology Co., Ltd.	765	—
	Beijing Zhongxing Intelligent Transportation Systems Ltd.	—	1,082
Dividends payable	Shenzhen Zhongxing WXT Equipment Company, Ltd.	14,837	12,087
	Lishan Microelectronics Research Institute	936	936
	Shenzhen Zhongxingxin Telecommunications Equipment Company, Limited	2,250	—
	Shenzhen Zhongxing Xindi Telecommunications Equipment Company, Limited	2,299	—
Notes receivable	Shenzhen Zhongxing Information Technology Co., Ltd.	700	—
	Shenzhen Zhongxing Xindi Telecommunications Equipment Company, Limited	499	—

Amounts due from/to connected parties are interest-free, unsecured and have no fixed terms of repayment.

NOTES TO FINANCIAL STATEMENTS

(Prepared under PRC GAAP)

(All amounts in RMB'000 unless otherwise stated)

VIII. CONTINGENT EVENTS

1. In November 2005, a Jiangsu Provincial Higher People's Court action was commenced by a customer against a subsidiary of the Group and the Company in respect of a claim for return of advance payment, accrued interests and compensating losses of approximately RMB71 million in aggregate. As at the date of approval of these financial statements, no decision had been made in the court proceedings. In the opinion of the directors, based on legal advice from the Company's lawyer engaged for this action, the subsidiary of the Group and the Company have valid defences against such claims and any resulting liabilities would not have any material adverse impact on the Group's financial position. Therefore, no provision in respect of such claims was made in the financial statements.
2. On 16 December 2005, an arbitration was commenced by a foreign supplier against the Company in respect of claims for breach of contract and infringement of intellectual property rights in the amount of approximately USD36,450,000 (equivalent to approximately RMB294.2 million) in aggregate.

As at the approval date of these financial statements, no arbitral award or other decision by the tribunal has been made on the claims. In the opinion of the directors, based on legal advice from the Company's lawyer engaged for the action, the Company has valid defences against the claims brought in the arbitration, the directors currently believe that the outcome of the arbitration would not have a material adverse impact on the Group's financial position. Therefore, no provision in respect of such claims has been made in the financial statements.

3. On 18 August 2005, the Company received a notice of arbitration from a foreign consultant in respect of (i) a claim of consultancy fee of approximately USD90,000 (equivalent to approximately RMB726,000); (ii) a claim of agency fee of approximately USD1,190,314 (equivalent to approximately RMB9,606,000); (iii) a compensation claim of approximately USD50,000 (equivalent to approximately RMB404,000) for harassment and undue delay in honoring of a consultancy agreement.

As at the approval date of these financial statements, no decision had been made in the arbitration. In the opinion of the directors, based on legal advice from the Company's lawyer engaged for this action, the Company has valid defences, against such claims and any resulting liabilities would not have material adverse impact on the Group's financial position. Therefore, no provision in respect of such claims was made in the financial statements.

4. During the year, the subsidiary of the Group in Pakistan has commenced a defence action against the Collectorate of Customs, Sales Tax and Central Excise (Adjudication/Appeals), Rawalpindi in respect of a claim by the latter of additional custom duties of approximately Rs.177 million (equivalent to approximately RMB23.9 million) and a penalty of approximately Rs.2.4 billion (equivalent to approximately RMB324 million) for an alleged misdeclaration of imported goods in the Customs, Central Excise and Sales Tax Appellate Tribunal, Islamabad, Pakistan. On 5 September 2005, all disputes between the parties relating to this action were referred to Alternate Dispute Resolution Committee ("the Committee") for resolution and the Committee has recommended in favour of the subsidiary of the Group.

As at the approval date of these financial statements, no decision has been made in the Tribunal. The directors estimated that the maximum financial impact to the Group relating to additional custom duties would be in the order of approximately Rs.36 million (equivalent to approximately RMB4.8 million) and have been accrued in the Group's financial statements for the year ended 31 December 2005. In the opinion of the directors, based on legal advice from the Company's lawyer engaged for this action, the subsidiary of the Group has valid defences, against the aforesaid claims and any resulting liabilities would not have material adverse impact on the Group's financial position. Therefore, no further provision in respect of custom duties penalty was considered necessary to be made in the financial statements.

5. As at 31 December 2005, the Group had outstanding bank guarantees amounting RMB2,823,760,000.

NOTES TO FINANCIAL STATEMENTS

(Prepared under PRC GAAP)

(All amounts in RMB'000 unless otherwise stated)

IX. COMMITMENTS

	2005	2004
Capital commitments		
Contracted but not provided for	231,561	282,446
Lease commitments	183,425	149,323
Investment commitments	21,065	—
	436,051	431,769

X. POST BALANCE SHEET EVENT

As at the approval date of the financial statements, the Group had no discloseable post balance sheet events.

XI. COMPARATIVE AMOUNTS

Certain comparative amounts have been restated to conform with the current year's presentation. In order to reflect the Group's business more accurately, we have reclassified the opening balances of our financial statements as follows:

The Group	Before reclassification	After reclassification
Inventories	4,643,758	1,871,767
Amount due from customers for contract work	—	2,752,024
Fixed assets — cost	2,725,769	2,785,789
Fixed assets — accumulated depreciation	793,323	830,873
Long-term prepaid expenses	23,785	1,315
Amount due to customers for contract work	—	2,318,731
Advances from customers	2,630,721	292,023
The Company	Before reclassification	After reclassification
Inventories	4,808,259	1,350,130
Amount due from customers for contract work	—	3,414,540
Amount due to customers for contract work	—	2,162,901
Advances from customers	2,455,494	249,004

In order to reflect the financial conditions of construction contracts more accurately, receipts from construction contract work in progress are recorded as amount due from customers for contract work or amount due to customers for contract work. The amount of contract costs incurred to date plus recognised gross profit (loss) of an individual contract work in excess of progress billings is recognised as amount due from customers for contract work; whereas, the amount of progress billings in excess of contract costs incurred to date plus recognised gross profit (loss) of an individual contract work is recognised as amount due to customers for contract work.

XII. APPROVAL OF FINANCIAL STATEMENTS

The financial statements were resolved and approved by the Board of Directors of the Company on 6 April 2006.

APPENDIX

(All amounts in RMB'000 unless otherwise stated)

I Reconciliation of differences between financial statements prepared under PRC and Hong Kong Financial Reporting Standards

Major differences between the financial statements prepared under PRC Accounting Rules and Regulations ("PRC AS") and the financial statements prepared under the Hong Kong Financial Reporting Standard are as follow:

	2005		2004	
	Net profit	Net asset	Net profit	Net asset
Under PRC AS	1,194,343	10,125,095	1,008,870	9,174,439
Differences in accounting standards				
Technology grants and research expenses under different accounting standards	106,740	177,182	(24,434)	69,589
Provision for retirement benefits under accounting standards generally accepted in Hong Kong	(1,536)	(30,459)	(1,733)	(28,923)
Recognition of excess over the cost of business combination	9,460	—	—	—
Deferred tax debit	(21,306)	(21,306)	—	—
Adjustments to previous financial statements as a result of changes in accounting estimates	—	—	289,786	—
Others	—	—	—	2,047
Prepared under Hong Kong financial reporting standards	1,287,701	10,250,512	1,272,489	9,217,152

(All amounts in RMB'000 unless otherwise stated)

II Fully diluted and weighted average net return on assets and earnings per share

	Profit for the reporting period	Return on net assets		Earnings per share	
		Fully diluted	Weighted average	Fully diluted	Weighted average
Profit from principal operations	7,525,463	74.33%	78.13%	7.84	7.84
Operating profit	1,092,299	10.79%	11.34%	1.14	1.14
Net profit	1,194,343	11.80%	12.40%	1.24	1.24
Net profit after extraordinary items	1,212,926	11.98%	12.59%	1.26	1.26

Net profits after extraordinary items are listed below:

			2005
Net profit			1,194,343
Add(less):	Subsidy income		(22,688)
	Non-operating income		(27,627)
	Non-operating expenses		16,722
	Impairment of difference in equity investment		55,455
	Income tax effect on extraordinary items		(3,279)
Net profit after extraordinary items			1,212,926

The Company recognised extraordinary items in accordance with the Rule No. 1 of Questions and Answers for Information Disclosure and Report Compilation by Companies with Public Listed Securities under Kuai Ji Zi [2004] No. 4 promulgated by the China Securities Regulatory Commission.

APPENDIX

(All amounts in RMB'000 unless otherwise stated)

III Breakdown of provisions for asset impairment

	Balance at the beginning	Addition during the year	Reduction during the year Other reasons	Balance at year end
I. Provision of bad debt	907,098	705,215	(439,102)	1,173,211
Including: Trade receivables	429,605	217,537	(201,896)	445,246
Other receivables	477,493	487,678	(237,206)	727,965
II. Provision for impairment of inventories	419,773	96,185	—	515,958
Including: Raw materials	86,161	—	—	86,161
Materials under sub-contract processing	—	1,599	—	1,599
Work in progress	—	5,779	—	5,779
Finished goods	333,612	88,807	—	422,419
III. Provision for impairment of long-term investments	13,036	—	—	13,036
Including: long-term equity investment	13,036	—	—	13,036
Long-term bond investment	—	—	—	—
IV. Provision for impairment of fixed assets	94,980	—	—	94,980
Including: buildings	7,708	—	—	7,708
Machinery	1,475	—	—	1,475
Electronic equipment	85,797	—	—	85,797
V. Provision for impairment of intangible assets	26,954	2	—	26,956
Including: land use rights	6,322	—	—	6,322
Software	12,882	2	—	12,884
Operating concession	7,750	—	—	7,750

STATEMENT OF CHANGES IN SHAREHOLDERS' EQUITY

(All amounts in RMB'000 unless otherwise stated)

	2005	2004
I. Share capital		
Balance at the beginning	959,522	667,296
Addition during the year	—	293,610
Including: Transfer from capital reserve	—	—
Transfer from surplus reserve	—	—
Transfer from profit allocation	—	—
Share capital as enlarged by issue of new shares	—	160,151
Bonus share issue	—	133,459
Reduction during the year	—	(1,384)
Balance at year-end	959,522	959,522
II. Capital reserve		
Balance at the beginning	5,491,658	2,106,043
Addition during the year	14,766	3,385,615
Including: share capital premium	—	3,383,411
Appreciation from asset valuation	—	—
Receipt of non-cash assets as donation	—	—
Exchange difference in respect of capital denominated in foreign currency	—	—
Provision for equity investment	9,459	2,204
Others	5,307	—
Reduction during the year	—	—
Including: transfer to share capital	—	—
Balance at year-end	5,506,424	5,491,658
III. Statutory and discretionary surplus reserves		
Balance at the beginning	733,350	410,038
Addition during the year	185,802	323,312
Including: Appropriations from net profit	185,802	323,312
Transfer from statutory public welfare fund	—	—
Reduction during the year	—	—
Including: making up of losses	—	—
Transfer to share capital	—	—
Distribution of cash dividend	—	—
Distribution of scrip dividend	—	—
Balance at year-end	919,152	733,350
Including: Statutory surplus reserve	919,152	733,350

STATEMENT OF CHANGES IN SHAREHOLDERS' EQUITY

(All amounts in RMB'000 unless otherwise stated)

	2005	2004
IV. Statutory public welfare fund		
Balance at the beginning	252,006	214,053
Addition during the year	92,902	37,953
Including: Appropriations from net profit	92,902	37,953
Reduction during the year	—	—
Including: Expenses for acquisition and construction of staff housing	—	—
Other expenses on public welfare	—	—
Balance at year-end	344,908	252,006
V. Undistributed profits at the beginning of year	1,495,431	1,221,165
Net profit for the year	1,194,343	1,008,870
Profit distribution for the year	(518,584)	(734,604)
Undistributed profits at year-end	2,171,190	1,495,431