

BALANCE SHEET

(Prepared under PRC GAAP)

Amounts in RMB'000

Assets	Note V	30 June 2006		31 December 2005	
		Consolidated (Unaudited)	Company (Unaudited)	Consolidated (Audited)	Company (Audited)
Current assets:					
Cash in banks and on hand	1	2,980,709	1,975,186	5,573,132	4,258,936
Bills receivable	2	1,969,091	1,805,225	1,244,853	1,209,151
Dividends receivable		—	13,385	—	16,465
Trade receivables	3	4,373,263	5,249,879	3,441,922	4,481,796
Factored trade receivables	4	36,040	4,961	36,416	5,007
Other receivables	5	338,780	1,753,262	279,975	1,230,352
Prepayments	6	71,241	28,154	151,174	67,305
Inventories	7	2,868,071	1,572,591	2,519,547	1,557,312
Amount due from customers for contract work	8	5,249,600	5,141,382	4,689,157	4,440,842
Prepaid expenses		2,834	—	—	—
Total current assets		17,889,629	17,544,025	17,936,176	17,267,166
Long-term investments:					
Long-term equity investments	9	93,381	2,928,056	85,459	2,833,305
Fixed assets:					
Fixed assets — cost	10	3,861,460	2,646,009	3,623,940	2,491,000
Less: accumulated depreciation	10	1,331,844	812,881	1,148,789	712,768
Net fixed assets	10	2,529,616	1,833,128	2,475,151	1,778,232
Less: fixed asset impairment	10	94,980	87,002	94,980	87,002
Fixed assets — net	10	2,434,636	1,746,126	2,380,171	1,691,230
Construction in progress	11	209,250	179,557	126,741	77,261
Total fixed assets		2,643,886	1,925,683	2,506,912	1,768,491
Intangible and other assets:					
Intangible assets	12	154,354	76,631	160,264	87,081
Long-term trade receivables		202,843	202,843	307,666	327,122
Factored long-term trade receivables	4	692,483	688,359	687,765	683,598
Long-term deferred assets	13	13,766	—	13,996	—
Total intangible and other assets		1,063,446	967,833	1,169,691	1,097,801
Deferred taxes:					
Deferred tax assets	14	80,976	76,419	80,893	76,419
Total assets		21,771,318	23,442,016	21,779,131	23,043,182

Notes on pages 140 to pages 194 form an integral part of these financial statements.

Hou Weigui
Legal representative

Wei Zaisheng
Chief Financial Officer

Shi Chunmao
Head of Finance Division

BALANCE SHEET
(Prepared under PRC GAAP)

Amounts in RMB'000

Liabilities and owner's equity	Note V	30 June 2006		31 December 2005	
		Consolidated (Unaudited)	Company (Unaudited)	Consolidated (Audited)	Company (Audited)
Current liabilities:					
Short-term loans	15	180,700	100,000	99,695	—
Bank advances on factored trade receivables	4	36,040	4,961	36,416	5,007
Bills payable	16	2,708,217	2,532,422	1,977,584	1,918,831
Accounts payable	17	3,326,232	5,535,973	4,292,208	6,538,622
Amount due to customers for contract work	8	509,624	509,624	733,455	688,876
Advances from customers	18	771,833	464,744	861,024	493,438
Accrued payroll	19	233,225	120,183	622,804	367,583
Welfare payable		317,856	237,371	394,216	326,370
Dividends payable	20	386,183	239,872	163,008	928
Taxes payable	21	(769,073)	(621,308)	(670,282)	(844,875)
Sundry payables		6,612	2,709	7,134	2,996
Other payables	22	583,204	1,160,567	626,066	1,084,091
Accrued expenses	23	361,577	287,896	346,668	286,561
Provisions	24	27,406	12,800	20,035	16,000
Long-term loans due within one year	25	500,000	500,000	500,000	500,000
Total current liabilities		9,179,636	11,087,814	10,010,031	11,384,428
Non-current liabilities:					
Long-term loans	26	680,000	600,000	80,000	—
Bank advances on factored long-term trade receivables	4	692,483	688,359	687,765	683,598
Other long-term liabilities	27	411,751	350,820	405,511	359,220
Total non-current liabilities		1,784,234	1,639,179	1,173,276	1,042,818
Total liabilities		10,963,870	12,726,993	11,183,307	12,427,246
Minority interests:					
Minority interests		555,784	—	470,729	—
Owner's equity:					
Share capital	28	959,522	959,522	959,522	959,522
Capital surplus	29	5,507,183	5,533,654	5,506,424	5,532,896
Surplus reserves	30	1,264,060	769,603	1,264,060	769,603
of which: statutory welfare fund		344,908	242,464	344,908	242,464
Undistributed profits	31	2,544,658	3,454,786	2,171,190	3,116,070
Exchange differences		(23,759)	(2,542)	(15,981)	(2,035)
Declared cash dividends		—	—	239,880	239,880
Total owner's equity		10,251,664	10,715,023	10,125,095	10,615,936
Total liabilities and owner's equity		21,771,318	23,442,016	21,779,131	23,043,182

Notes on pages 140 to pages 194 form an integral part of these financial statements.

Hou Weigui
Legal representative

Wei Zaisheng
Chief Financial Officer

Shi Chunmao
Head of Finance Division

INCOME STATEMENTS AND STATEMENTS OF INCOME DISTRIBUTION

(Prepared under PRC GAAP)

Amounts in RMB'000

Item	Note V	For the six months ended 30 June 2006		For the six months ended 30 June 2005	
		Consolidated (Unaudited)	Company (Unaudited)	Consolidated (Unaudited)	Company (Unaudited)
1. Revenue from principal operations	32	10,490,529	9,737,942	10,302,998	9,952,489
Less: Cost of sales	32	6,826,915	7,969,060	6,423,483	8,109,916
Taxes and surcharges	33	43,944	18,395	36,443	11,474
2. Profit from principal operations		3,619,670	1,750,487	3,843,072	1,831,099
Add: Profit from other operations	34	27,556	228,558	2,735	4,178
Less: Selling and distribution expenses		1,567,996	965,499	1,447,211	1,156,146
General and administrative expenses		1,752,021	663,110	1,588,646	685,648
Finance expenses	35	54,064	72,993	98,706	106,277
3. Operating profit		273,145	277,443	711,244	(112,794)
Add: Investment income	36	694	64,841	(289)	256,272
Subsidy income	37	211,860	24,510	126,528	—
Non-operating income	38	3,777	1,556	11,683	4,691
Less: Non-operating expenses	39	6,534	3,634	5,111	1,017
4. Total profit		482,942	364,716	844,055	147,152
Less: Income tax		55,234	26,000	74,380	—
Minority interests		54,240	—	82,012	—
5. Net profit		373,468	338,716	687,663	147,152
Add: Undistributed profits at beginning of year		2,171,190	3,116,070	1,495,431	2,682,269
6. Distributable profit		2,544,658	3,454,786	2,183,094	2,829,421
Less: Statutory surplus reserves		—	—	—	—
Statutory welfare fund		—	—	—	—
7. Profit available for distribution to owners		2,544,658	3,454,786	2,183,094	2,829,421
Less: Ordinary share dividends payable		—	—	—	—
Ordinary share dividends converted to shares		—	—	—	—
8. Undistributed profits		2,544,658	3,454,786	2,183,094	2,829,421

INCOME STATEMENTS AND STATEMENTS OF INCOME DISTRIBUTION

(Prepared under PRC GAAP)

Amounts in RMB'000

Supplementary Information:

Item	For the six months ended 30 June 2006 (Unaudited)	For the six months ended 30 June 2005 (Unaudited)
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	—	—
5. Losses resulting from debt restructuring	—	—
6. Others	—	—

Notes on pages 140 to pages 194 form an integral part of these financial statements.

Hou Weigui
Legal representative

Wei Zaisheng
Chief Financial Officer

Shi Chunmao
Head of Finance Division

CASH FLOW STATEMENT

(Prepared under PRC GAAP)

Amounts in RMB'000

Item	Note V	For the six months ended 30 June 2006	
		Consolidated (Unaudited)	Company (Unaudited)
1. Cash flows from operating activities			
Cash received from sale of goods or rendering of services		8,954,497	8,340,632
Tax refund received		499,777	314,174
Cash received relating to other operating activities		49,949	41,697
Sub-total of cash inflow		9,504,223	8,696,503
Cash paid for goods and services		8,235,078	8,975,068
Cash paid to and on behalf of employees		2,080,913	968,665
Cash paid for all types of taxes		562,541	83,894
Cash paid relating to other operating activities	40	1,460,484	1,315,011
Sub-total of cash outflow		12,339,016	11,342,638
Net cash flow from operating activities		(2,834,793)	(2,646,135)
2. Cash flows from investing activities			
Cash received from gains of investment		126	5,630
Net cash received from disposal of fixed assets, intangible assets and other long-term assets		1,743	1,141
Sub-total of cash inflow		1,869	6,771
Cash paid for acquisition of fixed assets, intangible assets and other long-term assets		362,628	293,957
Cash paid for acquisition of equity investments		6,843	—
Sub-total of cash outflow		369,471	293,957
Net cash flow from investing activities		(367,602)	(287,186)
3. Cash flows from financing activities			
Cash received from borrowings		844,700	800,000
Sub-total of cash inflow		844,700	800,000
Cash paid for debt repayments		163,696	100,000
Cash payments for distribution of dividends and interest expenses		62,482	45,819
Sub-total of cash outflow		226,178	145,819
Net cash flow from financing activities		618,522	654,181
4. Effect of foreign exchange rate changes on cash		(8,550)	(4,610)
5. Net decrease in cash and cash equivalents		(2,592,423)	(2,283,750)

Notes on pages 140 to pages 194 form an integral part of these financial statements.

Hou Weigui
Legal representative

Wei Zaisheng
Chief Financial Officer

Shi Chunmao
Head of Finance Division

CASH FLOW STATEMENT

(Prepared under PRC GAAP)

Amounts in RMB'000

Item	For the six months ended 30 June 2006	
	Consolidated (Unaudited)	Company (Unaudited)
1. Reconciliation of net profit to cash flows from operating activities		
Net profit	373,468	338,716
Add: Minority interests	54,240	—
Provision for impairment of assets	10,308	(61,746)
Depreciation of fixed assets	216,937	136,405
Amortisation of intangible assets	24,911	20,766
Increase in prepaid expenses	(2,834)	—
Increase/(decrease) in accrued expenses	22,280	(1,865)
Losses on disposal of fixed assets, intangible assets and other long-term assets	4,866	3,634
Finance expenses	36,767	49,721
Gain on investment	(694)	(64,841)
Decrease/(increase) in inventories	(117,288)	268,827
Increase in operating receivables	(2,344,358)	(2,697,642)
Decrease in operating payables	(1,113,313)	(638,110)
Deferred tax assets	(83)	—
Net cash flow from operating activities	(2,834,793)	(2,646,135)
2. Net decrease in cash and cash equivalents		
Cash at end of period	2,980,709	1,975,186
Less: Cash at beginning of period	5,573,132	4,258,936
Net decrease in cash and cash equivalents	(2,592,423)	(2,283,750)

Notes on pages 140 to pages 194 form an integral part of these financial statements.

Hou Weigui
Legal representativeWei Zaisheng
Chief Financial OfficerShi Chunmao
Head of Finance Division

NOTES TO FINANCIAL STATEMENTS

(Prepared under PRC GAAP)

30 June 2006

(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 (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. Limited transferred its entire shareholdings in the Company to in 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 (collectively the "Group") 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.

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.

I. COMPANY BACKGROUND (continued)

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 RMB800,755,200. 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 RMB959,521,650.

NOTES TO FINANCIAL STATEMENTS

(Prepared under PRC GAAP)

30 June 2006

(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 RMB30.76, which is 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 (such price to be on an ex-rights basis and net of any dividends, bonus issues and capitalization 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 30 June 2006, the total accumulated share capital in issue of the Company was 959,521,650 shares. Please see Notes V.28 for details.

II. PRINCIPAL ACCOUNTING POLICIES, ACCOUNTING ESTIMATES AND PREPARATION OF CONSOLIDATED 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 in thousands, unless otherwise stated.

4. Recording basis and accounting principle

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

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

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 prevailing at the beginning of the month.

At the end of the period, balance of foreign currency accounts is adjusted at the mid-point exchange rates quoted by the People's Bank of China at the end of the period. Exchange differences arising from these translations are recorded in the current income statement as profit or loss from exchange differences. 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 profits", are translated at the exchanged rates prevailing at the transaction date; "undistributed profits" are recorded based on the amount stated on the income statements and statements of income distribution 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 items of the income statements and statements of income distribution are translated to Renminbi at the average exchange rates during the period. All cash flow statement items are translated to Renminbi 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) Criteria for recognising 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.

(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 such as debtor's financial position, cashflow status etc. 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.

NOTES TO FINANCIAL STATEMENTS

(Prepared under PRC GAAP)

30 June 2006

(All amounts in RMB'000 unless otherwise stated)

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

8. Bad debts provision (continued)

- (3) A general provision refers to a bad debt provision made by the management, other than the specific provision, on the period-end balances of other receivables and prepayments 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 overseas operations
3-4 months	58%	Applicable to other receivables arising from overseas operations
4-5 months	75%	Applicable to other receivables arising from overseas operations
5-6 months	92%	Applicable to other receivables arising from overseas operations
Over 6 months	100%	Applicable to other receivables arising from overseas operations

Provision for bad debts of prepayments is made as follows:

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

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 recognised 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 inventory system.

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

9. Inventories (continued)

Inventories at the end of the period are stated at the lower of cost and net realisable value. When the provision for impairment of inventories is calculated, inventories are further classified into categories of system products and categories of terminal products (including raw materials, work-in-progress, and finished goods). The provision for impairment of inventories is made on the basis of individual categories in respect of any shortfall where the net realisable value is lower than cost. Net realisable values represent estimated selling prices less any estimated costs to be incurred to completion, estimated selling expenses and relevant tax amounts.

10. Construction contracts

The amount due from (to) customers for contract work is represented by costs incurred to date and recognised gross profit (loss) less progress billings. Contract costs are calculated at actual costs, comprising 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 recognised gross profit (loss) in excess of progress billings is recognised as assets; whereas, the amount of progress billings in excess of contract costs incurred to date plus recognised gross profit (loss) is recognised as liabilities.

The percentage of construction contract work completion is principally represented by the contract costs incurred to date as a percentage of estimated total contract costs. Revenue from construction contracts is recognised using the percentage of completion method when the contract activities have progressed to a stage where economic benefit can be reasonably foreseen.

Anticipated losses are calculated in respect of construction projects 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 recognised losses.

Upon the realisation of anticipated losses of construction projects for which estimated losses have been provided for, the estimated losses provided for will be written back and the actual amount of loss will be recognised.

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 and amortised over a period of not more than 10 years (including 10 years). The amount of initial cost of the investment falling short of the investor's share of the owner's equity in the investee company is credited to the capital reserve. In the event that the corresponding investment took place before 17 March 2003, it is included in the difference of long-term equity investments and amortised 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 recognised as investment income or loss for the current period accordingly.

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

11. Long-term investments (continued)

When the cost method is adopted, profit or cash dividends declared to be distributed by the investee enterprise should be recognised 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 period, 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 one year.

Fixed assets are recorded at cost. The cost of purchasing fixed assets comprises the purchase price, relevant 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 exceeding original estimates.

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 recognised 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, comprising direct materials, direct labor, equipment cost, installation and management fee, net profit or loss from trial run and borrowing cost for capitalisation.

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

13. Construction-in-progress (continued)

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

Provision for construction-in-progress impairment shall be made and be recognised 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. Such provision shall be determined at the difference between the carrying value of a particular construction-in-progress over its net realisable value.

14. Intangible assets

Intangible assets are recorded at the actual cost on acquisition.

Intangible assets are amortised 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 amortisation periods of intangible assets are as follows:

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

At the end of the period, 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 recognised as an impairment provision and is charged to the income statement in the current period.

15. Recognition of revenue

Construction contracts

Operating income from construction contracts is recognised by reference of the estimated completion (please refer to Note II.10) 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 recognised 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.

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

15. Recognition of revenue (continued)

Supply of labor service

The revenue from labor service is recognised 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 recognised according to the percentage of completion on the balance sheet date, otherwise revenue is recognised only to the extent of cost incurred that are expected to be recoverable.

16. Provision

The Group recognises the obligation which fulfills the following criteria and relates to contingent matters as liability: the obligation in question is a present obligation of the Group that will probably cause an outflow of economic benefits and can be reliably measured.

17. Income tax

The Group adopts tax-effect accounting method for accounting the enterprise income tax and adopts the liability method for determining the timing difference on income tax.

18. Subsidy income

The subsidy income is mainly derived from refunds of VAT, 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, contributions to development fund and financial subsidy for new products.

19. Related parties

Parties are considered to be related if the Group has the ability, directly or indirectly, to control, jointly control or exercise significant influence over it in making financial and operating decisions, or where the Group and one or more parties are subject to common control by another party.

20. 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 the Company together with its subsidiaries. A subsidiary is a company in which the Company 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 accounted for using the equity 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.

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

20. Preparation of consolidated (continued)

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 unrealised profit) are eliminated in full on combination.

Please refer to Note IV to these financial statements for details of subsidiaries included in the scope of consolidation on 30 June 2006.

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 withholds income tax from its salary payments to employees based on progressive tax rates.
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.
Overseas tax	Overseas taxes are payable in accordance with tax laws of various countries and regions.

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 manufacturing enterprise, is entitled to enterprise income tax exemption in the first and second profitable year and is entitled to 50% relief in enterprise income tax from the third to fifth year. The current year is the third profitable year and the enterprise income tax rate applicable was 7.5%.

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%.

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III. TAXATION (continued)

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% relief 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.

ZTE Mobile Tech Co., Limited ("ZTE Mobile") is entitled to full exemption from enterprise income tax for two years and a 50% relief in the three years thereafter starting from the first profitable year which was effective from 1 January 2003 until 31 December 2007. The enterprise income tax rate applicable to ZTE Mobile was 7.5% during the current year.

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% relief of enterprise income tax in the third to fifth years. As the current year was the second 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.

As a software enterprise, Shenzhen Zhongxing Software Company Limited was approved as a new software enterprise and entitled to full exemption from enterprise income tax for two years and a 50% relief in the three years thereafter starting from the first profitable year which was effective from 1 January 2003 until 31 December 2007. As the current year was the fourth profitable year for the company, the enterprise income tax rate applicable to Zhongxing Software was 7.5% during the current year.

Pursuant to the Approval Notice for Deduction and Exemption of Tax (Document Shen Guo Shui Nan Zi (2004) No. 0002) issued by the Nanshan State Tax Bureau in Shenzhen, Shenzhen Lead Communications Company, Limited, as a manufacturing enterprise, is entitled to enterprise income tax exemption in the first and second profitable years and a 50% relief of enterprise income tax in the third to fifth years. The current year was the fourth profitable year and the enterprise income tax rate applicable was 7.5%.

Pursuant to the Approval Notice for Deduction and Exemption of Tax (Document Shen Guo Shui Nan Zi (2004) No. 0381) issued by the Nanshan State Tax Bureau in Shenzhen, Shenzhen Ruide Electronic Industrial Company, Limited, as a manufacturing enterprise, is entitled to enterprise income tax exemption in the first and second profitable years and a 50% relief of enterprise income tax in the third to fifth years. The current year was the third profitable year and the enterprise income tax rate applicable was 7.5%.

Pursuant to the Approval Notice for Deduction and Exemption of Tax (Document Shen Guo Shui Long Heng Zi (2004) No. 0036) issued by the Longgang State Tax Bureau in Shenzhen, Shenzhen Kangquan Electromechanical, as a manufacturing enterprise, is entitled to enterprise income tax exemption in the first and second profitable years and a 50% relief of enterprise income tax in the third to fifth years. The current year was the third profitable year and the enterprise income tax rate applicable was 7.5%.

Pursuant to the Document Shen Guo Shui Nan Jian Mian (2004) No. 0217) issued by the Nanshan State Tax Bureau in Shenzhen, Shenzhen Zhongxing Liwei Technology Company, Ltd. is entitled to enterprise income tax exemption in the first and second profitable years and a 50% relief of enterprise income tax in the third to fifth years. As the current year was the second profitable year for the company, it was exempted from enterprise income tax.

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III. TAXATION (continued)

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% relief of enterprise income tax in the third to fifth years. As the current year was the second profitable year for the company, it was exempted from enterprise income tax.

Yangzhou Zhongxing Mobile Telecom Equipment Co., Limited, Anhui Wantong Posts and Telecommunications Company, Limited and Guangdong New Pivot Technology & Service Company, Limited are subject to an enterprise income tax rate of 33%.

Shenzhen Guoxin Electronics Development Company Limited, Shenzhen Changfei Investment Company, Limited, Shenzhen Zhongxing Mobile Telecom Equipment Co., Ltd. and 深圳市興飛科技有限公司 are subject to an enterprise income tax rate of 15%.

IV. CONTROLLING SUBSIDIARIES AND JOINTLY-CONTROLLED ENTITIES

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

(1) Subsidiaries acquired during the period

Name of investee company	Registered Capital '000	Scope of business	Investment by the Company '000	Percentage of equity interests
ZTE SINGAPORE PTE. LTD.	SGD50	Sales of telecommunication products and provision of after-sales services and technical support	USD32.5	100%
ZTE Korea Limited	KRW50,000	Sales of telecommunication products and provision of after-sales services and technical support	USD53.5	100%
Xi'an Zhongxing Software Company, Limited	RMB30,000	Telecom equipment, value-added services, network engineering, terminal equipment, network management systems, communication equipment system drivers, development and production of hardware and software for telecom and servicing business, sales of the Company's products; other software development and advisory services; import and export trade of self-produced products and relevant accessories.	RMB30,000	100%
ZTE India R&D Center Private Limited	Rs.100	Research of value-added service products	Rs.100	100%

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

(2) 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 '000	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, handsfree ear piece; manufacture of handset charger
Congo-Chine Telecom S.A.R.L.	The Democratic Republic of Congo	USD17,450	51%	—	51%	USD8,900	Construction of telephone network in Congo, provision of telecom services, 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
ZTE Soft Technology Co., Ltd.	Nanjing	USD7,231	76%	—	76%	RMB45,040	Development, manufacture and sale of software products, communication 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

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

(2) 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 '000	Principal Operations
			Direct	Indirect	Effective		
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
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 communication projects
Anhui Wantong Information System Integration Company, Limited	Hefei	RMB3,000	—	95%	95%	RMB1,530	Design and installation of communication 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 of telecommunication projects

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

(2) 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 '000	Principal Operations
			Direct	Indirect	Effective		
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 — 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 communication products
Telrise (Cayman) Telecom Limited	Cayman Islands	USD50	52.85%	—	52.85%	USD2,550	R&D of softswitch technologies
Telrise INC.	Cayman Islands	USD10	—	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, 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

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

(2) 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 '000	Principal Operations
			Direct	Indirect	Effective		
ZTE Integration Telecom Ltd.	Shenzhen	RMB55,000	75%	5%	80%	RMB41,250	Research, 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
ZTE-Communication Technologies, Ltd.	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
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 product sector, manufacture, sale and after-sale services of electronic products, and corporate management consultation (subject to license where a license is required)

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

(2) 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 '000	Principal Operations
			Direct	Indirect	Effective		
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-sale services of electronic products and corporate management consultancy
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)

(2) 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 '000	Principal Operations
			Direct	Indirect	Effective		
ZTE Romania S.R.L	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) Holdings 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 electronic 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 after-sale services and technical support
ZTE Nigeria Investment Ltd.	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
ZTE Sweden AB	Sweden	USD360	—	100%	100%	USD360	Sale of communications products, provision of after-sale services and technical support
PT. ZTE Indonesia	Indonesia	USD200	99.5%	0.5%	100%	USD200	Sale of communications products, provision of after-sale services and technical support

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

(2) 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 '000	Principal Operations
			Direct	Indirect	Effective		
ZTE Istanbul Trading Ltd. Co.	Turkey	USD50	—	100%	100%	USD49.5	Sale of communications products, provision of after-sale services and technical support
ZTE Hrvatska D.O.O.	Croatia	EUR3	—	100%	100%	EUR3	Sale of communications products, provision of after-sale services and technical support
ZTE Corporation Bulgaria Ltd.	Bulgaria	USD3.5	—	100%	100%	USD3.5	Sale of communications products, provision of after-sale services and technical support
ZTE Deutschland GmbH	Germany	EUR150	—	100%	100%	EUR150	Sale of communications products, provision of after-sale services and technical support
ZTE Poland Sp.zo.o.	Poland	USD50	—	100%	100%	USD50	Sale of communications products, provision of after-sale services and technical support
Shenzhen Zhongxing Liwei Technology Company, Ltd.	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
ZiMax Technologies Inc	United States of America	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

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

(2) 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 '000	Principal Operations
			Direct	Indirect	Effective		
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-sale services and technical support
ZTE Netherlands B.V.	Holland	EUR90	—	100%	100%	EUR18	Sale of communications products, provision of after-sale services and technical support
ZTE Ghana Limited	Ghana	USD300	—	100%	100%	USD300	Sale of communications products, provision of after-sale services and technical support
ZTE (Australia) Pty Ltd.	Australia	USD200	—	100%	100%	USD200	Sale of communications products, provision of after-sale services 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
ZTE SINGAPORE PTE. LTD.	Singapore	SGD50	—	100%	100%	SGD32.5	Sale of communications products and provision of after-sales services and technical support
ZTE Korea Limited	Korea	KRW50,000	—	100%	100%	USD53.5	Sale of communications products and provision of after-sales services and technical support

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

(2) 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 '000	Principal Operations
			Direct	Indirect	Effective		
Xi'an Zhongxing Software Company, Limited	Xi'an	RMB30,000	—	100%	100%	RMB30,000	Telecom equipment, value-added services, network engineering, terminal equipment, network management systems, communication equipment system drivers, development and production of hardware and software for telecom and servicing business, sales of the Company's products; other software development and advisory services; import and export trade of self-produced products and relevant accessories
ZTE India R&D Center Private Limited	India	Rs.100	—	100%	100%	Rs.100	Research of value-added service products

(3) Jointly-controlled entities

Full name of jointly-controlled entities	Place of registration	Registered capital '000	Shareholding percentage of the Company			Investment of the Group '000	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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IV. CONTROLLING SUBSIDIARIES AND JOINTLY-CONTROLLED ENTITIES (continued)

(4) Associates

Full name of associates	Place of registration	Registered capital '000	Shareholding percentage of the Company			Investment of the Group '000	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, multilayered 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 of data centre and metropolitan/Campus networks integrated core software products

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

(4) Associates (continued)

Full name of associates	Place of registration	Registered capital '000	Shareholding percentage of the Company			Investment of the Group '000	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	—	30%	30%	HKD5,000	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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IV. CONTROLLING SUBSIDIARIES AND JOINTLY-CONTROLLED ENTITIES (continued)

(4) Associates

Full name of associates	Place of registration	Registered capital '000	Shareholding percentage of the Company			Investment of the Group '000	Principal Operations
			Direct	Indirect	Effective		
深圳市鼎力網路有限公司	Shenzhen	RMB10,000	—	35%	35%	RMB3,500	R&D, purchase and sale, and maintenance of network technology, equipment, electronic equipment, components, computer software, hardware and mechanical equipment; second-class value-added telecommunication services; operations of advertising business
深圳市富德康電子有限公司	Shenzhen	RMB6,000	—	30%	30%	RMB1,500	Manufacture and sales of micro-amplifiers, micro-speakers and electronic products, domestic business and supply and sales of materials and resources, I/E of goods and technologies (excluding items prohibited and restricted under the laws, constitutions and subject to advance examination and approval as decided by the State Council)

V. EXPLANATORY NOTES TO MAJOR ITEMS OF FINANCIAL STATEMENTS (FIGURES SET OUT BELOW REPRESENT GROUP FIGURES, UNLESS OTHERWISE STATED)

1. Cash in banks and on hand

Item	30 June 2006			31 December 2005			
	Original currency	Exchange rate	RMB equivalent	Original currency	Exchange rate	RMB equivalent	
Cash	RMB	438	1.0000	438	387	1.0000	387
	HKD	63	1.0294	65	125	1.0403	130
	USD	769	7.9956	6,149	1,138	8.0702	9,184
	BRL	77	3.6025	277	1	3.4522	3
	THB	123	0.2112	26	1,540	0.1968	303
	FEC	—	—	—	69	7.3633	508
	PKR	—	—	—	574	0.1350	77
	SAR	205	2.1441	440	92	2.1521	198
	SOS	—	—	—	42	2.5225	106
	Others			1,202			150
	Sub-total			8,597			11,046

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V. EXPLANATORY NOTES TO MAJOR ITEMS OF FINANCIAL STATEMENTS (FIGURES SET OUT BELOW REPRESENT GROUP FIGURES, UNLESS OTHERWISE STATED)

(continued)

1. Cash in banks and on hand (continued)

Item	30 June 2006			31 December 2005			
	Original currency	Exchange rate	RMB equivalent	Original currency	Exchange rate	RMB equivalent	
Bank deposits	RMB	2,051,047	1.0000	2,051,047	3,609,771	1.0000	3,609,771
	HKD	48,258	1.0294	49,677	33,408	1.0403	34,754
	USD	65,886	7.9956	526,798	154,588	8.0702	1,247,556
	BRL	4,786	3.6025	17,242	8,858	3.4522	30,580
	PKR	198,178	0.1328	26,318	651,989	0.1350	88,019
	EGP	44,033	1.3946	61,408	65,376	1.4035	91,755
	GBP	—	—	—	945	14.1349	13,357
	SEK	19,101	1.1230	21,450	2,442	1.0154	2,480
	DZD	—	—	—	35,070	0.0897	3,146
	COP	6,149,032	0.0031	19,062	5,334,654	0.0035	18,671
	CEDI	—	—	—	3,509,473	0.0008	2,808
	EUR	3,278	10.1313	33,210	19,778	9.5797	189,467
	NGN	—	—	—	334,439	0.0576	19,264
	THB	12,538	0.2112	2,648	2,747	0.1968	541
	JPY	23,094	0.0695	1,605	—	—	—
	INR	32,351	0.1782	5,765	—	—	—
	SAR	—	—	—	1,514	2.1521	3,258
	SOS	—	—	—	613	2.5225	1,546
	RUB	18,175	0.3015	5,480	38,287	0.2803	10,732
	Others	—	—	22,420	—	—	1,452
	Sub-total			2,844,130			5,369,157
Other currencies	RMB	39,730	1.0000	39,730	79,435	1.0000	79,435
	USD	10,945	7.9956	87,513	1,400	8.0702	11,298
	HKD	718	1.0294	739	14,700	1.0403	15,292
	PKR	—	—	—	54,131	0.1350	7,308
	XOF	—	—	—	5,543,000	0.0143	79,265
	Others	—	—	—	—	—	331
	Sub-total			127,982			192,929
	Total			2,980,709			5,573,132

Cash in banks and on hand of the Group at the end of the period comprised a bank guarantee deposit of RMB50,113,000, frozen bank deposits equivalent to RMB77,869,000 (including bank deposits of RMB71 million frozen by Jiangsu High People's Court as a measure to protect assets under litigation. Please refer to Note VIII "Contingent Events" to the financial statements).

Cash in banks and on hand at the end of the period decreased by 46.52% compared to the beginning of the year mainly as a result of expenses incurred by the Group during the period and payments to suppliers.

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V. EXPLANATORY NOTES TO MAJOR ITEMS OF FINANCIAL STATEMENTS (FIGURES SET OUT BELOW REPRESENT GROUP FIGURES, UNLESS OTHERWISE STATED)
(continued)

2. Bills receivable

	30 June 2006	31 December 2005
Bank acceptance bills	986,401	448,693
Commercial acceptance bills	982,690	796,160
	1,969,091	1,244,853

There was no bills receivable due from shareholders holding 5% or more in the voting shares of the Company in the balance at the end of the period.

3. Trade receivables

Ageing analysis of trade receivables is as follows:

The Group

	30 June 2006				31 December 2005			
	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	3,964,628	83.12%	52,855	1.33%	3,227,830	83.04%	109,961	3.41%
Between one to two years	593,260	12.44%	174,600	29.43%	545,333	14.03%	232,046	42.55%
Between two to three years	143,686	3.01%	106,475	74.10%	47,377	1.22%	36,826	77.73%
Over three years	68,292	1.43%	62,673	91.77%	66,628	1.71%	66,413	99.68%
	4,769,866	100%	396,603	8.31%	3,887,168	100%	445,246	11.45%

Of the balance of trade receivables as at the end of the period, RMB342,000 was due from shareholders holding 5% or more in the voting shares of the Company. Please refer to Note VII "Relationship and transactions with connected parties" to the financial statements.

Trade receivables due from the top five parties amounted to RMB2,065,551,000 in aggregate, accounting for 43.30% of the total amount of trade receivables.

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V. EXPLANATORY NOTES TO MAJOR ITEMS OF FINANCIAL STATEMENTS (FIGURES SET OUT BELOW REPRESENT GROUP FIGURES, UNLESS OTHERWISE STATED)

(continued)

3. Trade receivables (continued)

The Company

	30 June 2006				31 December 2005			
	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	4,662,701	83.39%	36,076	0.77%	4,098,984	83.76%	97,303	2.37%
Between one to two years	645,353	11.54%	155,482	24.09%	648,024	13.24%	219,505	33.87%
Between two to three years	185,703	3.32%	94,278	50.77%	46,038	0.94%	34,166	74.21%
Over three years	97,783	1.75%	55,825	57.09%	100,487	2.06%	60,763	60.47%
	5,591,540	100%	341,661	6.11%	4,893,533	100%	411,737	8.41%

Trade receivables due from the top five parties amounted to RMB3,111,485,000 in aggregate, accounting for 55.65% of the total amount of trade receivables.

Of the balance of trade receivables as at the end of the period, RMB172,000 was due from shareholders holding 5% or more in the voting shares of the Company.

4. As at 30 June 2006, trade receivables factored to obtain bank advances pursuant to an agreement with a bank entered into by the Company and a subsidiary amounted to RMB728,523,000. 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 "substance over form," as the risks and rewards associated with the creditor rights had not been fully transferred.

5. Other receivables

Ageing analysis of other receivables is as follows:

The Group

	30 June 2006				31 December 2005			
	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	802,142	70.35%	532,990	66.45%	712,063	70.65%	487,678	68.49%
Between one to two years	136,273	11.95%	88,883	65.22%	122,012	12.10%	82,721	67.80%
Between two to three years	91,491	8.02%	78,316	85.60%	83,238	8.26%	71,825	86.29%
Over three years	110,373	9.68%	101,310	91.79%	90,627	8.99%	85,741	94.61%
	1,140,279	100%	801,499	70.29%	1,007,940	100%	727,965	72.22%

V. EXPLANATORY NOTES TO MAJOR ITEMS OF FINANCIAL STATEMENTS (FIGURES SET OUT BELOW REPRESENT GROUP FIGURES, UNLESS OTHERWISE STATED)

(continued)

5. Other receivables (continued)

The Group (continued)

Amounts of other receivables due from the top five parties to the Group amounted to RMB106,614,000 in aggregate, accounting for 9.35% of the total other receivables of the Group at the end of the period.

There was no outstanding amount of other receivables due from shareholders holding 5% or more in the voting shares of the Company as at the end of the period.

Loan receivable amounted to RMB25,262,000, representing the balance of a loan of EUR 3,150,000 granted to a customer, bears an annual interest rate of 1% to 3% above the three-month Euro Inter-bank Offered Rate which will be fully repaid by February 2007, and is secured by shares of the customers' immediate holding company and the ultimate holding company. The borrower repaid the first installment payment and the executive directors of the Company are of the opinion that the value of the securities on hand approximates the loan receivable and that no provision is necessary for the loan receivable.

The Company

	30 June 2006				31 December 2005			
	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	1,476,772	58.35%	522,609	35.39%	1,058,754	54.55%	481,644	45.49%
Between one to two years	712,695	28.16%	87,211	12.24%	656,484	33.83%	82,103	12.51%
Between two to three years	247,232	9.77%	77,553	31.37%	102,262	5.27%	62,013	60.64%
Over three years	94,341	3.72%	90,405	95.83%	123,248	6.35%	84,636	68.67%
	2,531,040	100%	777,778	30.73%	1,940,748	100%	710,396	36.60%

Amounts of other receivables due from the top five parties to the Company amounted to RMB1,391,928,000 in aggregate, accounting for 55% of the total other receivables of the Company at the end of the period.

There was no outstanding amount of other receivables due from shareholders holding 5% or more in the voting shares of the Company as at the end of the period.

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V. EXPLANATORY NOTES TO MAJOR ITEMS OF FINANCIAL STATEMENTS (FIGURES SET OUT BELOW REPRESENT GROUP FIGURES, UNLESS OTHERWISE STATED)

(continued)

6. Prepayments

Ageing analysis of prepayments is as follows:

	30 June 2006		31 December 2005	
	Amount	Percentage	Amount	Percentage
Within one year	70,754	99.32%	150,991	99.88%
Between one to two years	418	0.59%	53	0.03%
Between two to three years	69	0.09%	130	0.09%
	71,241	100%	151,174	100%

There was no outstanding prepayments due from shareholders holding 5% or more in the voting shares of the Company as at the end of the period.

7. Inventories

	30 June 2006	31 December 2005
Raw materials	1,521,443	1,221,858
Materials under sub-contract processing	138,881	102,958
Work-in-progress	420,490	538,703
Finished goods	1,017,812	892,766
Science and technology research and development cost*	270,820	279,220
Less: impairment provision	501,375	515,958
	2,868,071	2,519,547

* Pursuant to 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 science and technology research and development cost. The balance of science and technology research and development cost 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 research and development cost will be set off against other long-term liabilities in respect of the project.

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V. EXPLANATORY NOTES TO MAJOR ITEMS OF FINANCIAL STATEMENTS (FIGURES SET OUT BELOW REPRESENT GROUP FIGURES, UNLESS OTHERWISE STATED)
(continued)

8. Construction contracts

	30 June 2006	31 December 2005
Amount due from customers for contract work	5,249,600	4,689,157
Amount due to customers for contract work	(509,624)	(733,455)
	4,739,976	3,955,702
Contract costs incurred plus recognised profits less recognised losses to date	21,016,727	19,420,235
Less: Progress billings	(16,276,751)	(15,464,533)
	4,739,976	3,955,702
Category	30 June 2006	31 December 2005
Construction work	3,289,799	2,420,118
Dispatch of goods	1,450,177	1,535,584
	4,739,976	3,955,702

9. Long-term equity investments

The Group

		30 June 2006	31 December 2005
Long-term equity investments			
Equity investments under cost method	(1)	43,488	43,288
Equity investments under equity method			
Equity interest in associates	(2)	43,305	35,583
Equity interest in jointly-controlled entities	(3)	6,588	6,588
Differences in equity investment	(4)	13,036	13,036
		106,417	98,495
Less: Provision for impairment of long-term investments	(5)	13,036	13,036
		93,381	85,459

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V. EXPLANATORY NOTES TO MAJOR ITEMS OF FINANCIAL STATEMENTS (FIGURES SET OUT BELOW REPRESENT GROUP FIGURES, UNLESS OTHERWISE STATED)

(continued)

9. Long-term equity investments (continued)

The Group (continued)

(1) Equity investments under cost method

Name of investee	Share of registered capital	Initial investment	Balance at the beginning of the period	Increase/ decrease in investment cost during the period	Increase/ decrease in equity during the period	Balance at the end of the period	
深圳市創新投資集團有限公司	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	
中移鼎訊通信股份有限公司	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	
貴州艾瑪特信息超市項目開發有限公司	10%	200	—	200	—	200	
			43,488	43,288	200	—	43,488

(2) Equity interest in associates

Name of investee	Share of registered capital	Initial investment	Balance at the beginning of the period	Increase/ decrease in investment costs during the period	Increase/ decrease in equity during the period	Balance at the end of the period	
ZTE IC Design Co., Ltd	40%	30,000	13,218	—	—	13,218	
Beijing Zhongxing Yuanjing Technology Co., Ltd	30%	3,000	283	—	—	283	
KAZNURTEL Limited Liability Company	49%	1,012	2,477	—	—	2,477	
WuXi Kaier Technology Company, Limited	30.88%	3,500	3,598	—	694	4,292	
Shenzhen Zhongxing Xinyu FPC Company, Limited	22.73%	2,500	2,375	—	(4)	2,371	
Shenzhen Weigao Semiconductor Company, Limited	40%	4,000	2,976	—	—	2,976	
Shenzhen Decang Technology Company Limited	40%	1,000	811	—	189	1,000	
深圳市聚飛光電有限公司	30%	4,500	4,348	—	—	4,348	
中興軟件技術(南昌)有限公司	30%	4,500	2,354	—	—	2,354	
深圳思碼特電子有限公司	30%	5,218	3,143	1,843	—	4,986	
深圳市鼎力網絡有限公司	35%	3,500	—	3,500	—	3,500	
深圳市富德康電子有限公司	30%	1,500	—	1,500	—	1,500	
			64,230	35,583	6,843	879	43,305

(3) Equity interest in jointly-controlled entities

Name of investee	Share of registered capital	Initial investment	Balance at the beginning of the period	Increase/ decrease in investment costs during the period	Increase/ decrease in equity during the period	Balance at the end of the period	
Beijing Zhongxingxin Communication Equipment Company Limited	50%	2,500	4,613	—	—	4,613	
Bestel Communications Ltd.	50%	2,050	1,975	—	—	1,975	
			4,550	6,588	—	—	6,588

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(continued)

9. Long-term investments (continued)

The Group (continued)

(4) Differences in equity investment

Name of investee	Balance at the beginning of the year	Increase during the period	Amortised during the period	Impairment during the period	Remaining value
Shenzhen Guoxin Electronics Development Company, Limited	13,036	—	—	—	13,036

(5) Provision for impairment of long-term investment

	Balance at the beginning and the end of the period
Difference in equity investment in Shenzhen Guoxin Electronics Development Company Limited	13,036

The Company

		30 June 2006	31 December 2005
Long-term equity investment			
Equity investments under equity method			
Subsidiaries	(1)	2,873,075	2,779,384
Associates	(2)	4,613	4,613
Jointly-controlled entities	(3)	18,336	18,336
Equity investments under cost method	(4)	41,488	41,288
Difference in equity investment	(5)	3,580	2,720
		2,941,092	2,846,341
Less: Provision for impairment of long-term investment	(6)	13,036	13,036
		2,928,056	2,833,305

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(continued)

9. Long-term investments (continued)

The Company (continued)

(1) Subsidiaries

Name of investee	Share of registered capital	Balance at the beginning	Increase/decrease in investment cost during the period	Increase/decrease in equity during the period*	Cash bonus for the period	Balance at the end of the period
ZTE Kangxun Telecom Co., Ltd.	90%	1,303,114	—	49,939	—	1,353,053
Shenzhen Zhongxing Mobile Telecom Equipment Co., Ltd	90%	9,414	—	13	—	9,427
ZTE (USA) Inc.	100%	(9,290)	—	(28,428)	—	(37,718)
Wuxi Zhongxing Optoelectronics Technologies Company, Limited	65%	31,617	—	1,683	—	33,300
ZTE (H.K) Limited	100%	454,727	—	(62,470)	—	392,257
Anhui Wantong Posts and Telecommunications Company, Limited	51%	22,787	—	123	—	22,910
Telrise (Cayman) Telecom Limited	52.85%	2,923	—	(12)	—	2,911
Shenzhen Guoxin Electronics Development Company Limited	90%	3,356	—	—	—	3,356
Congo-Chine Telecom S.A.R.L	51%	24,256	31,502	20,482	—	76,240
Yangzhou Zhongxing Mobile Telecom Equipment Co., Limited	65%	(28,912)	—	(743)	—	(29,655)
ZTE Mobile Tech Co., Ltd	95%	29,129	—	6,014	—	35,143
南京中興軟創科技有限責任公司	76%	103,676	—	(12,613)	—	91,063
ZTE (UK) Ltd.	51%	(16,647)	—	(6,408)	—	(23,055)
ZTE Do Brasil LTDA	100%	(10,345)	—	(9,117)	—	(19,462)
Shenzhen Zhongxing Software Company, Limited	70%	697,581	—	263,912	—	961,493
ZTE Integration Telecom Ltd	75%	78,258	—	(9,822)	—	68,436
ZTE Wistron Telecom AB	100%	2,616	—	(134)	—	2,482
ZTE-Communication Technologies, Ltd	100%	5,110	—	(2,487)	—	2,623
ZTE Corporation Mexico S. DE R. L DE C.V.	100%	(13,325)	—	(4,299)	—	(17,624)
Shenzhen Changfei Investment Company, Limited	51%	49,655	—	6,410	—	56,065
Zhongxing Telecom Pakistan (Private) Ltd.	93%	(33,902)	—	62,766	—	28,864
Guangdong New Pivot Technology & Service Company, Limited	90%	9,280	—	(432)	—	8,848
Shenzhen Zhongxing Telecom Equipment Technology & Service Company Limited	90%	34,378	—	(196,784)	—	(162,406)
Shanghai Zhongxing Telecom Equipment Technology & Service Company Limited	51%	10,589	—	5,119	—	15,708
ZTE Holdings (Thailand) Co., Ltd.	49%	(12)	—	(6)	—	(18)
ZTE (Thailand) Co., Ltd.	49%	(1,022)	—	(949)	—	(1,971)
Shenzhen Zhongxing Special Equipment Company Limited	54%	1,850	—	4,355	—	6,205
ZTE Kangxun Telecom Company India Private Ltd.	100%	(52,142)	—	(36,521)	—	(88,663)
ZTE Romania S.R.L	100%	(7,483)	—	(8,332)	—	(15,815)
ZTE Malaysia Corporation SDN. BHD.	100%	(2,579)	—	(2,878)	—	(5,457)
ZiMax (Cayman) Holding Ltd.	100%	33,167	—	12,203	—	45,370
西安中興精誠通訊有限公司	70%	12,298	—	(4,172)	1,050	7,076
Closed Joint Stock Company TK Mobile	51%	14,329	—	219	—	14,548
PT. ZTE Indonesia	99.5%	5,577	—	11,059	—	16,636
Shenzhen Zhongxing Liwei Technology Company, Ltd.	30%	15,356	—	7,049	1,500	20,905
		<u>2,779,384</u>	<u>31,502</u>	<u>64,739</u>	<u>2,550</u>	<u>2,873,075</u>

* Equity movement during the period included profit/loss for the period of RMB63,981,000.

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(continued)

9. Long-term investments (continued)

The Company (continued)

(2) Jointly-controlled entities

Name of investee	Share of registered capital	Initial investment	Balance at the beginning of the period	Increase/decrease in investment costs during the period	Increase/decrease in equity during the period	Balance at the end of the period
Beijing Zhongxingxin Communication Equipment Company Limited	50%	2,500	4,613	—	—	4,613

(3) Associates

Name of investee	Share of registered capital	Initial investment	Balance at the beginning of the period	Increase/decrease in investment costs during the period	Increase/decrease in equity during the period	Balance at the end of the period
ZTE IC Design Co., Ltd	40%	30,000	13,218	—	—	13,218
Beijing Zhongxing Yuanjing Technology Co., Ltd	30%	3,000	286	—	—	286
KAZNURTEL Limited Liability Company	49%	1,012	2,478	—	—	2,478
中興軟件技術(南昌)有限公司	30%	4,500	2,354	—	—	2,354
			38,512	18,336	—	18,336

(4) Equity investments under cost method

Name of investee	Share of registered capital	Initial investment	Balance at the beginning of the period	Increase in investment costs during the period	Increase/decrease in equity during the period	Balance at the end of the period
深圳市創新投資集團有限公司	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
中移鼎訊通信股份有限公司	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
貴州艾瑪特信息超市項目開發有限公司	10%	200	—	200	—	200
			41,488	41,288	200	41,488

(5) Difference in equity investments

Name of investee	Balance at the beginning	Increase during the period	Amortised during the period	Balance at the end
Shenzhen Guoxin Electronics Development Company Limited	13,036	—	—	13,036
Congo-Chine Telecom S.A.R.L.	(10,316)	—	860	(9,456)
	2,720	—	860	3,580

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(continued)

9. Long-term investments (continued)

The Company (continued)

(6) Provision for impairment of long-term investment

	Balance at the beginning and the end of the period
Difference in equity investment in Shenzhen Guoxin Electronics Development Company Limited	13,036

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

10. Fixed Assets

	Buildings	Leasehold improvement	Motor Vehicles	Machinery equipment	Electronic equipment	Other equipment	Total
Cost:							
At the beginning of the year	917,623	51,631	210,369	1,009,942	1,419,878	14,497	3,623,940
Additions	—	73	12,855	104,163	138,214	739	256,044
Acquisition of subsidiaries	—	—	—	—	28,277	—	28,277
Transferred from Construction in progress	—	—	(4,520)	(5,638)	(36,163)	(320)	(46,641)
Disposal and retirement	454	—	455	206	(2,854)	1,579	(160)
At the end of the period	918,077	51,704	219,159	1,108,673	1,547,352	16,495	3,861,460
Accumulated depreciation:							
At the beginning of the year	110,451	28,046	64,229	331,685	607,436	6,942	1,148,789
Provision	19,110	7,932	11,064	67,952	109,471	1,408	216,937
Transfer	—	—	(2,679)	(2,718)	(27,921)	(307)	(33,625)
Exchange realignments	244	—	55	(635)	(106)	185	(257)
At the end of the period	129,805	35,978	72,669	396,284	688,880	8,228	1,331,844
Fixed assets, net:							
At the end of the period	788,272	15,726	146,490	712,389	858,472	8,267	2,529,616
At the beginning of the year	807,172	23,585	146,140	678,257	812,442	7,555	2,475,151
Provision for impairment:							
Balance at the beginning and the end of the period	7,708	—	—	1,475	85,797	—	94,980
Fixed assets, net:							
At the end of the period	780,564	15,726	146,490	710,914	772,675	8,267	2,434,636
At the beginning of the year	799,464	23,585	146,140	676,782	726,645	7,555	2,380,171

V. EXPLANATORY NOTES TO MAJOR ITEMS OF FINANCIAL STATEMENTS (FIGURES SET OUT BELOW REPRESENT GROUP FIGURES, UNLESS OTHERWISE STATED)

(continued)

11. Construction in progress

Name of project	Budget	Amount at the	Increase during	Transfer to fixed	Other	Amount at the	Funding sources	Status
		beginning of		assets during		end of the		
		the year	the period	the period	decrease	period		
Science and Technology Park R&D Center	—	12,195	1,732	—	—	13,927	Internal resources	Main building completed
Liuxiandong ZTE Industrial Park	1,300,000	46,665	33,110	—	—	79,775	Internal resources	Work in progress
Nanjing R&D Center Phase II	—	6,008	42,365	—	—	48,373	Internal resources	Work in progress
Shanghai R&D Center Phase II	—	1,162	22,425	—	—	23,587	Internal resources	Work in progress
New plant in Wuxi	—	14,589	2,104	—	—	16,693	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	5,363	25,942	9,293	4,083	Internal resources	Work in progress
Others	—	2,727	12,980	2,335	—	13,372	Internal resources	Work in progress
	1,300,000	126,741	120,079	28,277	9,293	209,250		

Balance of construction in progress at the end of the period was 65.10% more compared to the beginning of the year mainly as a result of the increase in construction expenses relating to ZTE Industrial Park and the R&D centers in Nanjing and Shanghai.

12. Intangible assets

	Initial amount	Method of possession	Amount at	Increase/	Amortised during the period	Accumulated amortisation	Amount	Remaining years for amortisation
			the beginning of the year	decrease during the period			at the end of the period	
Software	259,235	Acquisition	108,993	18,499	22,315	154,058	105,177	5 years
Patent technology	2,396	Acquisition	1,354	—	158	1,200	1,196	1–10 years
Land use rights	19,856	Acquisition	12,859	12	209	7,194	12,662	48 years
Operating concession	77,854	Acquisition	64,014	490	2,229	15,579	62,275	20 years
			187,220	19,001	24,911	178,031	181,310	

Provision for impairment of intangible assets:

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

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(continued)

13. 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 30 June 2006, the project was not completed and the equipment supplied by the Group was accounted for as long-term deferred assets. Such assets will be amortised over a period of 5 years after the commissioning of the project.

14. Deferred tax assets

	30 June 2006	31 December 2005
Unrealised profit of the Group	4,474	4,474
Provision for maintenance	37,350	37,350
Provision for impairment of inventories	39,069	39,069
Others	83	—
	80,976	80,893

15. Short-term loans

	30 June 2006		31 December 2005	
	Original currency	RMB equivalent	Original currency	RMB equivalent
Credit loans	RMB180,700	180,700	RMB52,000	52,000
Pledged loans	—	—	PKR353,300	47,695
		180,700		99,695

The balance of short-term loans at the end of the period increased by 81.25% compared to that at the beginning of the year, reflecting mainly new loans during the period.

16. Bills payable

Included in the balance of the account was an amount of bills payable to shareholders holding 5% or more in the voting shares of the Company of RMB2,272,000. Please refer to Note VII "Relationship and transactions with connected parties" to the financial statements for details.

The balance of bills payable at the end of the period increased by 36.95% compared to that at the beginning of the year. The increase mainly reflected increased settlement of the Group's payments by bills.

17. Accounts payable

Included in the balance of the account was an amount payable to shareholders holding 5% or more in the voting shares of the Company of RMB51,889,000. Please refer to Note VII "Relationship and transactions with connected parties" to the financial statements for details.

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(continued)

18. Advances from customers

There was no outstanding advances from customers who were shareholders holding 5% or more in the voting shares of the Company.

19. Accrued payroll

	30 June 2006	31 December 2005
	233,225	622,804

The balance of accrued payroll at the end of the period decreased by 62.55% over the beginning of the year, which mainly due to the payments of payroll and bonuses accrued at the end of last year during this period together with the non-accrual of deferred bonuses during this period as a result of the planning implementation of the stock incentive proposal.

20. Dividends payable

	30 June 2006	31 December 2005
Holders of State-owned corporate shares	100,878	3,186
Holders of corporate shares/investors	150,883	159,822
Holders of domestic and overseas circulating shares	134,422	—
	386,183	163,008

The balance of dividends payable at the end of the period increased by RMB223,175,000 compared to that at the beginning of the year, representing mainly the distribution of dividend for 2005 pursuant to the resolution of the shareholders' general meeting.

21. Taxes payable

	30 June 2006	31 December 2005
Value-added tax ("VAT")	(863,820)	(802,209)
Business tax	(6,420)	5,508
City maintenance and construction tax	(1,078)	(794)
Income tax		
PRC tax	11,012	42,020
Overseas tax	72,577	72,652
Property tax	1,156	18
Individual income tax	17,500	12,523
	(769,073)	(670,282)

22. Other payables

The balance of the account comprised RMB313,000 payable to shareholders holding 5% or more in the voting shares of the Company, details of which are disclosed in Note VII "Relationship and transactions with connected parties" to the financial statements.

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(continued)

23. Accrued expenses

	30 June 2006	31 December 2005
Interest expenses	576	395
Rent and water and electricity charges	3,122	4,541
Work installation expenses	27,267	14,972
Product maintenance fee	260,998	248,998
Commission	19,722	—
Others	49,892	77,762
	361,577	346,668

24. Provisions

	30 June 2006	31 December 2005
Provision of penalty	4,035	4,035
Guarantees for quality of products	23,371	16,000
	27,406	20,035

25. Long-term loans due within one year

	30 June 2006	31 December 2005
Long-term loans	500,000	500,000

26. Long-term loans

	30 June 2006		31 December 2005	
	Original currency	RMB equivalent	Original currency	RMB equivalent
Credit loans	RMB600,000	600,000	—	—
Guaranteed loans	USD 9,648	80,000	USD 9,648	80,000
	RMB500,000	500,000	RMB500,000	500,000
Less: long-term loans due within one year		500,000		500,000
		680,000		80,000

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(continued)

27. Other long-term liabilities

	30 June 2006	31 December 2005
Government grants	411,751	405,511

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 of the year		Increase/(decrease) of number of shares during the period			Balance at the end of the period	
	Number of shares	Percentage	Bonus issue	Others	Sub-total	Number of shares	Percentage
I. Restricted Shares							
1. State owned corporate shares	392,080	40.86%	—	—	—	392,080	40.86%
2. Other domestic shares	12,714	1.32%	—	—	—	12,714	1.32%
Including:							
Domestic corporate shares	11,433	1.19%	—	—	—	11,433	1.19%
Domestic natural person shares	1,281	0.13%	—	—	—	1,281	0.13%
3. Foreign shares							
Foreign corporate shares	18,291	1.91%	—	—	—	18,291	1.91%
Total number of restricted shares	423,085	44.09%	—	—	—	423,085	44.09%
II. Unrestricted shares							
1. RMB ordinary shares	376,286	39.22%	—	—	—	376,286	39.22%
2. Overseas listed foreign shares	160,151	16.69%	—	—	—	160,151	16.69%
Total number of unrestricted shares	536,437	55.91%	—	—	—	536,437	55.91%
III. Total number of shares	959,522	100%	—	—	—	959,522	100%

29. Capital surplus

	Amount at the beginning of the year	Increase during the period	Decrease during the period	Amount at the end of the period
Share premium	5,462,657	—	—	5,462,657
Provision for equity investments	38,398	759	—	39,157
Provision for acceptance of non-cash asset donation	62	—	—	62
Other capital reserve*	5,307	—	—	5,307
	5,506,424	759	—	5,507,183

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

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(continued)

30. Surplus reserves

	Amount at the beginning of the year	Increase during the period	Decrease during the period	Amount at the end of the period
Statutory surplus reserve	919,152	—	—	919,152
Statutory welfare fund	344,908	—	—	344,908
	1,264,060	—	—	1,264,060

The Company and its subsidiaries did not appropriate net profits for the period to any surplus reserve.

31. Undistributed profits

	Amount at the beginning of the year	Increase during the period	Decrease during the period	Amount at the end of the period
	2,171,190	373,468	—	2,544,658

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 "Segment Information by Industry and Region."

Sale to the top five customers of the Group generated revenue of RMB5,446,354,000 and RMB5,599,287,000 in the six months ended 30 June 2006 and 2005, respectively, accounting for 51.92% and 54.35% of the sales revenue of the Group, respectively.

33. Taxes and surcharges for principal operations

	Six months ended 30 June 2006	Six months ended 30 June 2005
Business tax	10,156	16,034
City maintenance and construction tax	8,542	5,832
Education surcharge	10,132	14,577
Overseas taxes	15,114	—
	43,944	36,443

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(continued)

34. Profit from other operations

	Six months ended 30 June 2006	Six months ended 30 June 2005
Sales of raw materials	4,449	—
Technology service and consultation fee	22,063	2,735
Others	1,044	—
	27,556	2,735

Profit from other operations recorded a nine-fold increase from the same period last year primarily as a result of increased provision of technical and consultancy services rendered by the Group to external customers.

35. Finance Expenses

	Six months ended 30 June 2006	Six months ended 30 June 2005
Interest expenses	53,977	73,613
Less: Interest income	26,347	31,201
Loss on exchange	(17,210)	(11,302)
Cash discounts and interest subsidy	18,178	37,855
Bank charges	25,466	29,741
	54,064	98,706

36. Investment income

The Group

	Six months ended 30 June 2006	Six months ended 30 June 2005
Investment income based on equity accounting	694	347
Gain/(loss) on transfer of equity investment	—	(230)
Amortisation of differences in equity investment	—	(406)
	694	(289)

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

NOTES TO FINANCIAL STATEMENTS

(Prepared under PRC GAAP)

30 June 2006

(All amounts in RMB'000 unless otherwise stated)

V. EXPLANATORY NOTES TO MAJOR ITEMS OF FINANCIAL STATEMENTS (FIGURES SET OUT BELOW REPRESENT GROUP FIGURES, UNLESS OTHERWISE STATED)

(continued)

36. Investment income (continued)

The Company

	Six months ended 30 June 2006	Six months ended 30 June 2005
Investment income based on equity accounting	63,981	256,049
Gain/(loss) on transfer of equity investment	—	(230)
Amortisation of differences in equity investment	860	453
	64,841	256,272

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

37. Subsidy income

	Six months ended 30 June 2006	Six months ended 30 June 2005
Refund of VAT on software products*	182,190	120,528
Other subsidies	29,670	6,000
	211,860	126,528

* 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 issued by the State Council and the approval reply of the State taxation authorities in Shenzhen.

38. Non-operating income

	Six months ended 30 June 2006	Six months ended 30 June 2005
Gains from disposal of fixed assets	—	973
Income from penalty payment	2,021	2,605
Income from compensation payment	4	2,558
Reward income	784	—
Others	968	5,547
	3,777	11,683

Non-operating income decreased by 67.67% mainly as a result of gains from the disposal of fixed assets during the period and decreased in compensation received.

NOTES TO FINANCIAL STATEMENTS

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(All amounts in RMB'000 unless otherwise stated)

V. EXPLANATORY NOTES TO MAJOR ITEMS OF FINANCIAL STATEMENTS (FIGURES SET OUT BELOW REPRESENT GROUP FIGURES, UNLESS OTHERWISE STATED)

(continued)

39. Non-operating expenses

	Six months ended 30 June 2006	Six months ended 30 June 2005
Net loss on written off of assets	3,765	4,373
Donations	31	—
Penalties	1,874	—
Others	864	738
	6,534	5,111

40. Other cash outflow from operating activities

Other cash outflow from operating activities in the consolidated cash flow statement at 30 June 2006 was RMB1,460,484,000, comprising mainly expenses relating to market development and technology research and development.

NOTES TO FINANCIAL STATEMENTS

(Prepared under PRC GAAP)

30 June 2006

(All amounts in RMB'000 unless otherwise stated)

VI. SEGMENT INFORMATION BY INDUSTRY AND REGION

The Group

Items of principal operations	Revenue from principal operations		Costs of sales		Gross profit	
	Six months ended 30 June 2006	Six months ended 30 June 2005	Six months ended 30 June 2006	Six months ended 30 June 2005	Six months ended 30 June 2006	Six months ended 30 June 2005
Communication system construction income	8,185,499	7,975,797	5,134,148	4,363,750	3,051,351	3,612,047
Communication terminal equipment	2,134,076	2,214,613	1,586,511	1,980,083	547,565	234,530
Telecommunications service income	170,954	112,588	106,256	79,650	64,698	32,938
Total	10,490,529	10,302,998	6,826,915	6,423,483	3,663,614	3,879,515

Items of principal operations	Revenue from principal operations		Costs of sales		Gross profit	
	Six months ended 30 June 2006	Six months ended 30 June 2005	Six months ended 30 June 2006	Six months ended 30 June 2005	Six months ended 30 June 2006	Six months ended 30 June 2005
Domestic	6,529,012	7,155,786	4,235,735	4,698,008	2,293,277	2,457,778
Overseas	3,961,517	3,147,212	2,591,180	1,725,475	1,370,337	1,421,737
Total	10,490,529	10,302,998	6,826,915	6,423,483	3,663,614	3,879,515

The Company

Items of principal operations	Revenue from principal operations		Costs of sales		Gross profit	
	Six months ended 30 June 2006	Six months ended 30 June 2005	Six months ended 30 June 2006	Six months ended 30 June 2005	Six months ended 30 June 2006	Six months ended 30 June 2005
Communication system construction income	7,598,640	7,840,148	6,381,657	6,153,441	1,216,983	1,686,707
Communication terminal equipment	2,139,302	2,112,341	1,587,403	1,956,475	551,899	155,866
Total	9,737,942	9,952,489	7,969,060	8,109,916	1,768,882	1,842,573

Items of principal operations	Revenue from principal operations		Costs of sales		Gross profit	
	Six months ended 30 June 2006	Six months ended 30 June 2005	Six months ended 30 June 2006	Six months ended 30 June 2005	Six months ended 30 June 2006	Six months ended 30 June 2005
Domestic	5,629,221	7,062,517	4,412,500	6,019,105	1,216,721	1,043,412
Overseas	4,108,721	2,889,972	3,556,560	2,090,811	552,161	799,161
Total	9,737,942	9,952,489	7,969,060	8,109,916	1,768,882	1,842,573

NOTES TO FINANCIAL STATEMENTS

(Prepared under PRC GAAP)

30 June 2006

(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 equity holdings	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	Addition during the period	Reduction during the period	At the end of the period
Shenzhen Zhongxingxin Telecommunications Equipment Company, Limited	RMB10 million	—	—	RMB10 million

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

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

Name of corporation	At the beginning of the year		Addition during the period		Reduction during the period		At the end of the period	
	Amount	%	Amount	%	Amount	%	Amount	%
Shenzhen Zhongxingxin Telecommunications Equipment Company, Limited	358,959	37.41%	—	—	—	—	358,959	37.41%

NOTES TO FINANCIAL STATEMENTS

(Prepared under PRC GAAP)

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(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.	Investee company of the shareholder of the Company's controlling shareholder
Beijing Zhongxing 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 Corporation	Shareholder of the Company
Beijing Zhongxingxin Communication Equipment Company, Limited	Subsidiary jointly-controlled by the Company
Shenzhen Zhongxing Xinyu FPC Company, Limited	Under the same controlling shareholder as the Company
Shenzhen Gaodonghua Communication Technology Co., Ltd.	Investee 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
Shenzhen Weigao Semiconductor Company, Limited	Associate
ZTE IC Design Co., Ltd	Associate
Shenzhen Decang Technology Company Limited	Associate
中移鼎訊通信股份有限公司	Associate
深圳思碼特電子有限公司	Associate
深圳市聚飛光電有限公司	Associate

5. Major transactions between the Group and related companies during the period are as follows:

(1) Sales of goods to the connected parties:

Item	Names of companies	Six months ended 30 June 2006	Six months ended 30 June 2005
Sales of goods	Shenzhen Zhongxing Information Technology Co., Ltd.	746	3,765
	Shenzhen Zhongxingxin Telecommunications Equipment Company, Limited	75	—
	Beijing Zhongxingxin Communication Equipment Company, Limited	37	4,094
	Beijing Zhongxing Yuanjing Technology Co., Ltd.	759	2,412
	Shenzhen Weigao Semiconductor Company, Limited	—	2,792
	Xi'an Microelectronics Technology Research Institute	—	5,253
	ZTE IC Design Co., Ltd	10,049	3,639
	Shenzhen Zhongxing WXT Equipment Company, Ltd.	4,483	2,634
	中移鼎訊通信股份有限公司	359	9,337

NOTES TO FINANCIAL STATEMENTS

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

5. Major transactions between the Group and related companies during the period are as follows:
(continued)

(2) Purchase of raw materials from connected parties:

Item	Names of companies	Six months ended 30 June 2006	Six months ended 30 June 2005
Purchase of raw materials	Shenzhen Zhongxingxin Telecommunications Equipment Company, Limited	149,958	137,098
	Shenzhen Zhongxing WXT Equipment Company, Ltd	38,480	76,661
	Shenzhen Zhongxing Xindi Telecommunications Equipment Company, Limited	34,045	39,287
	Shenzhen Zhongxing Information Technology Co., Ltd.	4,244	332
	Xi'an Microelectronics Technology Research Institute	337	3,492
	Shenzhen Zhongxing Xinyu FPC Company, Limited	12,428	22,863
	Beijing Zhongxingxin Communication Equipment Company, Limited	178	76
	Shenzhen Gaodonghua Communication Technology Co., Ltd.	677	—
	Chung Hing (Hong Kong) Development Limited Company	251	5,364
	ZTE IC Design Co., Ltd	11,215	9,732
Shenzhen Decang Technology Company Limited	5,713	—	
深圳思碼特電子有限公司	444	—	

Notes:

- (1) Sales of goods to connected parties: Goods were sold to connected parties by the Company at the market price during the period.
- (2) Purchase of raw materials from connected parties: Raw materials were purchased by Company from connected parties at the market price during the period.

6. Amounts due from/to connected parties

Items	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	51,889	104,563
	Shenzhen Zhongxing WXT Equipment Company, Ltd	45,646	65,870
	Shenzhen Zhongxing Information Technology Co., Ltd.	9,362	14,910
	Shenzhen Zhongxing Xinyu FPC Company, Limited	3,108	6,005
	Shenzhen Zhongxing Xindi Telecommunications Equipment Company, Limited	9,202	27,490
	Shenzhen Gaodonghua Communication Technology Co., Ltd.	—	1,408
	Beijing Zhongxingxin Communication Equipment Company, Limited	301	182
	Xi'an Microelectronics Technology Research Institute	395	2,616
	Chung Hing (Hong Kong) Development Limited Company	—	954
	ZTE IC Design Co., Ltd	11,193	11,067
Shenzhen Decang Technology Company Limited	—	3,156	
深圳市聚飛光電有限公司	627	—	
Other payables	Shenzhen Zhongxingxin Telecommunications Equipment Company, Limited	313	313
	Lishan Microelectronics Corporation	65	—
	Shenzhen Zhongxing WXT Equipment Company, Ltd	12	—
	Beijing Zhongxingxin Communication Equipment Company, Limited	1,024	1,024
	Shenzhen Zhongxing Xindi Telecommunications Equipment Company, Limited	—	132

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(All amounts in RMB'000 unless otherwise stated)

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

6. Amounts due from/to connected parties (continued)

Items	Items Name of connected parties	Amount at the end of the period	Amount at the beginning of the period
Bills payable	Shenzhen Zhongxing WXT Equipment Company, Ltd	—	3,040
	Shenzhen Zhongxing Xinyu FPC Company, Limited	338	3,173
	Shenzhen Zhongxing Information Technology Co., Ltd.	—	401
	ZTE IC Design Co., Ltd	786	775
	Shenzhen Decang Technology Company Limited	3,866	559
	Shenzhen Zhongxing Xindi Telecommunications Equipment Company, Limited	7	—
	Shenzhen Zhongxingxin Telecommunications Equipment Company, Limited	2,272	—
Prepayments	Shenzhen Zhongxing Information Technology Co., Ltd.	3,608	3,464
	ZTE IC Design Co., Ltd	182	—
Other receivables	Shenzhen Zhongxing Information Technology Co., Ltd.	—	1,038
	Shenzhen Decang Technology Company Limited	2,500	—
Trade receivables	Shenzhen Zhongxingxin Telecommunications Equipment Company, Limited	342	177
	Shenzhen Zhongxing WXT Equipment Company, Ltd	—	9,053
	Shenzhen Zhongxing Information Technology Co., Ltd.	30	3,062
	Beijing Zhongxingxin Communication Equipment Company, Limited	9	2,070
	ZTE IC Design Co., Ltd	5,904	2,150
	中移鼎訊通信股份有限公司	54	—
	Xi'an Microelectronics Technology Research Institute	9	—
Advances from customers	Xi'an Microelectronics Technology Research Institute	—	154
	Beijing Zhongxing Yuanjing Technology Co., Ltd.	—	765
	Shenzhen Weigao Semiconductor Company, Limited	4,644	—
	中移鼎訊通信股份有限公司	294	—
Dividends payable	Shenzhen Zhongxing WXT Equipment Company, Ltd	12,087	14,837
	Lishan Microelectronics Corporation	1,380	936
	Shenzhen Zhongxingxin Telecommunications Equipment Company, Limited	89,740	2,250
	Shenzhen Zhongxing Xindi Telecommunications Equipment Company, Limited	2,299	2,299
Bills 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.

VIII. CONTINGENT EVENTS

1. On 3 November 2005, a court action was commenced by a customer against a subsidiary of the Group and the Company in respect of a claim for return of advanced payment of RMB35 million and accrued interests and compensation losses of RMB36 million, amounting to approximately RMB71 million in aggregate. As at the date of the approval of these financial statements, no decision had been made in the court proceedings. As a measure to protect assets under the litigation, the court froze cash balance of RMB71 million of the Company, but the Group had not paid any compensation in respect of this litigation. 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.

On 11 July 2006, upon approval by the court, RMB40 million out of frozen bank deposits of RMB71 million was released. Such release was secured by real estates in Nanjing owned by the Group valued at cost of RMB117.2 million. Based on legal advice from the Company's lawyer engaged for this action, the directors are of the opinion that the aforesaid litigation and securities would not have any material adverse impact on the Group's profit and assets for the current period.

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 the financial statements, no 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 this action, the Company has valid defences against the claims and, 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 a claim of consultancy fee of approximately USD90,000 (equivalent to approximately RMB726,000); a claim of agency fee of approximately USD1.19 million (equivalent to approximately RMB9,606,000); 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 the 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.

NOTES TO FINANCIAL STATEMENTS

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(All amounts in RMB'000 unless otherwise stated)

VIII. CONTINGENT EVENTS (continued)

4. In mid-2005, Zhongxing Telecom Pakistan (Pvt) Ltd, a subsidiary of the Company (hereinafter the "Pakistan Subsidiary"), 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 PKR177 million (equivalent to approximately RMB23.9 million) and a penalty of approximately PKR2,400 million (equivalent to approximately RMB324 million) for an alleged misdeclaration of imported goods by the Pakistan Subsidiary. The Central Board of Revenue ("CBR") of Pakistan, the governing authority of the Collectorate of Customs, Sales Tax and Central Excise (Adjudication/Appeals), Rawalpindi, ordered payment claims to be suspended and the dispute to be settled by the Committee for Alternate Dispute Resolution Islamabad ("ADRC"). Following thorough investigation and analysis, ADRC submitted the final report to CBR on 5 September 2005, stating its view that the Pakistan Subsidiary had completed due customs procedures for its imports and that the aforesaid administrative penalty should be repealed by the Collectorate of Customs, Sales Tax and Central Excise (Adjudication/Appeals), Rawalpindi. To date, the case is pending CBR's final decision and the Group has not made any compensation in respect of the administrative penalty notice. Based on the legal advice from the lawyer engaged by the Company for this action, the directors estimated that the maximum financial impact to the Group would be in the order of approximately PKR36 million (equivalent to approximately RMB4.8 million). The Company has made a provision of RMB4 million in respect of this claim. The aforesaid claim would not have any material adverse impact on the Group's financial position and operating results.
5. As at 30 June 2006, the Group had outstanding bank guarantees amounting RMB2,123,865,000.

IX. COMMITMENTS

	30 June 2006	31 December 2005
Capital commitments contracted but not provided for	257,595	231,561
Lease commitments	219,926	183,425
Investment commitments	—	21,065
	477,521	436,051

X. POST BALANCE SHEET EVENT

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

XI. APPROVAL OF FINANCIAL STATEMENTS

The financial statements were resolved and approved by the Board of Directors of the Company on 24 August 2006.

(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 GAAP") and the financial statements prepared under the Hong Kong accounting standard are as follow:

	Six months ended 30 June 2006	30 June 2006 Net assets RMB in thousands	Six months ended 30 June 2005	31 December 2005 Net assets RMB in thousands
Under PRC GAAP	373,468	10,251,664	687,663	10,125,095
Differences in accounting standards				
— Technology grants and research expenses under different accounting standards	(29,627)	147,555	(27,710)	177,182
— Provision for retirement benefits under accounting standards generally accepted in Hong Kong	—	(30,459)	—	(30,459)
— Recognition of negative goodwill	—	—	406	—
— Deferred tax	3,217	(18,089)	—	(21,306)
Prepared under Hong Kong accounting standard	347,058	10,350,671	660,359	10,250,512

APPENDIX

(All amounts in RMB'000 unless otherwise stated)

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

Item	Profit for the reporting period	Return on net assets		Earnings per share (RMB)	
		Fully diluted	Weighted average	Fully diluted	Weighted average
Profit from principal operations	3,619,670	35.31%	35.10%	3.77	3.77
Operating profit	273,145	2.66%	2.65%	0.28	0.28
Net profit	373,468	3.64%	3.62%	0.39	0.39
Net profits after extraordinary items	350,592	3.42%	3.40%	0.37	0.37

Net profits after extraordinary items are listed below:

	Six months ended 30 June 2006
Net profit	373,468
Less (add): Subsidy income	29,670
Non-operating income	3,777
Non-operating expenses	(6,534)
Income tax effect on extraordinary items	(4,037)
Net profits after extraordinary items	350,592

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.

(All amounts in RMB'000 unless otherwise stated)

III Breakdown of provisions for asset impairment

Item	Balance at the beginning of the year	Charge for the period	Other movements during the period	Balance at the end of the period
I. Provision of bad debt	1,173,211	24,891	—	1,198,102
Including: Trade receivables	445,246	(48,643)	—	396,603
Other receivables	727,965	73,534	—	801,499
II. Provision for impairment of inventories	515,958	(14,583)	—	501,375
Including: Raw materials	86,161	(12,397)	—	73,764
Materials under sub-contract processing	1,599	(1,599)	—	—
Work in progress	5,779	2,283	—	8,062
Finished goods	422,419	(2,870)	—	419,549
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	26,956	—	—	26,956
Including: Land use rights	6,322	—	—	6,322
Software	12,884	—	—	12,884
Operating concession	7,750	—	—	7,750

APPENDIX

(All amounts in RMB'000 unless otherwise stated)

IV. Statement of Changes in Shareholders' Equity

	Six months ended 30 June 2006	Six months ended 30 June 2005
I. Share capital:		
Balance at the beginning of the year	959,522	959,522
Addition during the period	—	—
Including: Transfer from capital reserve	—	—
Transfer from profit allocation	—	—
Share capital as enlarged by issue of new shares	—	—
Bonus share issue	—	—
Reduction during the period	—	—
Balance at the end of the period	959,522	959,522
II. Capital reserve:		
Balance at the beginning of the year	5,506,424	5,491,658
Addition during the period	759	9,408
Including: Share capital premium	—	—
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	759	4,101
Others	—	5,307
Reduction during the period	—	—
Including: Transfer to share capital	—	—
Balance at the end of the period	5,507,183	5,501,066
III. Statutory and discretionary surplus reserves:		
Balance at the beginning of the year	919,152	733,350
Addition during the period	—	—
Including: Appropriations from net profit	—	—
Transfer from statutory public welfare fund	—	—
Reduction during the period	—	—
Balance at the end of the period	919,152	733,350
Including: Statutory surplus reserve	919,152	733,350
IV. Statutory public welfare fund:		
Balance at the beginning of the year	344,908	252,006
Addition during the period	—	—
Including: Appropriations from net profit	—	—
Reduction during the period	—	—
Balance at the beginning of the period	344,908	252,006
V. Undistributed profits		
Undistributed profits at the beginning of year	2,171,190	1,495,431
Net profit for the period	373,468	687,663
Profit distribution for the period	—	—
Undistributed profits at the end of the period	2,544,658	2,183,094