The Board of Directors of the Company is pleased to present the interim results report together with the financial statements of the Group for the six months ended 30 June 2006.

FINANCIAL RESULTS

Please refer to page 136 and page 195 of this report for the results of the Group for the six months ended 30 June 2006 which had been prepared in accordance with PRC GAAP and Hong Kong accounting standards.

(I) REVIEW OF BUSINESS DURING THE FIRST SIX MONTHS OF 2006

Overview of the telecommunications industry in China in the first six months of 2006

China's telecommunications industry maintained sustainable growth during the first half of 2006. According to the statistics from the Ministry of Information Industry, revenue for the telecommunications sector in China grew by 10.7% to RMB313.9 billion and capital expenditure in China grew by 9.1% to RMB84.87 billion, as compared to the same period last year. There were notable changes in the investment structure as investments in CDMA and PHS declined further. Against the background of the impending 3G launch in the nation, carriers made timely moves to realign their investments in tandem with the 3G era. China Telecom and China Netcom strengthened their organic development, and sharply decreased their investments in traditional fixed-lines and PHS; China Mobile increased its investment in new technologies, new businesses and business network support systems with an increasing level of centralised procurement, while China Unicom diverted its investment to GSM networks.

Overview of the global telecommunications industry in the first six months of 2006

The global telecommunications sector maintained its growth trend during the first half of 2006. According to the statistics from Gartner, wireless communications will continue to maintain an appropriate growth rate, with the growth rates in the emerging markets in the Middle East, Africa, Latin America, Central and Eastern Europe and Asia-Pacific being significantly higher than the global average.

The mobile communications sector was the fastest-growing sector among the telecommunications equipment market, imposing enormous pressure upon the fixed-line sector. As a result of efforts by major carriers, the number of global 3G users exceeded the 100-million threshold. The 3G sector was heading into a new stage of development, underpinned by commercial application of the maturing HSDPA technology. A new cycle of industry restructuring began for the telecommunications sector as carriers and equipment manufacturers alike were actively engaged in mergers and acquisitions. Through mergers and acquisitions, large-scale telecommunications equipment manufacturers set new standards in terms of cost control, technological innovation and increased operational efficiency to put other smaller companies under further pressure.

Operating results of the Group for the first six months of 2006

Against the backdrop of adjustments in the investment structure of domestic carriers which had a substantial impact on the Company and an increasingly competitive international market, the management of the Company managed to implement its annual strategic plans, realising the Group's objectives of strategic adjustments and market optimisation for the first half of the year.

In view of the changes in the domestic market, the Group has enhanced the organisation and setup of its domestic distribution system, and increased its investment into international markets. The international markets maintained a favourable growth rate, particularly since global market coverage was basically completed last year. During the first six months of 2006, the Company has further implemented its development strategy for multinational carriers and developed markets. In North America, the Company has sought to enter the market by introducing new products with the establishment of trial stations and commercial stations for CDMA systems and terminals, fixed line terminals and broadband access. Business relationships have been established with carriers.

Based on financial statements prepared under PRC GAAP, revenue from the Group's principal operations amounted to RMB10.491 billion in the first six months of 2006, representing a 1.82% increase compared to the same period last year. Net profit dropped 45.69% to RMB373 million. Earnings per share amounted to RMB0.39 while net cash outflow from operating activities amounted to RMB2.95 per share.

Based on financial statements prepared under Hong Kong accounting standards, revenue from the Group's principal operations amounted to RMB10.491 billion in the first six months of 2006, representing a 1.82% increase compared to the same period last year. Net profit dropped 47.44% to RMB347 million. Earnings per share amounted to RMB0.36 while net cash outflow from operating activities amounted to RMB3.03 per share.

Operating results of major products

Analysed in terms of products, the Company's terminals business saw significant improvement in terms of market coverage and gross margin. There has been a rapid growth in value-added services and data products, as well as smooth expansion in wireless systems and optical communications in the international markets. Enhancements in our overall product structure continued with more balanced contribution by each product.

Wireless communications products

The Group's systems products cover GSM, CDMA, PHS systems of 2G and WCDMA, CDMA2000 and TD-SCDMA products of 3G. In the first six months of 2006, as a result of adjustments in the investment structure of domestic carriers, there has been a sharp decrease in the investment in the Group's traditional leading-edge products (such as CDMA and PHS systems) but an increase in the investment in certain new products. In the domestic market, the Group has seized upon new investment opportunities by expanding its investment in the rural communications project and mobile GSM network. In the international market, breakthroughs were achieved in countries such as Eastern Europe and Central America through strengthened cooperation with overseas carriers, in addition to maintaining continuous growth in traditional markets such as India.

In terms of 3G products, the Group has completed preparations for the construction of its domestic 3G network. In TD-SCDMA testing, products of the Group have achieved anticipated results. At the same time, experiments on WCDMA and CDMA-EVDO and commercial use of the Group's products have also expanded overseas as it concluded the world's first EV-DO Rev.A commercial contract. WCDMA partnerships have been established with multinational carriers in developed markets.

Optical communications and data communications products

The Group provides a variety of data communications equipment such as NGN, IPTV, DSL systems, routers, routing switches and wireless access data products. During the first half of 2006, optical communications and data products maintained their growth trend. IPTV continued to expand on its leading position, and constructed the first IPTV commercial network of H.264 standard in China. The Group strengthened its cooperation at a deeper level with carriers through large-scale applications in major cities such as Beijing and Shanghai, demonstrating to the Group's domestic and overseas customers the Company's technological capabilities in developing high-end business. In line with the adjustment in the investment direction of domestic carriers, there was growth in the broadband access and multimedia terminals businesses. There was also growth in the sales of transmission products to major domestic carriers, as the Group successfully bidded for the six transmission cables of China Telecom. In the international market, the Group achieved breakthroughs in certain countries in the Asia-Pacific and Africa, while entering into cooperation with certain multinational carriers in the developed markets.

Wireline switch and access products

Traditional switch and access markets experienced a significant decline during the first six months of 2006, with domestic carriers diverting their investment focus to the implementation of network intelligence projects. In close tracking of such adjustment, the Group provided to the carriers conceptual input and suggestions for the construction of fixed line networks with a view to opening up a market niche for other products. Fixed line intelligence products of the Group, particularly caller tunes and multimedia messaging systems, experienced rapid growth.

Handsets

The global terminals market maintained relatively rapid growth over the past two years. According to the statistics from Gartner, total handset delivery for the first quarter of this year reached 224 million, increasing 23.8% as compared to the same period last year, with particularly strong user growth in developing markets. During the first quarter, sales in Eastern Europe, Middle East and Africa, Latin America and Asia-Pacific regions grew by more than 30% as compared to the same period last year. Strong sales of low-end and ultra low-end handsets are pivotal to the growth in developing markets.

The Group's handsets business enjoyed sound growth in the first half of the year in line with developments in the global trend. The Group provides handsets of various technical specifications ranging from 2G to 3G. During the first six months of 2006, the Group continued to increase its investment in the research and development of handsets, particularly that of 3G handsets, and introduced a variety of models that had been designed to meet market trends and development, including GSM/PHS and 3G products. At the same time, the Group sought to sustain profitability through strict cost control. In terms of market sales, the Group mainly entered into direct sales with carriers. By expanding its cooperation with overseas carriers, such as those in the India market, and providing products that cater local needs, the Group successfully mitigated the negative impact of the decline of the domestic market for PHS handsets and achieved continuous growth for this product.

The Group's 3G handsets and data cards have further expanded in the international market, with growth in both sales and number of customers. The Group has continued to provide multinational carriers in developed countries with WCDMA terminals. EV-DO network cards have been the subject of bulk purchases by mainstream carriers in developed countries in North America. In relation to TD-SCDMA, the Group has also successfully obtained the first approval for the network trial of the TD-SCDMA terminal from the Ministry of Information Industry. The Group will continue to promote customer relationship with carriers, especially cooperation with multinational carriers, by providing more new models and customised products, in order to promote the sales of 3G handset products.

(II) MANAGEMENT DISCUSSION AND ANALYSIS IN ACCORDANCE WITH PRC GAAP

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

1. Analysis of the results of the principal operations

Increase/decrease in revenue, profit from principal operations and net profit, net cashflow from operating activities and net increase in cash and cash equivalents:

Unit: RMB in thousands

Item	For the current period	For the corresponding period last year	Percentage increase/ decrease
Revenue from principal operations	**10,490,529**	10,302,998	1.82%
Profit from principal operations	**3,619,670**	3,843,072	-5.81%
Net profit	**373,468**	687,663	-45.69%[1]
Net cashflow from operating activities	**(2,834,793)**	(2,587,873)	-9.54%
Net increase in cash and cash equivalents	**(2,592,423)**	(3,800,867)	31.79%[2]

Note 1: The 45.69% decrease in net profit over the same period last year was mainly attributable to reduced profit margin of our principal operations for the current period coupled with increased operating expenses and research and development costs (reflected in administrative expenses).

Note 2: The net increase in cash and cash equivalents increased by 31.79% compared to the corresponding period last year, which was mainly attributable to the increase in bank loans.

2. Analysis of financial position

Unit: RMB in thousands

Item	As at 30 June 2006	As at 31 December 2005	Percentage increase/ decrease
Total assets	**21,771,318**	21,779,131	-0.04%
Trade receivables	**4,373,263**	3,441,922	27.06%[1]
Inventory	**2,868,071**	2,519,547	13.83%
Owner's equity (excluding minority interests)	**10,251,664**	10,125,095	1.25%

Note 1: The balance of trade receivables at the end of the period increased by 27.06% over the opening balance mainly as a result of the increase in contract payments due from customers.

3. Financial indicators for the reporting period and comparison with the corresponding period last year by industry and product segment

By industry or product	Revenue from principal operations (RMB in thousands)	Cost of principal operations (RMB in thousands)	Profit margin of principal operations	Increase/decrease in revenue from principal operations compared with the same period last year	Increase/decrease in cost of principal operations compared with the same period last year	Increase/decrease in profit margin compared with the same period last year
I. By Industry						
Telecommunications Equipment Industry	10,490,529	6,826,915	34.50%	1.82%	6.28%	Decrease by 2.8 percentage points
II. By Product						
Wireless communications products	3,513,422	1,939,906	44.37%	-25.21%	-20.41%	Decrease by 3.39 percentage points
Wireline switch and access products	1,074,977	683,234	36.02%	49.18%	81.12%	Decrease by 11.28 percentage points
Optical and data communications products	1,710,492	1,222,698	28.10%	14.70%	24.83%	Decrease by 5.86 percentage points
Handsets	2,134,076	1,586,511	25.24%	-3.64%	-19.88%	Increase by 15 percentage points
Telecommunications software systems, services and other products	2,057,562	1,394,566	31.80%	74.59%	114.81%	Decrease by 12.76 percentage points
Total	10,490,529	6,826,915	34.50%	1.82%	6.28%	Decrease by 2.8 percentage points
Of which:						
Connected transactions*	16,508	10,945	33.70%	-48.02%	-45.99%	Decrease by 2.5 percentage points
Pricing principles for connected transactions	The prices for connected transactions between the Company and connected parties were basically consistent with market prices.					
Statement on the necessity and continuity of the connected transactions	Sales by the Company to the connected parties mainly related to distribution of the Company's products by the connected parties as agent. Such transactions will continue in future.					

Of which: Connected transactions involving sales of products or provision of labour services to the controlling shareholder and its subsidiaries by the Company during the reporting period amounted to RMB75,000.

* The above references to connected transactions relate to connected transactions as defined under PRC laws and regulations.

4. Revenue and profit from principal operations for the reporting period by geographic segment

Unit: RMB in thousands

Region	Revenue from principal operations	Increase/decrease in revenue from principal operations as compared to the same period last year	Profit from principal operations
The PRC	6,529,012	-8.76%	2,249,333
Asia (excluding the PRC)	1,746,638	-12.29%	539,700
Africa	1,416,392	36.08%	450,273
Others	798,487	595.03%	380,364
Total	10,490,529	1.82%	3,619,670

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

By product	Revenue from principal operations (RMB in thousands)	Cost of principal operations (RMB in thousands)	Profit margin from principal operations
Wireless communications products	3,513,422	1,939,906	44.37%
Wireline switch and access products	1,074,977	683,234	36.02%
Optical communications and data communications products	1,710,492	1,222,698	28.10%
Handsets	2,134,076	1,586,511	25.24%
Telecommunications software systems, services and other products	2,057,562	1,394,566	31.80%

6. The Company had no other business operations with a material impact on net profit during the reporting period.

7. Significant changes in the profit structure, principal operations and structure, or the profitability of principal operations during the reporting period

(1) Analysis of reasons for significant changes in the profit structure during the reporting period compared to the previous year:

Item	**As a percentage of total profit for the six months ended 30 June 2006**	As a percentage of total profit for the twelve months ended 31 December 2005	Percentage increase/ decrease
Profit from principal operations	**749.50%**	501.07%	Increase by 248.43 percentage points[1]
Profit from other operations	**5.71%**	1.05%	Increase by 4.66 percentage points
Expenditure during the period	**698.65%**	429.40%	Increase by 269.25 percentage points[2]
Investment gains	**0.14%**	-3.95%	Increase by 4.09 percentage points
Subsidy income	**43.87%**	30.50%	Increase by 13.37 percentage points
Net balance of non-operating income/expenditure	**-0.57%**	0.73%	Decrease by 1.30 percentage points

Note 1: The increase in profit from principal operations as a percentage of total profit was mainly attributable to the growth in operating expenses and research and development costs (reflected in administrative expenses).

Note 2: The increase in expenses as a percentage of total profit was mainly attributable to the increase in marketing expenses and research and development costs (reflected in administrative expenses).

(2) Reasons for substantial changes in principal operations and structure compared to the same period last year and last year:

Product Segment	As a percentage of revenue from principal operations Compared to the full year of 2005	Compared to the first six months of 2005
Wireless communications[1]	Decrease by 7.90 percentage points	Decrease by 12.11 percentage points
Handsets	Decrease by 2.51 percentage points	Increase by 3.25 percentage points
Telecommunications software systems, services and other products	Increase by 0.76 percentage points	Increase by 1.83 percentage points
Wireline switch and access	Increase by 0.26 percentage points	Decrease by 1.15 percentage points
Optical and data communications[2]	Increase by 9.39 percentage points	Increase by 8.18 percentage points

Note 1: The significant decrease in revenue from wireless communications products as a percentage of revenue from principal operations, as compared to the same period and the full year last year, was mainly attributable to adjustments in the investment structure of domestic carriers.

Note 2: The significant increase in revenue from optical communications and data communications products as a percentage of revenue from principal operations, as compared to the same period and the full year last year, was mainly attributable to increased domestic sales of such products.

(3) There were no substantial changes in the profitability (profit margin) of principal operations compared to the previous year:

Item	**First six months of 2006**	Full year of 2005
Profit margin of principal operations	**34.50%**	34.88%

8. The Company did not hold any interest in any investee company in which the income generated accounted for more than 10% of the net profit of the Company.

9. Difficulties encountered by the Group's operations in the first half of the year

- Inadequate human resources for our international business: As we progress in our in-depth implementation of our internationalisation strategy, our demand for human resources grew rapidly. However, as the recruitment and training of international talent requires a considerable period of time, our shortage of international talent was intensified.

- Enhancement of the ability to execute turnkey projects required: We need to improve our abilities in the execution of orders, dispatch of goods and project implementation to ensure smooth delivery of turnkey projects, which are characterised by numerous execution phases, long turnover periods and complex operations.

10. Investments

(1) *Use of proceeds from the global offering of H shares*

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

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

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

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

II. As at the end of the reporting period, the aforesaid proceeds had been utilised by the Company as follows:

Unit: RMB in ten thousands

Total proceeds	354,217.8	Use of proceeds during the reporting period	19,465.7
		Use of proceeds on a cumulative basis	349,202.4

Committed projects	Amount of proceeds proposed to be invested	Any changes to project	Actual amount invested from proceeds	Earnings generated	Whether project schedule has been met	Whether expected earnings have been attained
IP switching platforms for mobile communications	24,039.0	No	24,039.0	See below	Yes	Yes
Integrated mobile broadband service systems	22,525.0	No	22,525.0	See below	Yes	Yes
High speed packet mobile communication base station systems	23,820.0	No	21,576.1	See below	Yes	Yes
Intelligent wireless integrated access systems	12,890.1	No	12,890.1	See below	Yes	Yes
Core routers	20,838.0	No	18,066.5	See below	Yes	Yes
NGN systems	20,118.0	No	20,118.0	See below	Yes	Yes
Automated optical switching network systems	17,457.0	No	17,457.0	See below	Yes	Yes
Sub-total	141,687.1	—	136,671.7	—	—	—
Overseas operations	212,530.7	No	212,530.7	See below	Yes	Yes
Total	354,217.8	—	349,202.4	See note	—	—

Note: The Group seeks to improve its utilisation of idle proceeds by applying them as working capital, subject to the project schedules, to reduce the requirements for banking facilities and achieve savings in financing costs. Meanwhile, funds will be invested in relevant projects in strict adherence to planned schedules.

III. Project progress and earnings from the projects are set out below:

IP switching platforms for mobile communications

Research and development of the project was progressing as scheduled. The IP switching platforms for mobile communications for NGN network, base station controllers and the IP switching platform supporting numerous core networks based on 3G wireless standards were completed, putting the Company in a leading position in the industry. Mass production of IP switching platforms has commenced and the project is expected to generate sound earnings following commercial application by domestic mobile networks and in numerous countries around the world.

Integrated mobile broadband service system

Research and development of the integrated service platform for this project was completed and products in connection with services including network paging, network conferences, one-touch dialing, caller tunes, soft terminal communications, SMS and WAP were being extensively used in the networks of domestic carriers. Moreover, such products were also employed to provide value-added services to telecommunications carriers in countries including Columbia, Malaysia, the Philippines and Pakistan. In future, the integrated platform will be able to support services on PSTN, PHS, GSM, CDMA, 3G and NGN networks simultaneously. Given its competitive edge in technology, this project has potentially good prospects.

High-speed packet mobile communications base station systems

Research and development for the project was progressing smoothly with the completion of development of various advanced functions and the introduction of the CDMA2000 EV-DO Rev.A system which promises superior performance. Currently, ZTE's CDMA2000 1xEV-DO products are being put to large-scale commercial application in global markets, with presence in various countries and regions including Asia-Pacific, Africa, Northern Europe and South America. ZTE became the focus of the industry after it had been officially awarded the world's first EV-DO Rev.A commercial contract in May 2006.

Intelligent wireless integrated access systems

Certain products under this project have been successfully launched following completion of product development. Meanwhile, initial results have been achieved in connection with next generation intelligent wireless integrated access system products equipped with expansion connectors to access 3G networks. As product capability continuously improves, these systems will have the capacity to meet the demands of the international market, and will become intelligent wireless integrated access systems suitable for the development of next generation networks. As a result, there will be bright prospects for such products.

Core routers

Research and development has been completed for the project, which has passed the stringent testing procedures of China Telecom Research Institute with outstanding performance. The high-end routers have been put to commercial application. Contracts have been awarded to construct core connections in the next-generation CNGI backbone networks for numerous carriers, including China Mobile and China Unicom, as well as to undertake trial projects of urban networks in various provinces for China Telecom's CN2. Positive results have been achieved in its market launch with encouraging responses from users.

NGN systems

The launch of bulk-volume media gateway equipment and softswitch control equipment in 2005 have resulted in such products becoming benchmark products in the industry. Our NGN system is currently being applied in the long-distance softswitch commercial trial network of China Telecom and the Shanghai International Station project, as well as in fixed-line convergence stations or commercial NGN projects in areas including Guangdong, Shanghai, Wuhan, Chongqing, Sichuan, Liaoning and Inner Mongolia, indicating that ZTE's proprietary NGN systems are fully capable of providing services on a large-scale and are capable of meeting increasing demands of users.

Automated optical switching network systems

Research and development of automated optical switching network systems for commercial application has been completed. Preparations for the commencement of trial stations and preliminary marketing are currently under way. Automated optical switching network technologies prepare operators for future requirements in telecommunications as they facilitate the introduction of new businesses with ease, as well as enhancing operational management of optical networks. Prospects are promising as carriers are expected to deploy automated optical switching systems in the coming years, first in the backbone networks and then gradually extending to urban and regional networks.

Overseas Operations

The investment of issue proceeds in overseas operations resulted in positive returns as the Group's overseas business recorded growth in the first half of 2006.

(2) ***Significant investments made out of funds other than proceeds from the global offering***

In May 2006, ZTE (H.K.) Limited (a wholly-owned subsidiary of the Company), and ZTE Software, a subsidiary of the Company, established Xi'an Zhongxing Software Company, Limited with a registered capital of RMB30 million. The principal scope of business of this company is: development, production and sale of telecommunications equipment, value-added services, network planning, terminal equipment, network management system, telecommunications system drivers, development, production and sales of hardware and software for service-based telecommunications businesses, development of other software and provision of related technical consultancy services and import/export businesses.

11. Other Matters

(1) The Group did not make any profit forecast on the operating results for the reporting period.

(2) The Group did not disclose any business plans for 2006 in its 2005 annual report.

(III) MANAGEMENT DISCUSSION AND ANALYSIS IN ACCORDANCE WITH HONG KONG ACCOUNTING STANDARDS

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

Turnover

Unit: RMB in millions

Product Segment	For the six months ended 30 June 2006 Revenue	As a percentage of turnover	For the six months ended 30 June 2005 Revenue	As a percentage of turnover
Wireless communications	**3,513.4**	**33.5%**	4,698.0	45.6%
Wireline switch and access	**1,075.0**	**10.3%**	720.6	7.0%
Optical and data communications	**1,710.5**	**16.3%**	1,491.3	14.5%
Handsets	**2,134.1**	**20.3%**	2,214.6	21.5%
Telecommunications software systems, services and other products	**2,057.5**	**19.6%**	1,178.5	11.4%
Total	**10,490.5**	**100.0%**	10,303.0	100.0%

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

Unit: RMB in millions

Region	For the six months ended 30 June 2006 Revenue	As a percentage of turnover	For the six months ended 30 June 2005 Revenue	As a percentage of turnover
The PRC	**6,529.0**	**62.2%**	7,155.8	69.5%
Asia (excluding the PRC)	**1,746.6**	**16.7%**	1,991.5	19.3%
Africa	**1,416.4**	**13.5%**	1,040.8	10.1%
Others	**798.5**	**7.6%**	114.9	1.1%
Total	**10,490.5**	**100.0%**	10,303.0	100.0%

The Group's turnover increased by 1.82% as compared to the same period last year to RMB10,491 million for the first six months of 2006. Turnover from international sales registered solid growth of 25.87% to RMB3,962 million. Analysed by product, revenue from the wireline switch and access segments, optical and data communications segment and telecommunications software systems segment all recorded growth from the corresponding period last year, offsetting decreases in sales revenue from the wireless communications products and handsets to result in marginal growth in total turnover for the Group for the first six months of 2006 over the same period in the previous year.

The decrease in revenue from the Group's wireless communications segment was attributable to investment adjustments in that segment by domestic carriers as compared to the same period last year.

Growth in the turnover from the Group's wireline switch and access segment was mainly attributable to increased international sales.

Growth in the turnover from the Group's optical and data communications segment was mainly attributable to increased domestic sales. Growth in the domestic sales for the Group's optical transmission products and DSL products was partially offset by decreased international sales.

Decrease in the turnover from the Group's handset products was mainly attributable to a decrease in domestic sales, although this decrease was partially offset by growth in international sales driven by record sales of 3G handsets and substantial increase of CDMA handsets over the same period in the previous year.

Increase in the turnover from the Group's telecommunications software systems, services and other products segment was mainly attributable to the substantial increase in the sales of fixed terminals, IPTVs and modems.

Cost of sales and gross profit

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

Unit: RMB in millions

	For the six months ended 30 June 2006		For the six months ended 30 June 2005	
Product Segment	Cost of sales	As a percentage of revenue from the product segment	Cost of sales	As a percentage of revenue from the product segment
Wireless communications	**1,971.8**	**56.1%**	2,517.7	53.6%
Wireline switch and access	**684.2**	**63.6%**	365.0	50.7%
Optical and data communications	**1,229.7**	**71.9%**	1,106.5	74.2%
Handsets	**1,542.4**	**72.3%**	1,872.8	84.6%
Telecommunications software systems, services and other products	**1,395.8**	**67.8%**	659.4	56.0%
Total	**6,823.9**	**65.0%**	6,521.4	63.3%

Unit: RMB in millions

	For the six months ended 30 June 2006		For the six months ended 30 June 2005	
Product Segment	Gross profit	Gross profit margin	Gross profit	Gross profit margin
Wireless communications	**1,541.6**	**43.9%**	2,180.3	46.4%
Wireline switch and access	**390.8**	**36.4%**	355.6	49.3%
Optical and data communications	**480.8**	**28.1%**	384.8	25.8%
Handsets	**591.7**	**27.7%**	341.8	15.4%
Telecommunications software systems, services and other products	**661.7**	**32.2%**	519.1	44.0%
Total	**3,666.6**	**35.0%**	3,781.6	36.7%

The cost of sales of the Group's principal operations increased 4.64% year-on-year to RMB6,824 million. The Group's overall gross profit margin dropped slightly to 35.0%, primarily as a result of reduced gross profit margin for wireless communications, wireline switch and access and other products, although the decrease was partially offset by growth in gross profit margin for handsets.

Cost of sales for the Group's wireless communications systems decreased by 21.68% to RMB1,972 million, while the segment's gross profit margin was 43.9% compared to 46.4% for the same period last year. The lower gross profit margin for wireless communications systems was mainly attributable to decreased gross profit margin for GSM systems as a result of intense competition in the market, which was partially offset by improved gross profit margin for CDMA systems and PHS systems. Gross profit margin for the Group's CDMA systems products increased mainly as a result of higher gross profit margin generated from international sales, while gross profit margin for the PHS systems benefited from network upgrade projects by domestic carriers during the period.

Cost of sales for the Group's wireline switch and access products amounted to RMB684 million, increasing by 87.45% compared to the same period last year. Gross profit margin for the Group's wireline switch and access segment decreased to 36.4% from 49.3% for the same period last year amid increasing competition for the segment.

Cost of sales for the Group's optical and data communications products amounted to RMB1,230 million, increasing by 11.13% compared to the same period last year. The increase in gross profit margin for the Group's optical and data communications segment to 28.1% from 25.8% for the same period last year was mainly attributable to the substantial increase in gross profit margin for the DSL products, which was partially offset by the decrease in gross profit margin for other products as the NGN systems have yet to be utilised on a large-scale in the domestic market.

Cost of sales for the Group's handset products amounted to RMB1,542 million, decreasing by 17.64% compared to the same period last year. Gross profit margin for the Group's handsets segment rebounded to 27.7% from 15.4% for the same period last year, which was mainly attributable to effective cost reductions resulting from improved manufacturing processes, substantial improvement in gross profit margin for international sales of CDMA handsets underpinned by increased sales volume and gross profit margin in South Asia and Latin America, and the normal sales during the current period of certain inventories for which provision for impairment losses had been made in the previous period. Overall, gross profit margin for handsets enjoyed solid year-on-year growth.

Cost of sales for the Group's telecommunications software systems, services and other products amounted to RMB1,396 million, increasing by 111.68% compared to the same period last year. Gross profit margin for the Group's telecommunications software systems, services and other products segment declined to 32.2% from 44.0% for the same period last year. The decline reflected primarily increased sales of lower margin products and decreased sales of higher margin products, such as software and services, as a percentage of total sales revenue.

Other income and revenue, net

The net amount of other income and revenue for the six months ended 30 June 2006 was RMB281 million, which was effectively even compared with the same period last year, as increased income from VAT subsidies was offset by the decrease in technology funding granted by the government.

Research and development costs

The Group's research and development costs for the first six months of 2006 increased by 9.71% to RMB1,255 million from RMB1,144 million for the same period last year, or from 11.11% to 11.97% as a percentage of turnover. The increase was mainly attributable to the increase in research and development management expenses as a result of increased technical cooperation projects and purchases of research and development equipment.

Selling and distribution costs

The Group's selling and distribution costs for the first six months of 2006 increased by 7.56% to RMB1,598 million from RMB1,485 million for the same period last year, or from 14.42% to 15.23% as a percentage of turnover, mainly as a result of increased travel and rental expenses in line with the expansion of our overseas market.

Administrative expenses

Administrative expenses increased by 32.50% to RMB652 million, as compared to RMB492 million for the same period last year, or from 4.78% to 6.21% as a percentage of income from principal operations. The increase was mainly attributable to stronger management support for marketing activities.

Other operating income/(expenses), net

The Group recorded an operating income of RMB64 million for the first six months of 2006, decreasing by 228.84% compared to RMB50 million in other operating expenses for the same period last year. This was primarily the result of a reversal in the provision for impairment in accounts receivable following a decrease in estimated loss from bad and doubtful debts, combined with an increase in exchange gains resulting from a relatively modest appreciation in the value of RMB and a realigned mix of the Group's assets and liabilities denominated in foreign currencies.

Profit from operating activities

The Group's profit from operating activities for the first six months of 2006 decreased by 43.13% to RMB507 million from RMB891 million for the first six months of 2005 primarily as a result of increased administrative expenses as a percentage of revenue from principal operations, lower gross profit margin and increased research and development costs.

Finance costs

The Group's finance costs for the first six months of 2006 decreased by 27.84% to RMB54 million from RMB75 million for the same period last year primarily as a result of lower financing costs owing to reduced factoring loans.

Tax

The Group's income tax expense for the first six months of 2006 decreased by 30.07% to RMB52 million from RMB74 million for the same period last year, but increased from 9.11% to 11.47% as a percentage of pre-tax profit. The increase was mainly attributable to the decrease in contribution to profit before taxation from subsidiaries of the Group which were entitled to lower tax rates or other tax concessions.

Minority interests

The Group's minority interests for the first six months of 2006 amounted to RMB54 million, 33.55% down from RMB82 million for the same period last year, but rose from 11.0% to 13.52% as a percentage of net profit. The rise was mainly attributable to reduced operating profit for the period.

Net profit and net profit margin

Net profit (after minority interests) of the Group for the period decreased by 47.44% to RMB347 million, compared to RMB660 million for the same period in 2005. Net profit margin (excluding minority interests) was lower at 3.3% compared to 6.4% for the same period in 2005.

Cash flow data

Unit: RMB in millions

Item	For the six months ended 30 June 2006	For the six months ended 30 June 2005
Net cash inflow/(outflow) from operating activities	**(2,909.7)**	(2,579.5)
Net cash inflow/(outflow) from investing activities	**(307.3)**	(430.6)
Net cash inflow/(outflow) from financing activities	**681.0**	(806.4)
Net increase/(decrease) in cash and cash equivalents	**(2,536.0)**	(3,816.5)

Operating activities

The Group had a net cash outflow from operating activities of RMB2,910 million for the first six months of 2006 compared to a net cash outflow of RMB2,580 million for the same period last year, primarily as a result of the cash outflow of RMB3,641 million resulting from an increase in working capital for the first six months of 2006 compared to a net cash outflow of RMB3,278 million for the first six months of 2005, and the reduction of operating profit before changes in working capital by 24.09% to RMB731 million for the first six months of 2006 from RMB963 million for the first six months of 2005. The increase in working capital was mainly attributable to an increase of RMB1,656 million in trade and bills receivables and RMB560 million in contract amounts due from customers coupled with increased inventory, while trade and bills payables and contract amounts due to customers decreased. Trade and bills receivables for the first six months of 2006 increased in line with the increase in the percentage completion of contracted projects ahead of schedule, and contract amounts due from customers increased as a result of business growth and a cumulative increase of outstanding sales contracts. The reduction in contracted services due to customers reflected the decrease in prepayments received by the Group for telecommunications contracts. Reductions in trade and bills payables reflected the increase in payments to suppliers.

Investing activities

The net cash outflow from the Group's investment activities for the first six months of 2006 was RMB307 million compared to RMB431 million for the same period last year. The cash was mainly used for building refurbishment in the expansion of the Group's operations and scale of production, including acquisition of equipment and facilities, testing apparatus, computers and additional office equipment, as well as in the construction of the ZTE Industrial Park in Shenzhen and research and development centers in Nanjing and Shanghai.

Financing activities

The Group had a net cash inflow from financing activities for the first six months of 2006 of RMB681 million, which mainly represented bank loans in the amount of RMB680 million borrowed during the period.

Disclosure required under the Hong Kong Stock Exchange Listing Rules

In compliance with paragraph 40 of Appendix 16 to the Hong Kong Stock Exchange Listing Rules, the Company confirms that, save as disclosed herein, there has been no material change in the current information regarding the Company in relation to those matters set out in paragraph 32 of Appendix 16 to the Hong Kong Stock Exchange Listing Rules from the information disclosed in the 2005 Annual Report of the Company.

(IV) BUSINESS OUTLOOK AND RISK EXPOSURE FOR THE REMAINDER OF 2006

1. Business outlook for the remainder of 2006

In view of the market situation and competition, both domestic and international, the Group will seek to improve its operating performance during the second half of the year by focusing its efforts on the following:

- continuing to focus on refined management and operational efficiency of the international distribution system and increase efforts to achieve breakthroughs in developed countries and the market for multi-national carriers, to further improve the Group's competitiveness in the international market;

- continuing to consolidate and optimise domestic marketing regimes; and

- implementing the shift in focus from business and technology-based units to sales-based units with a view to enhancing the management of product line operation and its profitability.

2. Risk exposure

The Group's international business involves more than 100 countries and regions in which major differences exist in terms of politics, laws, taxation, market profile and culture, imposing high demands on the business capabilities of the Group.