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(I) MATERIAL LITIGATION OR ARBITRATION

During the year, the Group had no material litigation or arbitration. Progress during the year of litigation and arbitration proceedings occurring prior to the reporting period and other litigation and arbitration during the year were as follows:

1. In November 2005, Beijing Success Communications and Electronic Engineering Co., Ltd. instituted litigation against the Company's subsidiary Yangzhou Zhongxing Mobile Telecom Equipment Co., Ltd. (''Yangzhou Zhongxing''), and the Company to demand an indemnity of RMB71 million, comprising the refund of an advanced payment of RMB35 million and compensation for interests and other losses amounting to RMB36 million.

   The court in charge of the first trial filed a written request for instructions to the Supreme People's Court after its trial committed failed to reach a unanimous opinion following two sessions of court hearing for the first trial. The case is now pending the instructions of the Supreme People's Court. As the case is currently under trial, it is difficult at this stage to ascertain with any certainty the final outcome of the litigation. Based on the legal opinion furnished by the Company's lawyers, the Directors are of the opinion that the above litigation will not have any material adverse impact on the Group's current financial position.

2. Shenzhen Intermediate People's Court handed its judgement for the first trial of the litigation instituted by the Company against Fairchild Semiconductor Corporation in November 2006, ordering Fairchild Semiconductor Corporation to pay an indemnity of RMB65,733,478 to ZTE. Fairchild Semiconductor Corporation has filed an appeal to the Guangdong Provincial People's High Court against the first trial judgement.

3. On December 2005, a supplier of the Company alleged that the Company had breached the supply contract and infringed its intellectual property and claimed indemnity for a total amount of US$36.45 million (approximately RMB294.2 million) by instituting overseas arbitration.

   As at the date of publication of this report, the arbitration tribunal had been formed and the Company had filed its defences and paid the arbitration fees. As the arbitration authority had yet to issue an award, it is difficult at this stage to ascertain with any certainty the final outcome of the arbitration. Based on the legal opinion furnished by the Company's lawyers, the Directors are of the opinion that the above case will not have any material adverse impact on the Group's current financial position.

4. In August 2005, an Indian consultant firm issued an arbitration notice to the Company to claim indemnity for a total amount of approximately US$1,714,000 (approximately RMB13,384,000) in respect of advisory fees, agency fees and related damages. The consultant firm subsequently raised its total claim amount to approximately US$2,143,000 (approximately RMB16,734,000).

   As at the date of this annual report, the Terms of Reference submitted by the two parties to the case had not been approved by the Commission on Arbitration of the International Chamber of Commerce. As the case is currently under trial, it is difficult at this stage to ascertain with any certainty the final outcome of the arbitration. Based on the legal opinion furnished by the Company's lawyers, the Directors are of the opinion that the above case will not have any material adverse impact on the Group's current financial position.

5. An administrative penalty notice had been served upon Zhongxing Telecom Pakistan (Pvt) Ltd, a subsidiary of the Company (the ''Pakistanis Subsidiary''), by the Rawalpindi Collectorate of Customs in respect of a claim of additional custom duties of approximately 177 million Pakistan Rupee (approximately RMB23.9 million) for the misdeclaration of the imported goods by the Pakistanis Subsidiary. Subsequently, Rawalpindi Collectorate of Customs raised the claim of additional custom duties to approximately 240 million Pakistan Rupee (approximately RMB31.2 million) and a fine of approximately 2.4 billion Pakistan Rupee (approximately RMB324 million). In September 2005, the Committee for Alternate Dispute Resolution Islamabad (ADRC) appointed by the Central Board of Revenue (CBR) of Pakistan to resolve

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the dispute furnished a Report of Committee to CBR. As at the date of this annual report, the Group was awaiting the final decision of the CBR and no administrative penalties had yet been paid. Based on the legal opinion on the dispute furnished by the lawyers engaged by the Company and the ADRC report, the Directors are of the opinion that the Company has sufficient and valid reasons to believe that the CBR will give a just ruling based on the ADRC report and this matter would not have any material adverse impact on the Group's current financial position.

6. In August 2006, a certain customer instituted arbitration against the Company and demanded indemnity in the amount of 762,982,000 Pakistan Rupee (approximately RMB97,890,000). As at the date of this annual report, the arbitration authorities had not granted any ruling to establish whether there had been a breach of contract and to determine the amount of loss. Meanwhile, the Company had put forth counter-claims of breach of contract against the customer and demanded it to pay indemnity in respect of the Company's losses arising from its breach of contract. As the arbitration authorities has yet to grant any ruling, it is difficult at this stage to ascertain with any certainty the final outcome of the arbitration. Based on the legal opinion furnished by the Company's lawyers, the Directors are of the opinion that the above case will not have any material adverse impact on the Group's current financial position.

   The Company will make timely announcement in the event of any substantial progress of the above arbitration and litigation proceedings.

(II) ACQUISITIONS, DISPOSALS OF ASSETS, MERGERS AND TAKEOVERS

The Group had no acquisition and disposal of assets, merger or takeover during the year.

(III) SIGNIFICANT CONNECTED TRANSACTIONS OF THE GROUP

1. Significant connected transactions of the Group during the year:

(1) *Significant connected transactions under applicable laws and regulations of the PRC:*

During the year, the Company has not made purchases from any one of its connected persons that exceeded 5% of the audited net assets of the Company. Ongoing connected transactions during the reporting period are set out as follows:

During the reporting period, ongoing connected transactions (as defined in the Rules Governing Listing of Stocks on Shenzhen Stock Exchange) of the Group included the purchase of raw materials from and sales of products to connected parties by the Company and its subsidiaries. Such connected transactions were conducted after arm's length negotiation on the basis of normal commercial terms. The prices at which the Group made purchases from the connected parties were not higher than the prices at which the connected parties sell similar products to other users in similar quantities. The prices at which the Group sold its products to the connected parties were not lower than the prices at which the Group sells similar products to other users in similar quantities. In addition, such connected transactions would not have any adverse impact on the Group's profit. The Company is not dependent on the connected party and the connected transactions do not affect the independence of the Company.

Details of the implementation of the Group's ongoing connected transactions during the year are set out in the following table (for information on the connected parties, their connected relationships with the Group, basic terms of the connected transactions agreements between the Group and the connected parties, estimated transaction amounts for 2006 under each agreement, impact of the connected transactions on the Group and review of the connected transactions by the general meeting or the Board of Directors of the Company, please refer to the announcement on ongoing connected transactions published by the Company on 7 April 2006 in China Securities Journal, Securities Times, Shanghai Securities News, The Standard and Hong Kong Economic Times.

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Classification of transaction	Member of the Group (party to connected transaction)	Connected person (counterparty to connected transaction)	Subject matter	Pricing basis	Amounts for connected transactions from January to December 2006 (excluding VAT) (RMB in 10,000)	As a percentage of transactions in the same classification	Settlement	Whether different from estimated status
Purchase of raw materials	ZTE Kangxun	Zhongxingxin and its subsidiaries Zhongxing Xindi, Zhongxing Xinyu	Various telecommunications products such as cabinets, cases, distribution frames, soft circuit boards and other raw materials	Consistent with market prices (as per contract)	45,081	3.28%	banker's acceptance bill	No
	ZTE Kangxun	Xi'an Microelectronics	Circuit protectors and other electronic products	Consistent with market prices (as per contract)	552	0.04%	banker's acceptance bill	No
	ZTE Kangxun	Zhongxing WXT and its subsidiary Shenzhen Gaodonghua Communication Technology Co., Ltd.	IC, connector assemblies, optical devices, modules and other ancillary equipment	Consistent with market prices (as per contract)	12,714	0.93%	banker's acceptance bill	No
	ZTE Kangxun	Chung Hing (Hong Kong) Development Limited	Printers and other electronic products	Consistent with market prices (as per contract)	22	0.00%	banker's acceptance bill	No
	Lead	Zhongxing Xinyu	Soft circuit boards and other products	Consistent with market prices (as per contract)	141	0.01%	banker's acceptance bill	No
	ZTE Kangxun	Shenzhen Zhongxing Information Technology Co., Ltd.	Dispatch exchange systems, integrated police alarm command dispatch systems, pre-hospitalisation first aid command dispatch systems	Consistent with market prices (as per contract)	682	0.05%	banker's acceptance bill	No
Product sales	The Company	Xi'an Microelectronics	Handsets and other products	Consistent with market prices (as per contract)	13	0.00%	banker's acceptance bill	No
	ZTE Kangxun	Zhongxing WXT	IC and other products	Consistent with market prices (as per contract)	563	0.02%	banker's acceptance bill	No
	The Company and ZTE Kangxun	Shenzhen Zhongxing Information Technology Co., Ltd.	Optical transmission systems, power supply equipment, data products and conferencing TV	Consistent with market prices (as per contract)	144	0.01%	banker's acceptance bill	No

Connected transactions involving sales of products or provision of labour services to the controlling shareholder and its subsidiaries by Company during the reporting period amounted to RMB6,948,000.

The Company has entered into the 2007 connected transactions framework agreements with the connected persons, which has been approved at the nineteenth meeting of the third session of the Board of Directors on 25 October 2006 and at the First Extraordinary General Meeting for 2007 on 13 March 2007. For details please refer to the announcement on ongoing connected transactions published by the Company in China Securities Journal, Securities Times and Shanghai Securities news on 26 October 2006, the announcement on the resolutions of the First Extraordinary General Meeting for 2007 published by the Company in China Securities Journal, Securities Times and Shanghai Securities News on 14 March 2007.

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(2) *Continuing connected transactions under the Hong Kong Stock Exchange Listing Rules:*

Following the listing of the Company's H shares on the Hong Kong Stock Exchange, the Group will continue certain transactions that constitute continuing connected transactions within the meaning of the Hong Kong Stock Exchange Listing Rules as stated below. With respect to the continuing connected transactions, the Hong Kong Stock Exchange has granted to the Group certain waivers from announcement and/or independent shareholders' approval requirements under the Hong Kong Stock Exchange Listing Rules. Details of such waiver have been disclosed in the prospectus of the Company dated 29 November 2004. Details of the continuing connected transactions are as follows:

a) *Purchases of handset batteries by ZTE Kangxun from Ruide*

- Description of the connected relationship between the parties to the transaction:

The Company holds 90% stake in ZTE Kangxun:

The Company holds 57.5% stake in Ruide through its subsidiaries, Shenzhen Changfei Investment Company, Limited. The other substantial shareholder of Ruide is Zhongxing Xindi with approximately 23.0% stake. The remaining stake of approximately 19.5% in Ruide is held by an individual shareholder who is a director of Ruide and a connected person of the Group (while not at the level of the Company). Zhongxing Xindi is a non-wholly owned subsidiary of Zhongxingxin and is therefore an associate of Zhongxingxin as defined under the provisions of the Hong Kong Stock Exchange Listing Rules. Zhongxingxin holds 60% stake in Zhongxing Xindi. Given that Zhongxingxin is a controlling shareholder of the Company (and also a promoter of the Company), Zhongxing Xindi, being an associate of Zhongxingxin, constitutes a connected person of the Company at the level of the Company (and not at the level of the Company's subsidiaries). In addition, given that Zhongxing Xindi is a substantial shareholder of Ruide, Ruide itself constitutes a connected person of the Group under the Hong Kong Stock Exchange Listing Rules.

- Total transaction amount for 2006:

Approximately RMB176,961,000

- Pricing and other terms:

ZTE Kangxun has entered into a framework purchase agreement dated 19 November 2004 with Ruide expiring on 31 December 2006. Ruide will still be required to undergo the Group's qualification and bidding procedures for the selection of suppliers. If Ruide succeeds in its bid to supply to ZTE Kangxun, ZTE Kangxun will issue purchase orders from time to time to Ruide pursuant to the framework agreement entered into with it. Purchase orders will specify product types, agreed quantities and prices, quality specifications, delivery times, places and modes, as well as contact details. Prices will be arrived at after arm's length negotiations, with reference to the prices quoted by Ruide for sales of similar quantities of the same or similar products to independent third parties at the relevant time.

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- Reasons for such transactions

The Group's handset products have become one of the major sources of revenue for the Company. The Directors of the Company consider it an important strategy to have a co-operative and reliable supplier for handset batteries. The Group's investment in Ruide was made with this purpose in mind. Through the Group's qualification and bidding procedures, Ruide was selected as one of our suppliers.

b) *Sales of liquid crystal displays (LCD) and electronic components by ZTE Kangxun to Lead*

- Description of the connected relationship between the parties to the transaction:

The Company is a major shareholder of Lead with a 62.5% stake. Zhongxingxin is a substantial shareholder of Lead with a 22.5% stake while an individual holds the remaining 15% stake. Given that Zhongxingxin is a connected person of the Group at the level of the Company (and not at the level of the Company's subsidiaries) and is a substantial shareholder of Lead, Lead itself constitutes a connected person of the Group under the Hong Kong Stock Exchange Listing Rules.

- Total transaction amount for 2006:

Approximately RMB6,213,000

- Pricing and other terms:

ZTE Kangxun has entered into a framework agreement dated 19 November 2004 with Lead expiring on 31 December 2006. Pursuant to the framework agreement, lead is to issue purchase orders to ZTE Kangxun from time to time, specifying product types, agreed quantities and prices, quality specifications, delivery times, places and modes, as well as contact details. Prices will be arrived at after arm's length negotiations, with reference to the prices quoted by the Group for sales of similar quantities of the same or similar products to independent third parties at the relevant time.

- Reasons for such transactions

The Group's handset products have become one of the major sources of revenue for the Company. Liquid crystal modules are required for the production of handsets and the Group does not produce such components. The production of liquid crystal modules involves the assembly of liquid crystal displays with various electronic components. As this involves merely low cost assembly work, the Directors of the Company consider it suitable for outsourcing the production of liquid crystal modules to Lead and other independent third parties. Lead was selected as our supplier through the Group's qualification and bidding procedures. As Lead does not produce the said components required for the production of liquid crystal modules, ZTE Kangxun (as the Group's principal platform for procurement) purchases liquid crystal displays and various electronic components from independent third party suppliers for onward supply to Lead. The Directors of the Company consider it to be convenient and cost effective to include Lead's requirements in ZTE Kangxun's procurements for such parts.

c) *Purchases of raw materials and components comprising primarily telecommunications cabinets, cases and racks, and distribution frames by ZTE Kangxun from Zhongxingxin, Zhongxing Xindi and Zhongxing Xinyu*

- Description of the connected relationship between the parties to the transaction:

Zhongxingxin is the largest shareholder of the Company.

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Given that Zhongxing Xindi is a non-wholly owned subsidiary of Zhongxingxin, Zhongxing Xindi is an associate of Zhongxingxin as defined under the provisions of the Hong Kong Stock Exchange Listing Rules. Zhongxingxin holds a 70% stake in Zhongxing Xindi. Given that Zhongxingxin is a controlling shareholder of the Company (and also one of the promoters of the Company), Zhongxing Xindi, as an associate of Zhongxingxin, constitutes a connected person of the Group.

Given that Zhongxing Xinyu is a non-wholly owned subsidiary of Zhongxingxin, Zhongxing Xinyu is an associate of Zhongxingxin as defined under the provisions of the Hong Kong Stock Exchange Listing Rules. Zhongxingxin holds a 55% stake in Zhongxing Xinyu. Given that Zhongxingxin is a controlling shareholder of the Company (and also one of the promoters of the Company), Zhongxing Xinyu, as an associate of Zhongxingxin, constitutes a connected person of the Group.

- Total transaction amount for 2006:

Approximately RMB450,809,000

- Pricing and other terms:

ZTE Kangxun has entered into framework purchase agreements dated 19 November 2004 with Zhongxingxin, Zhongxing Xindi and Zhongxing Xinyu, respectively. The framework agreements expired on 31 December 2006. Zhongxingxin and its relevant subsidiaries will each still be required to undergo the Group's qualification and bidding procedures for the selection of suppliers. If any one of them succeeds in its bid to supply to ZTE Kangxun, ZTE Kangxun will issue purchase orders from time to time to the successful bidder pursuant to the relevant framework agreement entered into with that bidder. Purchase orders will specify product types, agreed quantities and prices, quality specifications, delivery times, places and modes, as well as contact details. Prices will be arrived at after arm's length negotiations and on normal commercial terms.

- Reasons for such transactions

Zhongxingxin, Zhongxing Xindi and Zhongxing Xinyu were selected through the Group's qualification and bidding procedures, and the Group believes that they have consistently been able to meet the Group's stringent demands for fast product turnaround time, high product quality and timely delivery. By virtue of the foregoing, Zhongxingxin and Zhongxing Xindi were selected as the suppliers of distribution frames and packaging materials and Zhongxing Xinyu was selected as the supplier of flexible printed circuit boards. As the Group considers that having reliable and cooperative suppliers is important and beneficial to us, purchasing from Zhongxingxin, Zhongxing Xindi and Zhongxing Xinyu allows us to secure essential control over most of the components of our production by being able to ensure timely delivery of such components while maintaining product quality.

d) *Purchases of liquid crystal modules (LCM) by ZTE Kangxun from Lead*

- Description of the connected relationship between the parties to the transaction:

Lead is a connected person of the Group as its substantial shareholder, Zhongxingxin, is a connected person at the level of the Company (and not at the level of the subsidiaries of the Company). Please refer to the above for further details of Lead.

- Total transaction amount for 2006:

Approximately RMB196,576,000

- Pricing and other terms:

ZTE Kangxun has entered into a framework purchase agreement dated 19 November 2004 with Lead expiring on 31 December 2006. Lead will still be required to undergo the Group's qualification and bidding procedures for the selection of suppliers. If Lead succeeds in its bid to supply to ZTE Kangxun, ZTE Kangxun will issue purchase orders from time to time to Lead pursuant

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to the framework agreement entered into with it. Purchase orders will specify product types, agreed quantities and prices, quality specifications, delivery times, places and modes, as well as contact details. Prices will be arrived at after arm's length negotiations, with reference to the prices quoted by Lead for sales of similar quantities of the same or similar products to independent third parties at the relevant time.

- Reasons for such transactions

The Group's handset products have become one of the major sources of revenue for the Company. The Group requires steady, reliable and quality supplies of liquid crystal modules for the Group's handset products. As the production of these liquid crystal modules involves merely low value-added assembly work, there are few suppliers of raw materials and components that are able to undertake such large-scale production as required by the Group for the prices we offer. Lead was established to handle large-scale production at low unit cost and to specialise in the supply of liquid crystal modules. The Group believes that it has also been able to provide us a fast production turnaround time, consistent product quality and timely delivery. The Group has now taken a majority stake in Lead as the Directors of the Company consider that having Lead as our subsidiary allows us to secure steady supplies of quality liquid crystal modules in large volumes from a co-operative, reliable and specialised supplier that would not otherwise be easily available from other suppliers for comparable prices.

The Group has entered into connected transactions framework agreements with the above connected parties for the three years from 2007 to 2009, and has fulfilled the statutory procedure of reporting, announcement and seeking approval at the general meeting in accordance with Chapter 14A of the Hong Kong Stock Exchange Listing Rules in respect of the estimated annual caps for the connected transactions for the years 2007 to 2009. For details please refer to the announcements on ongoing connected transactions and the resolutions of the First Extraordinary General Meeting for 2007 published by the Company in The Standard and Hong Kong Economic Times on 2 November 2006 and 14 March 2007, respectively.

2. The Independent Non-executive Directors of the Company have reviewed the connected transactions of the Group and confirmed that:

- the transactions were conducted in the ordinary and usual course of business of the Company;
- the transactions were entered into on normal commercial terms; and
- the transactions were conducted in accordance with the terms of the agreements governing them and the terms of the transactions are fair and reasonable and in the interests of the shareholders of the Company as a whole.

3. The auditors of the Company have reviewed the connected transactions and confirmed to the Board of Directors of the Company that the transactions:

- were approved by the Board of Directors of the Company;
- were conducted in accordance with the pricing policies of the Company;
- were conducted in accordance with the terms of the agreements governing them; and
- within the relevant annual caps as agreed by the Hong Kong Stock Exchange.

(4) DEBTORS AND CREDITORS BETWEEN THE GROUP AND ITS CONNECTED PARTIES

Debtors and creditors between the Company and its connected parties during the year were incurred during the ordinary course of business and did not have any material impact on the Company. There were no guarantees for connected parties between the Company and its connected parties.

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(5) MATERIAL CONTRACTS OF THE GROUP

1. During the year, the Group did not put on trust, sub-contract, or lease any assets of other companies nor did other companies put on trust, sub-contract or lease any of the Company's assets of a material nature.

2. External guarantee by the Company

(1) External guarantees of the Group during the reporting period are set out as follows:

Third party guarantees provided by the Company (excluding guarantees in favour of subsidiaries)

Guaranteed party	Date of incurrence (date of execution of relevant agreements)	Amounts guaranteed	Type of guarantee	Term	Whether fully performed	Whether provided in favour of connected parties (Yes/No)
Djibouti Telecom S.A	8 September 2006	RMB50 million	Joint liability	12 years	No	No

Total amount guaranteed during the reporting period	RMB50 million
Total balance of amount guaranteed at the end of the reporting period (A)	RMB50 million
Guarantees provided in favour of subsidiaries	
Total amount guaranteed in favour of subsidiaries during the reporting period (Note 1)	US$3 million
Total amount guaranteed among subsidiaries during the reporting period	RMB47,015,000 US$117,600
Total balance of amount guaranteed in favour of subsidiaries at the end of the reporting period (B)	RMB47,015,000 US$3,117,600
Total amount guaranteed by the Company (including guarantees in favour of subsidiaries)	
Total guaranteed amount (A+B) (Note 2)	RMB121,359,400
Total guaranteed amount as a percentage of net assets of the Company at the end of the reporting period	1.14%
of which:	
Amounts of guarantees provided in favour of shareholders, de facto controllers and their connected parties (C)	0
Amount of debt guarantee provided directly or indirectly in favour of parties with a gearing ratio exceeding 70% (D)	0
Amount of total guarantee exceeding 50% of net assets (E)	0
Aggregated amount of the three guarantee amounts stated above (C+D+E)	0

Note 1: This guarantee was provided by the Company in favour of its wholly-owned subsidiary ZTE (H.K.) Limited.

Note 2: Guaranteed amounts denominated in US dollars are translated at the exchange rate of US$1 to RMB7.8087 (being the exchange rate published by the People's Bank of China on 29 December 2006).

Note 3: All external guarantees of the Company shall be submitted to the Board of Directors for its review and shall require the approval of two-thirds of the members of the Board. If such external guarantees are otherwise subject to review and approval at the general meeting, then they shall be tabled at the general meeting following approval by the Board of Directors.

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(2) Progress of previously granted guarantees during the reporting period

In January 2005, the Company performed its guarantee to make a repayment of RMB3.50 million on behalf of Chengdu Information Port Company Limited. As at the end of the reporting period, Juyou Industrial Group Limited, as counter-guarantor, had made a repayment of RMB1.55 million to the Company, and an amount of RMB1.95 million remained outstanding. The Group will continue to actively procure the settlement of the outstanding amount. (Please refer to the 2005 annual report of the Group for details of the guarantee).

3. During the year, the Group did not have any entrusted investments.

(VI) UNDERTAKINGS

1. Undertaking in respect of Share Reform

The statutory and special undertakings given by the nine holders of shares of the Company that are subject to lock-up in connection with the Share Reform are set out in the section headed "Number of shares held by shareholders subject to lock-up and terms of lock-up" in this report.

2. The above undertakings had been properly fulfilled and there had been no circumstances of violations of such undertakings.

Change in the number of circulating shares not subject to lock-up held by the original holder of non-circulating shares (Zhongxingxin) holding over 5% of the Company's shares at the end of the reporting period is set out as follows:

Name of shareholder	Circulating shares not subject to lock-up held on the date of listing of shares subject to lock-up (shares)	Increase/ decrease during the year (shares)	Reasons for change	Circulating shares not subject to lock-up held at the end of the year (shares)
Zhongxingxin	47,976,083	0	—	47,976,083

Note: As at the close of the market on 22 January 2007, Zhongxingxin had disposed of 11,489,083 A shares of the Company, accounting for 1.20% of the total share capital of the Company, through Shenzhen Stock Exchange.

3. There were no other undertakings by the Company or shareholders interested in 5% or more of the shares in the Company.

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(7) INFORMATION ON THE PHASE I SHARE INCENTIVE SCHEME OF THE COMPANY

I. Principal terms of the Phase I Share Incentive Scheme of the Company are set out as follows:

ZTE shall implement the Share Incentive Scheme by way of the grant of new shares. Specifically, ZTE shall grant to Scheme Participants a quota of 47,980,000 Subject Shares, representing approximately 5% of the Total Share Capital of ZTE. Upon the fulfilment of the unlocking conditions, Scheme Participants may apply to unlock the granted Subject Shares on an annual basis pursuant to the Share Incentive Scheme. The unlocked Subject Shares shall be freely tradable in accordance with the laws. The quota of Subject Shares shall be cancelled if the unlocking conditions are not satisfied.

2. The Share Incentive Scheme shall be in force for a term of five years, comprising a Lock-up Period of two years and an Unlocking Period of three years:

(a) The Lock-up Period shall last for a period of two years commencing from the date of approval of the Share Incentive Scheme by the general meeting of ZTE, during which the Subject Shares granted to Scheme Participants under the Share Incentive Scheme shall be subject to lock-up and shall not be transferable;

(b) The Unlocking Period shall last for three years following expiry of the Lock-up Period, during which Scheme Participants may, subject to unlocking conditions stipulated by the Share Incentive Scheme being satisfied, apply for unlocking in 3 tranches: the first unlocking period shall be the first year following the expiry of the Lock-up Period and the number of shares to be unlocked shall not exceed 20% of the aggregate number of the Subject Shares granted; the second unlocking period shall be the second year following the expiry of the Lock-up Period and the number of shares to be unlocked shall not exceed 35% of the aggregate number of the Subject Shares granted; the third unlocking period shall be the third year following the expiry of the Lock-up Period and the number of shares to be unlocked shall represent all outstanding Subject Shares. If the unlocking conditions are not satisfied in any one year during the Unlocking Period, no application made by the Scheme Participants during such year, nor in subsequent years for the unlocking of such Subject Shares will be accepted. ZTE shall return the Scheme Participants the Subscription Cost for the Subject Shares still subject to the lock-up purchased by the Scheme Participants at their own cost. The quota for such Subject Shares shall be cancelled if the unlocking conditions are not satisfied.

3. The Scheme Participants of the Share Incentive Scheme shall be the Directors and Senior Management of ZTE and Key Personnel of ZTE and its controlled subsidiaries. Scheme Participants who have participated in the Share Incentive Scheme shall not participate in ZTE's distribution of Deferred Bonus in 2006. Employees not participating in the Share Incentive Scheme will not be entitled to receive the portion of the 2006 Deferred Bonus which will be converted for Scheme Shares and which would otherwise be distributed to the Scheme Participants if they did not participate in the Share Incentive Scheme.

4. Out of the total number of Subject Shares under Share Incentive Scheme, 10% or 4,798,000 shares will be set aside for employees who make significant contributions to the Company and important personnel required by the Company who are identified after the Share Incentive Scheme has been reviewed and passed at the general meeting. The Supervisory Committee will verify the qualifications of the aforesaid employees. The admission of Directors, Supervisors and Senior Management as Scheme Participants shall be submitted to the general meeting for its approval.

5. The weighted average rates of return on net assets of ZTE for the years 2007, 2008 and 2009 shall be adopted as the results appraisal conditions to Scheme Participants' application for unlocking the Subject Shares in the first, second and third tranche, respectively. Such rates of return on net assets shall not be less than 10% (before or after extraordinary income/loss items, whichever is lower).

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6. After the Share Incentive Scheme has been approved by the general meeting and the grant conditions have been fulfilled, the Scheme Participants shall pay the subscription amounts for the Subject Shares to get the quota for the Subject Shares.

7. The price per share at which ZTE shall grant to the Scheme Participants the Subject Shares shall be the Grant Price, which, unless otherwise stipulated in the Share Incentive Scheme, shall represent the closing price of ZTE A Shares as quoted on the Stock Exchange on the trading day immediately preceding the date on which the Board meeting for reviewing the Share Incentive Scheme for the first time was convened. Upon the grant of shares to the Scheme Participants by the Company, Scheme Participants shall pay the subscription amounts for the Subject Shares on the basis of the purchase of 5.2 Subject Shares at the Grant Price for every 10 Subject Shares granted, out of which the subscription amounts for 3.8 shares shall be funded by Scheme Participants at their own cost and the subscription amounts for 1.4 Subject Shares shall be funded by the conversion of the Deferred Bonus that Scheme Participants would have received prior to their agreement not to participate in the distribution of 2006 Deferred Bonus, calculated as a percentage of the Grant Price.

8 ZTE shall not provide loans or other financial assistance in any form to the Scheme Participants, including guarantees for loans.

9. The Share Incentive Scheme shall be formulated by the Remuneration and Evaluation Committee of the Board of Directors of ZTE and reviewed by the Board. It shall be implemented upon approval by the general meeting of the Company after due examination and approval by the CSRC and consent of the holders of the state-owned shares with the approval of the State-owned assets management authorities.

II. Progress of the Phase I Share Incentive Scheme

The Phase I Share Incentive Scheme of the Company was formulated by the Remuneration and Evaluation Committee of the Board of Directors of the Company to establish a long-term incentive mechanism closely linked with the Company's business performance and long-term strategy, so as to help optimise the overall remuneration structure and create a competitive advantage in human resources that will contribute to the long-term, sustainable growth of the Company's operation. Phase I of the Share Incentive Scheme (Draft) was approved at the nineteenth meeting of the third session of the Board of Directors of the Company on 25 October 2006. Thereafter the Company submitted Phase I of the Share Incentive Scheme (Draft) to the State-owned Assets Management Commission under the State Council and CSRC for approval in accordance with relevant State regulations. The Remuneration and Evaluation Committee thereafter revised the scheme according to the comments of relevant regulatory authorities, and Phase I of the Share Incentive Scheme (Revised Version) was approved at the twentieth meeting of the third session of the Board of Directors of the Company on 15 December 2006. To further improve Phase I of the Share Incentive Scheme, the Company further revised Phase I of the Share Incentive Scheme (Revised Version). A no comment letter was issued by CSRC with respect to the Phase I of the Share Incentive Scheme (Version Dated 5 February 2007), which was then approved at the First Extraordinary General Meeting of the Company for 2007 on 13 March 2007.

Relevant Scheme Participants of the Phase I Share Incentive Scheme of the Company paid subscription amounts for their Subject Shares between 14 March 2007 and 18 March 2007, which will be used as additional working capital for the Company.

III. Accounting treatment adopted for the Phase I Share Incentive Scheme

The Phase I Share Incentive Scheme shall be accounted for in accordance with PRC Enterprise Accounting Standard No. 11 — Share-based Payments and Hong Kong Accounting Standards/HKFRS 2 — Share-based Payments. For details of the accounting methods and their impact on the Company, please refer to Item 21 of Note II to the financial statements prepared in accordance with PRC GAAP and Note 38 to the financial statements prepared in accordance with HKASs.

MATERIAL MATTERS

(8) INTERNAL CONTROL OF THE COMPANY

Information on the internal control of the Company is set out in the section headed "Internal Control" in the Corporate Governance Report under "Corporate Governance Structure" of this annual report.

(9) ENGAGEMENT OF AUDITORS BY THE COMPANY

Details are set out in the section headed "Remuneration of Auditors" under "Corporate Governance Structure" of this annual report.

(10) AMENDMENTS TO THE ARTICLES OF ASSOCIATION

Resolutions approving comprehensive amendments to the Articles of Association were passed by the 2005 annual general meeting of the Company held on 14 June 2006.

(11) RECEPTION OF INVESTORS AND ANALYSTS, COMMUNICATIONS AND PRESS INTERVIEWS

Nature	Location	Time	Mode	Audience received	Contents of discussion	Materials furnished
Presentation of company	Hong Kong	April 2006	2005 results presentation	Analysts and investors	2005 Annual Report	Published regular reports
	Hong Kong	August 2006	2006 interim results presentation	Analysts and investors	2006 Interim Report	Published regular reports
	Company	April 2006	Teleconference	Analysts and investors	First quarterly report 2006	Published regular reports
	Company	October 2006	Teleconference	Analysts and investors	Third quarterly report 2006	Published regular reports
External meetings	Hong Kong	February 2006	Credit Suisse presentation	Customers of Credit Suisse	Day-to-day operations of the Company	Published regular reports
	Shenzhen	March 2006	BNP presentation	Customers of BNP	Day-to-day operations of the Company	Published regular reports
	Beijing	March 2006	Deutsche Bank presentation	Customers of Deutsche Bank	Day-to-day operations of the Company	Published regular reports
	Shanghai	May 2006	Haitong Securities presentation	Customers of Haitong Securities	Day-to-day operations of the Company	Published regular reports
	Shanghai	May 2006	CLSA presentation	Customers of CLSA	Day-to-day operations of the Company	Published regular reports
	Shanghai	May 2006	CICC presentation	Customers of CICC	Day-to-day operations of the Company	Published regular reports
	Huizhou	June 2006	China Merchant Securities presentation	Customers of China Merchant Securities	Day-to-day operations of the Company	Published regular reports
	Hong Kong	September 2006	CLSA presentation	Customers of CLSA	Day-to-day operations of the Company	Published regular reports
	Beijing	November 2006	Goldman Sachs Gao Hua Securities presentation	Customers of Goldman Sachs Gao Hua Securities	Day-to-day operations of the Company	Published regular reports
	Shenzhen	December 2006	CICC presentation	Customers of CICC	Day-to-day operations of the Company	Published regular reports

MATERIAL MATTERS

Nature	Location	Time	Mode	Audience received	Contents of discussion	Materials furnished
Company visits by analysts	Overseas investors					
	Company	During 2006	Verbal	Lehman Brothers, GENESIS Assets Management, PANTERA CAPITAL MANAGEMENT, LP Schroders London, Naito Securities, Guotai Junan (Hong Kong) Securities, JP Morgan Chase, ABN, Deutsche Bank, Ginger Capital Fund, SKANDIA, UBS, TEMPLETON, CLSA, Citibank, Willington Funds, Fidelity Funds, Value Partners, Pacific Crest Securities Inc., Capital Securities, Goldman Sachs Gao Hua, Daiwa (Hong Kong), SG Assets Management (Singapore) Limited, ROBECO of the Netherlands, Credit Suisse, Gold Financial Holdings Group Limited, Morgan Stanley, UOB Kay Hian, First Shanghai Securities, HALBIS PARTNERS, Merill Lynch Securities	Day-to-day operations of the Company	Published regular reports
	Domestic investors					
	Company	During 2006	Verbal	China Re Asset Management Company Limited, CITIC Securities, Penghua Fund, Fortune SGAM Fund Management Co., Ltd, Huaan Securities, PICC Group, China Jianshe Securities (中國建設証券), Southern Fund Management Co., Ltd, CITIC Fund, Changsheng Fund Management Co., Ltd, Everbright Securities, Guotai Junan Securities, CICC, China International Fund Management Co., Ltd. (上投摩根基金公司), Haifutong Fund (海富通基金公司), Bosera Funds, Pingan Securities, CITIC-Prudential Fund Management Co., Ltd, Sinolink Securities Co., Ltd, Jiashi Fund, ICBC-Credit Suisse Fund	Day-to-day operations of the Company	Published regular reports

(12) *INVESTIGATIONS, ADMINISTRATIVE PENALTIES, PUBLIC CENSURES AND REPRIMANDS*

During the year, the Company, the Board of Directors and the Directors have not been investigated, under administrative penalty or publicly censured by the China Securities Regulatory Commission or openly reprimanded by the Shenzhen Stock Exchange.

(13) *SIGNIFICANT EVENTS*

During the year, the Company was not involved in any significant events as specified under Rule 67 of the Securities Law of the People's Republic of China and Rule 17 of Detailed Rules Governing Public Listed Companies' Information Disclosure (Provisional) and matters which the Board of Directors considered as significant events.

(14) *OTHER MATERIAL MATTERS*

During the year, the Company and its subsidiaries were not involved in any material matters requiring disclosure that have not been disclosed.