

Restructuring of the Telecommunications Industry

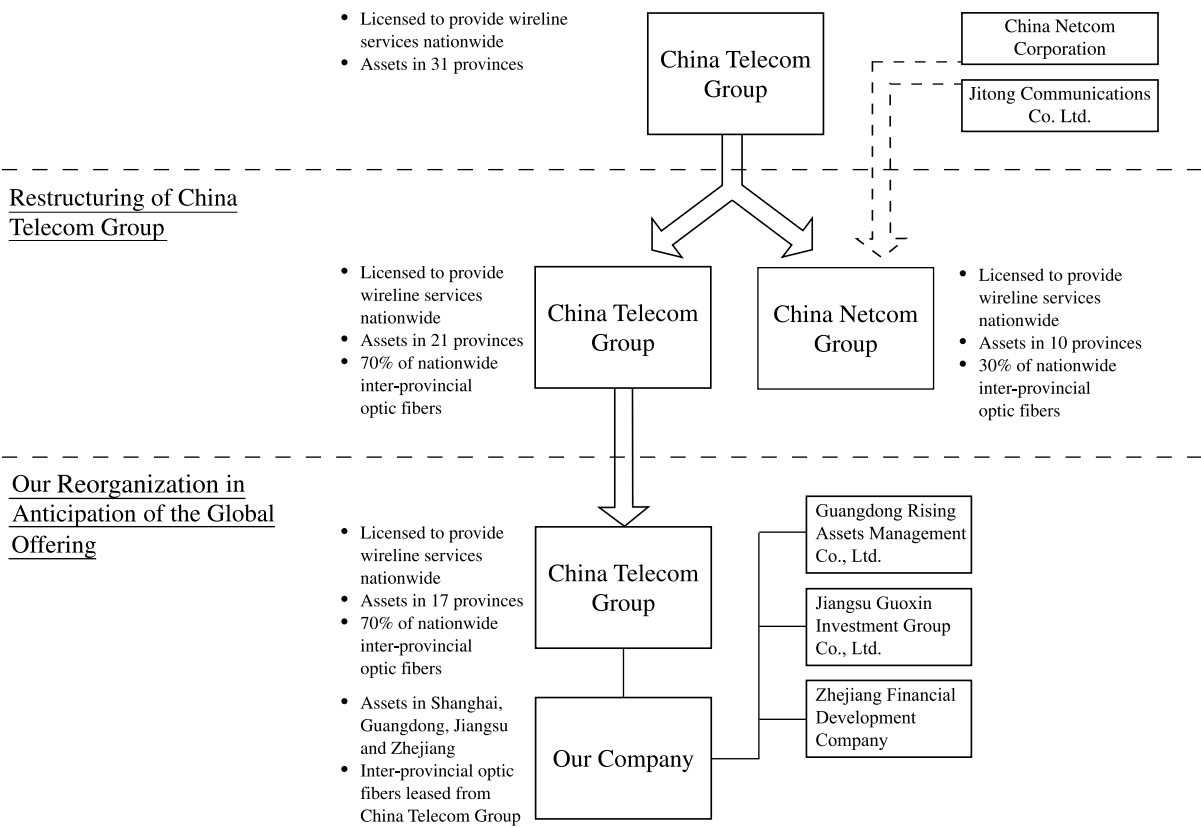
Historically, the former Ministry of Posts and Telecommunications, through the former Directorate General of Telecommunications, provincial Posts and Telecommunications Administrations and their city- and county-level posts and telecommunications bureaus, controlled and operated public telecommunications networks and businesses in China.

As part of the Chinese government's restructuring of the telecommunications industry, the Ministry of Information Industry was formed in March 1998 to assume, among other matters, the regulatory responsibilities of the former Ministry of Posts and Telecommunications. One of the principal objectives of the restructuring was to separate the government's regulatory functions from its business management functions. As a result, the Ministry of Information Industry ceased to operate telecommunications networks and businesses, but continues as the principal regulator of the telecommunications industry, providing industry policy guidance as well as exercising regulatory authority over all telecommunications service providers in China.

In 1999, with the approval of the State Council, the telecommunications networks and businesses previously controlled and operated by the former Ministry of Posts and Telecommunications were separated along four business lines: wireline, mobile, paging and satellite communications. The Directorate General of Telecommunications was renamed China Telecommunications Corporation in May 2000 to operate the nationwide wireline telecommunications business resulting from such separation. China Mobile and China Satellite Communications Corporation, or China Satellite, were established in May 2000 and December 2001, respectively, as state-owned enterprises to assume the nationwide mobile business and satellite communications business, respectively, while the paging business was transferred to China Unicom.

Restructuring of China Telecom Group

The following diagram illustrates the restructuring of China Telecom Group and our Reorganization in anticipation of this Global Offering.



In November 2001, the State Council approved a comprehensive restructuring plan relating to the wireline telecommunications sector. Under the restructuring plan, the telecommunications assets of our parent company, China Telecommunications Corporation, in ten northern provinces, autonomous regions and centrally administered municipalities in China were split off from China Telecommunications Corporation in May 2002 and were merged with China Netcom Corporation and Jitong Communications Co. Ltd. to form China Netcom Group. China Telecommunications Corporation retained the telecommunications assets in the remaining 21 provinces, autonomous regions and centrally administered municipalities (including Shanghai Municipality, Guangdong Province, Jiangsu Province and Zhejiang Province, our service regions) and continues to own the brand name of “China Telecom.” Under the restructuring plan, most telecommunications assets except for the nationwide inter-provincial optic fibers previously owned by China Telecom Group were divided between China Telecom Group and China Netcom Group based on their geographic locations. China Telecommunications Corporation and China Netcom Group own 70% and 30%, respectively, of the nationwide inter-provincial optic fibers. Under the restructuring plan, both China Telecommunications Corporation and China Netcom Group were permitted to operate nationwide wireline telecommunications networks and provide nationwide services.

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In connection with the implementation of the restructuring plan, China Telecommunications Corporation and China Netcom Group entered into a number of framework agreements providing for the separation of the network resources, and will continue to negotiate and enter into agreements regarding the asset separation and on-going operating arrangements. These agreements and arrangements relate to the division of network resources, trademarks, network access codes and other assets and nationwide enterprise customers of China Telecom Group prior to the restructuring, and circuit leasing, network maintenance and other business arrangements. Since the conclusion of some of these agreements may not be completed by the time of the global offering contemplated in this prospectus, at this time we cannot accurately predict the impact, if any, of such agreements on our business operations. See the Section headed “Risk Factors—Risks Relating to Our Business.”

Our Reorganization

In anticipation of the Global Offering, we were incorporated on September 10, 2002 as a joint stock company with limited liability with China Telecommunications Corporation, a wholly state-owned enterprise, as our controlling shareholder. To effect our Reorganization, we entered into a restructuring agreement with China Telecommunications Corporation, under which the Reorganization took effect as of December 31, 2001. As part of the Reorganization, China Telecom Group’s telecommunications operations in Shanghai Municipality, Guangdong Province, Jiangsu Province and Zhejiang Province, together with the related assets and liabilities, were transferred to us. These assets, liabilities and operations have been segregated since December 31, 2001. As part of the Reorganization, China Telecom Group retained certain assets historically associated with the businesses in Shanghai Municipality, Guangdong Province, Jiangsu Province and Zhejiang Province. These assets had a carrying amount of RMB11,285 million as of December 31, 2001 and primarily consisted of investments in non-telecommunications industries, the inter-provincial optic fibers, international gateway and international transmission equipment, telecommunications equipment for special communications services and certain office equipment, properties and buildings. In consideration of the net assets related to the telecommunications operations transferred to us, which had a carrying amount of RMB97,485 million as of December 31, 2001, we issued 68,317 million of our shares to China Telecommunications Corporation. See the Section headed “Financial Information—Our Reorganization and Asset Revaluation.”

The telecommunications operations that were transferred to us included:

- wireline telephone services, including local telephone, domestic and international long distance and interconnection services as well as a range of related value-added services;
- data and Internet services, including managed data, dial-up and dedicated Internet access, broadband access, system integration and related value-added services; and
- leased line services.

Under the restructuring agreement, China Telecommunications Corporation has undertaken to indemnify us against any actions, suits, proceedings, claims, losses, damages, payments or other expenses caused by or arising from any assets transferred to us by China Telecommunications Corporation due to events that occurred prior to the effective date of our

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Reorganization. This indemnity will, pursuant to the terms of the restructuring agreement, survive the termination of such restructuring agreement without limit in point of time. However, under PRC law, legal proceedings to enforce contractual obligations such as this indemnity must be brought within two years after the Company becomes aware or should have become aware that its relevant rights have been infringed upon.

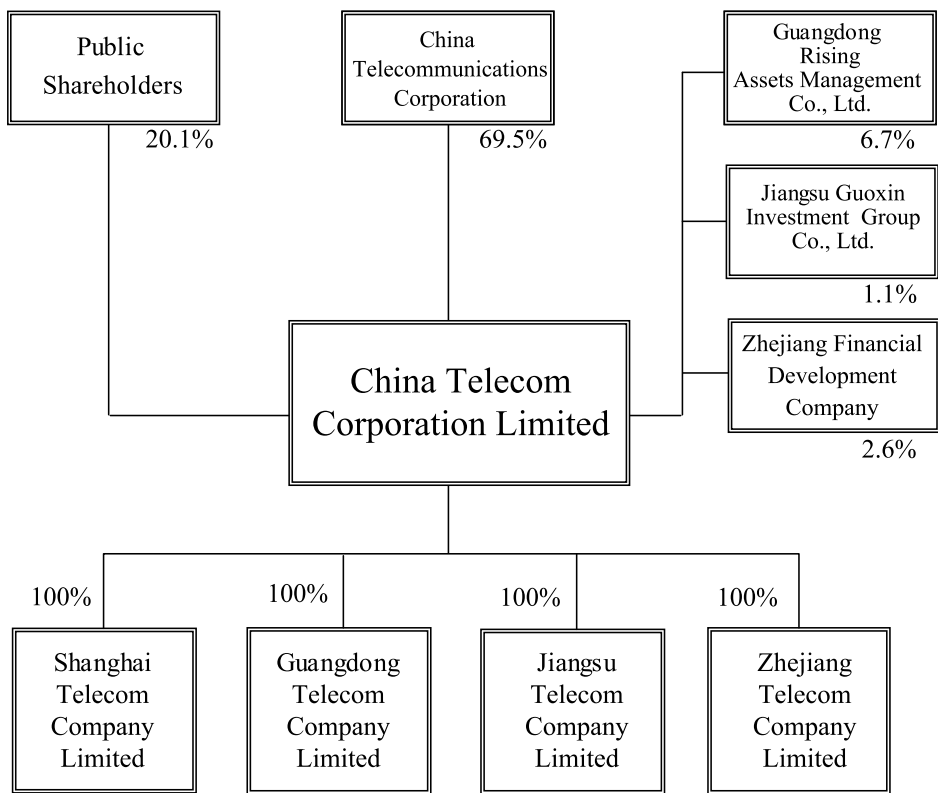
In addition, under the restructuring agreement, China Telecommunications Corporation has undertaken to indemnify us against any liabilities or losses as a result of any adverse effect that agreements entered or to be entered into between China Telecom Group and China Netcom Group may have on our assets and operations or the implementation of our agreements with China Telecom Group.

Immediately prior to the Global Offering, China Telecommunications Corporation owns 87.0% of our outstanding Shares. In addition, Guangdong Rising Assets Management Co., Ltd., Jiangsu Guoxin Investment Group Co., Ltd. and Zhejiang Financial Development Company each owns 8.4%, 1.4% and 3.2%, respectively, of our outstanding Shares. As part of a reform plan recently approved by the State Council on the administration of rural telecommunications services, China Telecom Group transferred a portion of its interest in our Company to these shareholders, which are state-owned enterprises owned and controlled by the provincial governments in each of Guangdong Province, Jiangsu Province and Zhejiang Province, as compensation for the financial support they have provided historically in the construction of rural telecommunications infrastructure in their provinces. See the Section headed “Share Capital.” Under a share transfer agreement each of these shareholders has entered into with China Telecom Group, each of Guangdong Rising Assets Management Co., Ltd., Jiangsu Guoxin Investment Group Co., Ltd. and Zhejiang Financial Development Company has agreed:

- not to sell, transfer or pledge any of our shares it obtained under the share transfer agreement during the three-year period after the completion of the Global Offering, and
- following the expiry of the three-year period after the completion of the Global Offering, not to sell or transfer more than 20% of our Shares it obtained under the share transfer agreement during any six-month period for a period of two years thereafter.

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The following chart sets forth our corporate organization and shareholders following our Reorganization and after giving effect to the Global Offering, assuming the Joint Global Coordinators (on behalf of the International Underwriters and the US Underwriters) do not exercise the Over-allotment Option.



Following our Reorganization, China Telecommunications Corporation retained the ownership of, and continues to operate, the wireline telecommunications networks, and provides telecommunications services in other provinces, autonomous regions and centrally administered municipalities that are outside our service regions. China Telecommunications Corporation has made non-competition and other undertakings to us, including an undertaking to fully support our existing operations and future development. See the Section headed “Business—Connected Transactions—Arrangements Relating to the Reorganization and the Global Offering” for details of these undertakings.

In connection with the Reorganization, we have entered into various arrangements with members of China Telecommunications Corporation in respect of those assets controlled and owned by China Telecom Group relating to the mutual provision of ongoing telecommunications and other services, such as the national inter-provincial optic fibers, equipment required for the operation of the special communications services, ancillary non-core business related assets, office buildings, network management centre, international gateways, undersea cables, satellite facilities, international tariff settlement system and all office equipment within China Telecom Group’s central headquarters. These agreements include agreements for trademark licensing, centralized services, interconnection arrangements, optic fiber leasing, property leasing and other services. See the Section headed “Business—Connected Transactions” for a more detailed description of these arrangements.

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Following our Reorganization, China Telecommunications Corporation continues to be the holder of the licences required for operating our telecommunications business. In accordance with the approval of the MII, we derive our exclusive rights to operate our businesses from our status as a subsidiary controlled by China Telecommunications Corporation, and China Telecommunications Corporation shall hold and maintain all licenses received from the MII in connection with our business for our benefit. The government currently does not charge licence fees for the telecommunications licenses held by China Telecommunications Corporation. To the extent the government begins to charge such fees in the future, we will likely share the cost with China Telecommunications Corporation. In addition, we may not be able to benefit from the licenses held by China Telecommunications Corporation if we cease to remain its controlled subsidiary. See the Section headed “Business—Connected Transactions.”