

Overview

We are the leading provider of wireline telephone, data and Internet and leased line services in four of the most economically developed regions in China. Our service regions consist of Shanghai Municipality, Guangdong Province, Jiangsu Province and Zhejiang Province. The average GDP per capita in our service regions in 2001 was RMB14,451, compared to the national average of RMB7,543.

We are the leading provider of wireline local telecommunications services in terms of the number of access lines in service in our service regions. The number of our access lines in service increased rapidly in recent years, from 31.9 million as of the end of 1999 to 53.2 million as of June 30, 2002, which constituted a market share of 99.8% in our service regions as of June 30, 2002. The wireline penetration rate in our service regions was 24.2% as of June 30, 2002, which we believe presents significant potential for further growth. In the six months ended June 30, 2002, our revenue from wireline local telecommunications services was RMB17,517 million, representing 47.5% of our total operating revenue for that period. We also offer a range of value-added voice and information services, including caller identification, or caller ID, calling card, conference call and toll free services.

Our long distance telephone services have also grown steadily in terms of usage, principally as a result of the growth in our domestic long distance services. The total traffic volume of outgoing domestic long distance calls carried through our networks increased from 22.9 billion minutes in 1999 to 30.6 billion minutes in 2001. Such traffic volume reached 16.3 billion minutes in the six months ended June 30, 2002, representing a market share of 54.5% of all domestic long distance calls carried by wireline and mobile operators in our service regions. In our long distance services, we face increasing competition from other providers of wireline and mobile telecommunications services. Our market shares, in terms of the total traffic volume of outgoing calls carried, of domestic long distance and international long distance services, decreased from 70.1% and 98.4%, respectively, in 2000 to 54.5% and 68.6%, respectively, in the first six months of 2002. In the six months ended June 30 2002, our revenue from domestic and international long distance services was RMB7,148 million and RMB1,601 million, respectively, representing 19.4% and 4.3%, respectively, of our total operating revenue for that period.

We are the leading provider of Internet services in terms of the number of subscribers in our service regions. Our Internet services have experienced rapid growth in recent years. The number of subscribers for our dial-up and dedicated Internet access services increased from 1.4 million as of the end of 1999 to 9.6 million as of December 31, 2001, representing a market share of 75.4% in our service regions. We began to offer broadband access services in 2000, and the number of our broadband subscribers increased from 9,900 as of the end of 2000 to 824,480 as of June 30, 2002. Total revenue from data and Internet services was RMB2,511 million in the six months ended June 30, 2002, representing 6.8% of our total operating revenue for that period.

We also provide a variety of managed data services in our service regions. Our managed data services include DDN, frame relay and ATM services. In the six months ended June 30, 2002, our revenue from managed data services was RMB846 million, representing 2.3% of our total operating revenue for that period.

In addition, we provide digital circuits, optic fibers and other leased line services to corporations and other telecommunications operators. Our revenue from leased line services was RMB1,555 million in the six months ended June 30, 2002, representing 4.2% of our total operating revenue for that period.

We own and operate an extensive and advanced backbone network system, as well as substantially all of the local access networks, in our service regions. Our backbone and local network systems, together with the network systems of China Telecom Group, form an advanced, integrated and reliable nationwide network system that is the largest in China. Our extensive and advanced telephone, data and Internet networks, together with our comprehensive network management and business support systems, provide reliable platforms for our broad range of quality telecommunications services.

Upon completion of the Global Offering, our controlling shareholder, China Telecommunications Corporation, a wholly state-owned enterprise, will directly own 69.5% of our issued share capital (or 67.5% if the Over-allotment Option is exercised in full). China Telecommunications Corporation provides wireline telecommunications services outside of our service regions. We currently do not expect to expand our core business beyond our service regions other than through potential acquisitions of selected telecommunications operations and assets of China Telecommunications Corporation. China Telecommunications Corporation has undertaken to give us a preferential right to acquire its interest in companies or other entities that provide telecommunications services. See the Section headed “—Connected Transactions—Arrangements Relating to the Reorganization and the Global Offering—Letter of Undertakings.”

Under a non-competition agreement between us and China Telecommunications Corporation, China Telecommunications Corporation has undertaken to us, for so long as our H Shares are listed on the Hong Kong Stock Exchange or another exchange, and China Telecommunications Corporation holds over 30% of our issued share capital or is regarded as our controlling shareholder under the Hong Kong Listing Rules, China Telecommunications Corporation will not at any time, directly or indirectly, provide basic telecommunications services or selected value-added telecommunications services in our service regions that may compete with us. See the Section headed “—Connected Transactions—Arrangements Relating to the Reorganization and the Global Offering—Non-Competition Agreement.”

Competitive Strengths

We believe that we are well positioned to capture significant growth opportunities in China's rapidly growing telecommunications market because of our following principal competitive strengths:

Leading market position and extensive customer base

We operate in four of the most economically developed regions in China and have the leading market position in our service regions for the services we provide. As of June 30, 2002, we had approximately 40.8 million residential customers and approximately 8.0 million

enterprise customers, including small- and medium-sized enterprise customers and large enterprise customers. The total number of our customers increased by approximately 4.7 million in the six months ended June 30, 2002. By offering comprehensive solutions and targeted customer services, we are able to attract and retain many large enterprise customers. We are also able to realize significant benefits of economies of scale in many aspects of our operations, such as service provisioning, equipment procurement, sales and marketing, customer service and support, and research and development.

Full range of wireline telecommunications services

We provide local and long distance telephone services, data and Internet services, leased line services and value-added voice and information services. The breadth of our services enables us to bundle our service offerings and provide tailored solutions to our large enterprise customers. In addition, we provide small- and medium-sized enterprises with specialized services to meet their specific telecommunications needs while offering our residential customers standardized services to meet their basic telecommunications needs in a cost effective way.

Extensive, reliable, advanced and integrated network infrastructure and ownership of local access network resources

Our networks cover all cities and counties in our service regions. Our fiber optic transmission network deploys advanced synchronous digital hierarchy, or SDH, architecture and dense wavelength division multiplexing, or DWDM, technology. Our telephone, data and Internet networks are fully digitalized. Our networks enable us to provide a full range of high-quality, reliable and end-to-end wireline telecommunications services and to develop effectively new services and products. Moreover, our ownership of the “last mile” access infrastructure, which is not readily replicable by our competitors, gives us a significant competitive advantage in delivering our services to our customers.

Strong financial position

Our operations generate strong cash flow. For the year ended December 31, 2001, our operations generated RMB32,761 million in cash flow. Our debt to equity ratio was 30.3% as of December 31, 2001. We believe our strong financial position affords us great flexibility in responding to the capital requirements of our business and changes in market conditions.

Leading brand name

The “China Telecom” name is one of the best known brands in China. It is associated with the image of a provider of reliable and high-quality telecommunications services in China. China Telecommunications Corporation has granted us a licence to use this brand name free of charge in our service regions for an initial term of three years under a license agreement, which will be automatically renewable upon expiration, unless we provide a sixty-day notice to China Telecommunications Corporation prior to termination. We currently do not expect to re-negotiate the terms of that license agreement with China Telecommunications Corporation. We believe this brand name provides us with an important competitive advantage.

Experienced and market oriented management team

Our management team has in-depth industry knowledge and extensive managerial experience in telecommunications business and operations. It is focused on formulating innovative business initiatives and capturing attractive business opportunities. Our management team is able to develop and execute our business strategies effectively while quickly responding to changes in our business environment.

Business Strategies

Our overall business objective is to achieve sustainable growth of our business and maximize the return on our investments. To achieve this objective and enhance our competitiveness, we intend to further develop our wireline telecommunications services, accelerate the growth of our data and Internet services as well as value-added services, optimize our network structure and control operating expenses. Specifically, we intend to pursue the following business strategies:

Continue to develop our wireline telecommunications services

We intend to continue to develop our wireline telecommunications services through the following initiatives to further expand our customer base and increase usage of our services:

- *Expanding customer base:* We continue to increase the number of access lines in service to capture new customers in high-demand areas. We also seek to maintain our existing customer base through tailored service offerings, bonus and loyalty programs and the provision of virtual private network, or VPN, services and central exchange, or CENTREX, services to enterprise customers. In addition, we have begun to provide VoIP services to attract subscribers of mobile communications services.
- *Increasing usage:* We plan to increase the usage of our telephone services through expanded offerings of value-added and other services, service bundling, and flexible pricing strategies, such as off-peak discounts. We also seek to increase the usage of our services by offering prepaid services to subscribers of other networks. In addition, we intend to expand our public telephone network and calling card services.
- *Offering wireline value-added services:* We provide wireline value-added services, such as caller ID and call forwarding services, by utilizing our existing network capabilities. We will leverage our intelligent network platforms to meet customer demand for prepaid, toll free and VPN services. In addition, we plan to provide information and wireline short messaging services based on new technologies and applications as well as call center, billing and other outsourcing services to enterprise customers through our “1000” customer service hotlines.

Focus on high-growth Internet and data services

As Internet access and usage continue to grow rapidly and the demand for data services increases in our service regions, we intend to focus on the following initiatives:

- *Internet services:* We intend to increase the market share and revenue of our Internet services by taking advantage of the extensive coverage of our existing

wireline networks and by providing customers with flexible and convenient access to the Internet. We will further develop co-marketing arrangements with third-party manufacturers, such as computer manufacturers, and content and service providers.

- *Broadband services:* We actively promote our DSL services as the primary means of broadband access by high-end residential and small- and medium-sized enterprise customers. We provide fiber optic access and wireless LAN access in commercial centers and to selected enterprise customers. We continue to cooperate with international and domestic content providers and application developers to provide high-end value-added services.
- *Data services:* We utilize our data network platforms and dedicated sales force to promote our managed data and other value-added services. We intend to accelerate the development of our frame relay and ATM services whilst maintaining our strength in DDN services.

Emphasize customer segmentation in marketing our services

We segment our customers into large enterprise customers, small- and medium-sized enterprise customers and residential customers. We offer individually tailored services to large enterprise customers, specialized services to small- and medium-sized enterprise customers, and standardized services to our residential customers.

- *Individually tailored services for large enterprise customers:* For large corporate and government customers and multinational corporations, we offer individually tailored and one-stop solution services through our designated customer service managers, and seek to develop a long-term relationship with them. “One-stop solution service” offers large enterprise customers a single access point for a range of services such as telecommunications related consulting and project design, Internet service provisioning, implementation and provisioning, billing and payment services, disruption reporting handling, and technical support services.
- *Specialized services for small- and medium-sized enterprise customers:* We target small- and medium-sized enterprise customers with a full range of high-quality and specially designed services. These include telecommunications product related services specifically designed for small and medium enterprise customers. Examples of these services are the “1000” enterprise customer service hotline number, CENTREX services, and various types of broadband leasing services such as DDN, ATM and frame relay services (as described in the sections headed “Business—Business Strategies—Continue to develop our wireline telephone services” and “Business—Business Strategies—Focus on high-growth Internet and data services” above). We have expanded our team of community managers to serve these customers through regular visits and combined sales and maintenance services.
- *Standardized services for residential customers:* We intend to provide our residential customers with standardized services in a cost-effective way in order to meet their basic telecommunications needs. We also offer convenient services to our customers, such as hotline and on-line services.

Increase network utilization, control capital expenditure and enhance return on capital investment

We intend to take the following measures to increase network utilization and enhance return on capital investments:

- *Increase network utilization:* We continue to systematically analyze market demand and plan the timing of our investments in order to improve the utilization of our network resources. In addition, we plan to rationalize the allocation of our network resources to improve network efficiency.
- *Enhance return on capital investment:* We are implementing disciplined financial management measures, such as return-on-investment hurdle rate and demand and profitability analysis, in order to control our capital expenditures. In addition, we intend to minimize the risks associated with capital investments by adopting proven technologies. We also intend to increase our investments in high-growth areas, such as Internet, broadband and value-added services.

Reduce operating costs and improve operational efficiency

We plan to take the following measures to optimize our operating cost structure:

- *Centralize financial and operating management:* To further enhance our operational efficiency and lower our operating costs, we will continue to centralize our financial management, budgeting process, equipment procurement, billing process, network resource allocation and network maintenance at the provincial level. Prior to such centralisation, such decisions were made throughout each town and county, and as a result the way in which capital was deployed was less efficient. Through centralisation, we intend to tighten control over capital expenditure, decrease working capital requirements and decrease the cost of finance.
- *Implement business process re-engineering:* Working in conjunction with a leading international management consulting firm, we have implemented a pilot program in business process re-engineering for our operations in the city of Suzhou in Jiangsu Province. This pilot program has improved our responsiveness to changes in market conditions, raised our operational efficiency and enhanced the quality of our services in Suzhou. We plan to implement this business process re-engineering program in other areas of our service regions within the next two years.

Explore external growth opportunities

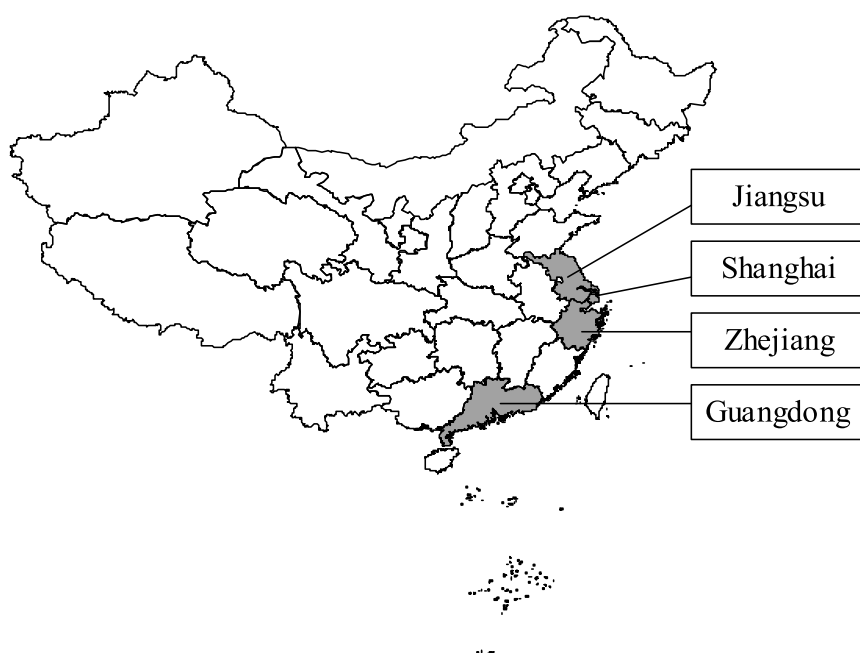
In addition to promoting organic growth, we will explore opportunities prudently for external expansion and strategic alliances:

- *Asset acquisition opportunities in China:* As the telecommunications market in China continues to grow, we believe that certain markets in the service regions of China Telecom Group present significant growth opportunities for us. We intend to explore opportunities for acquiring quality assets from China Telecom Group in order to expand the geographical reach of our services.

- *International strategic alliance opportunities:* We will continue to maintain and develop bilateral and multilateral collaboration with international telecommunications operators in order to provide seamless and integrated cross-border telecommunications services to multinational corporations. We will also explore alliance and partnership opportunities with leading companies worldwide.

Overview of Our Service Regions

The map below indicates our service regions, which consist of Shanghai Municipality, Guangdong Province, Jiangsu Province and Zhejiang Province, four of China's most economically developed regions. The accompanying table sets forth selected demographic and market information related to our service regions and the whole country as of or for the year ended December 31, 2001, unless otherwise indicated.



	Our Service Regions	China
Population (in millions)	220	1,276
2001 GDP per capita (RMB)	14,451	7,543
1999-2001 compound annual growth rate of GDP	11.4%	8.1%
Wireline telephone penetration rate ⁽¹⁾	22.1%	14.1%
Number of Internet subscribers (in thousands)	12,782 ⁽²⁾	33,700 ⁽³⁾
Internet penetration rate ⁽⁴⁾	5.8%	2.6%

(1) Calculated by dividing the number of telephone access lines in service by the relevant population.

(2) Excludes inactive subscribers, who have registered accounts with us but have not used our Internet access services.

(3) Includes inactive subscribers.

(4) Calculated by dividing the number of Internet subscribers by the relevant population.

Sources: Data in respect of the population, 2001 GDP per capita, and 1999 to 2001 compound annual growth rate of GDP and wireline telephone penetration rate of China are derived from information published by the National Statistical Bureau and the Ministry of Information Industry; data in respect of the population, 2001 GDP per capita, 1999 to 2001 compound annual growth rate of GDP and wireline telephone penetration rate of our service regions are derived from information provided by Provincial Telecommunications Administrations in our service regions; and data in respect of Internet subscribers are derived from information published by CNNIC.

Our service regions are located in the southeastern coastal regions of China. Our service regions accounted for 33.1% of the total GDP of China in 2001 and are among the most developed regions in China, with a compound annual growth rate of GDP of 11.4% from 1999 to 2001. Our service regions also constitute some of the most developed telecommunications markets in China. The wireline penetration rate in our service regions reached 22.1% as of December 31, 2001, significantly higher than the national average of 14.1% as of the same date. However, the penetration rate in our service regions is relatively low compared to those in more developed markets in Asia and elsewhere. We believe this presents significant growth potential for us.

Our service regions are also home to the headquarters of many large domestic corporations and governmental agencies and the regional headquarters of many multinational corporations. In addition, there is a large number of small- and medium-sized enterprises in our service regions.

Overview of Our Business

We are the leading provider of wireline telephone, data, Internet and leased lines services in our service regions. The following table sets forth the percentages of contribution by our different services to our total operating revenue for the periods indicated:

	Year Ended December 31,			Six Months Ended June 30,
	1999	2000	2001	2002
Wireline telephone services:				
Local				
Installation fees	0.7%	0.8%	1.1%	1.3%
Monthly fees	10.5	10.9	14.9	16.5
Local usage fees	28.1	28.9	30.6	29.7
Domestic long distance ⁽¹⁾	23.3	24.2	21.4	19.4
International long distance ⁽¹⁾⁽²⁾	9.2	7.3	4.9	4.3
Interconnection	7.3	6.9	5.6	6.2
Upfront connection fees	9.1	8.9	9.2	8.3
Sub-total	88.2	87.9	87.7	85.7
Data and Internet services:				
Internet ⁽³⁾	0.7	1.6	3.1	4.5
Managed data ⁽⁴⁾	2.2	2.5	2.2	2.3
Sub-total	2.9	4.1	5.3	6.8
Leased line services	7.0	6.0	4.2	4.2
Others services⁽⁵⁾	1.9	2.0	2.8	3.3
Total operating revenue	100.0%	100.0%	100.0%	100.0%

(1) Includes revenue from our VoIP long distance services.

(2) Includes revenue from calls to Hong Kong, Macau and Taiwan.

(3) Includes revenue from dial-up, dedicated and broadband Internet access services as well as value-added data services.

(4) Includes revenue from DDN, frame relay and ATM services.

(5) Includes revenue from value-added voice services and sales and maintenance of customer-end equipment.

Wireline Telephone Services

Our telephone services consist of local telephone, domestic and international long distance and interconnection services.

Wireline telephone services are our main services, generating 87.7% of our total operating revenue in 2001. Revenue generated by these services increased from RMB57,607 million in 1999 to RMB60,142 million in 2001 and reached RMB31,596 million in the six months ended June 30, 2002. The demand for value-added voice and information services has also increased in recent years. Our wireline telephone services will continue to provide steady revenue stream and drive overall earnings growth.

Local Telephone Services

Our local telephone services have grown significantly in recent years and represented the largest revenue source for our wireline telephone services and contributed 46.6% of our total operating revenue in 2001 and 47.5% in the six months ended June 30, 2002, as compared to 39.3% in 1999.

Access lines. The following table sets forth selected information regarding our local telecommunications services as of the dates indicated:

	As of December 31,			As
	1999	2000	2001	of June 30,
	(in thousands, except percentages)			2002
Number of access lines in service ⁽¹⁾ :				
Residential	25,502	31,770	38,096	40,809
Enterprise ⁽²⁾	5,492	6,343	7,029	8,033
Public telephones	842	1,320	1,917	1,963
Wireless local access	56	389	1,436	2,444
Total	31,892	39,822	48,478	53,249
Wireline telephone penetration rate	15.7%	18.3%	22.1%	24.2% ⁽³⁾
Market share measured by number of access lines in service ⁽⁴⁾	100.0%	100.0%	99.9%	99.8%

(1) Includes ISDN lines as measured by the number of bearer channels.

(2) Includes small- and medium-sized enterprises and large enterprises.

(3) Population used for calculating the penetration rate is estimated based on the population as of the end of 2001, and assuming that the growth rate in the first half of 2002 is the same as the growth rate in 2001.

(4) *Sources:* Data in respect of the number of the Company's access lines in service have been provided by the Company. Data in respect of the total number of access lines in our service regions are derived from the Provincial Telecommunications Administrations in our service regions, except data for Zhejiang Province in 1999 and 2000, which are estimated by us.

The number of our access lines in service has increased steadily from 31.9 million as of the end of 1999 to 48.5 million as of the end of 2001 and 53.2 million as of June 30, 2002. We had a 99.8% market share in our service regions in terms of the number of access lines in service as of June 30, 2002. The wireline penetration rate in our service regions increased from 15.7% as of the end of 1999 to 24.2% as of June 30, 2002.

In 1999, we began to selectively build wireless local access networks that are based on the Personal Handyphone System, or PHS, technology and offer wireless local access services with

limited mobility to our customers as a useful supplement to our wireline local access services. PHS technology is a wireless access telephone technology that evolved from analog cordless telephone technology. Currently, the PHS system in China operates in the 1895-1918.1 MHz range. PHS technology has developed into a public communication system with limited mobility. When rolling out and marketing our wireless local access services, we have closely monitored market demand and have focused generally on small- and medium-sized cities. The number of subscribers for our wireless local access service increased from approximately 56,000 as of the end of 1999 to approximately 2.4 million as June 30, 2002.

We also operate an extensive network of public telephones in our service regions, and the number of public telephones reached approximately 2 million as of the end of June 30, 2002. Public telephone services are targeted at the large and growing non-resident population in our service regions. We believe demand for our public telephone services will continue to expand.

Service usage. The following table sets forth certain usage information regarding our local telephone services for the periods indicated:

	Year Ended December 31,			Six Months Ended June 30,
	1999	2000	2001	2002
Total usage (pulses in billions) ⁽¹⁾	80.8	180.7	212.4	111.6
Total usage (minutes in billions) ⁽²⁾⁽³⁾	111.8	141.9	171.5	98.4

(1) Pulses are the billing units for calculating local telephone usage fees. The definition of a pulse for intra-district calls changed in connection with the 2001 tariff adjustments. The pulse data for 2000 were converted into pulses under the new definition through a statistical sampling of calling patterns, and may be subject to certain statistical error. The pulse data for 1999 were recorded on the basis of the definition of a pulse in effect prior to the 2001 tariff adjustments and, as a result, are not comparable to the pulse data for 2000 and 2001. See “—Tariffs” for the respective definitions of a pulse before and since the 2001 tariff adjustments.

(2) Minutes reported were calculated from pulses through a statistical sampling of calling patterns and may be subject to certain statistical error.

(3) Includes 5.8 billion minutes in 1999, 24.2 billion minutes in 2000, 53.7 billion minutes in 2001 and 26.3 billion minutes in the six months ended June 30, 2002, in respect of Internet dial-up usage generated by our Internet subscribers and subscribers of other Internet access providers.

As the number of access lines in service has increased, the total usage of our local telecommunications services, including those associated with dial-up Internet access and VoIP long distance calls, increased from 111.8 billion minutes in 1999 to 171.5 billion minutes in 2001 and 98.4 billion minutes in the six months ended June 30, 2002. The number of minutes of local telephone usage per access line in service per month decreased slightly from 330 minutes in 2000 to 324 minutes in 2001. Dial-up Internet usage increased from 5.8 billion minutes in 1999 to 53.7 billion minutes in 2001, representing a compound annual growth rate of 204.3%. Dial-up Internet usage, as a percentage of total local usage, increased from 5.2% in 1999 to 31.3% in 2001. Tariffs for the communications fees of dial-up Internet access were much lower than the usage fees for voice services.

Tariffs. For our local telecommunications services, we charge an upfront installation fee, a fixed monthly fee and local call usage fees based on call duration. The tariffs are regulated by the Chinese government. The local call usage fees are either intra-district or inter-district, depending upon whether a call is within a single service district or between

service districts. In December 2000, the Chinese government issued a notice of tariff adjustments, which we implemented in the first half of 2001. The tariff adjustments changed the tariff levels for many telecommunications services, including local and long distance telephone, data and leased line services. See the Section headed “Regulation — Tariff Setting.”

The following table sets forth the changes in our tariffs before and after the tariff adjustments we implemented in 2001 for local telecommunications services:

	Before Tariff Adjustments	After Tariff Adjustments
	(RMB)	
Monthly fee ⁽¹⁾ :		
Residential customers	7.6 – 24.0	12.0 – 25.0
Enterprise customers	10.0 – 37.0	15.0 – 35.0
Usage fee:		
Intra-district	0.16 – 0.22 per pulse (three minute intervals)	0.18 – 0.22 for the first two pulses (first three minutes or less) and 0.09 – 0.11 for each additional pulse (one minute intervals)
Inter-district	0.20 – 0.50 per pulse (one minute intervals)	0.20 – 0.50 per pulse (one minute intervals)
Communications fee:		
Internet dial-up	0.08 – 0.11 per pulse (three minute intervals)	0.02 per pulse (one minute intervals)

(1) Monthly fees for customers vary depending on whether a subscriber is located in the provincial capital, a city, a county or rural areas.

Prior to July 2001, we charged an upfront connection fee for basic access services. State guidance rates for connection fees for basic access services varied from time to time and were adjusted from a range of RMB2,500 to RMB5,000 in 1999 to a range of RMB500 to RMB1,000 in 2001, and the connection fees were eliminated entirely in July 2001. The decrease in and ultimate elimination of connection fees have stimulated customer growth, especially for residential customers. In addition, all previous surcharges on telephone services, which were mostly levied by provincial and local governments, were eliminated in July 2001.

Domestic Long Distance Services

We offer long distance services through our public switched telephone network as well as VoIP long distance services. Total revenue from our domestic long distance services represented 21.4% of our total operating revenue in 2001, compared to 23.3% in 1999. We are the largest provider of domestic long distance services using public switched telephone networks in our service regions, with a 60.4% market share, as measured by total minutes carried through, of all wireline and mobile operators in our service regions in 2001. Our market share decreased to 44.7% in the six months ended June 30, 2002. In addition, we commenced offering VoIP long distance services in 1999 and became the largest provider of such services in our service regions in 2001. Access to VoIP long distance services requires the subscriber to dial a pre-set access number and/or personal identification number in the case of prepaid cards.

Service usage. The following table shows the total minutes of domestic long distance calls carried through our long distance network and the market share of our domestic long distance services for the periods indicated:

	Year Ended December 31,			Six Months Ended June 30,
	1999	2000	2001	2002
Total minutes of usage (in millions) ⁽¹⁾ :				
Public switched telephone networks	22,873	24,780	19,133	7,705
VoIP	3	2,187	11,497	8,635
Total	22,876	26,967	30,630	16,340
Market share ⁽²⁾ :				
Public switched telephone networks		68.8%	60.4%	44.7%
VoIP		89.6%	72.0%	67.8%
Overall market share		70.1%	64.2%	54.5%

(1) Includes calls originated by mobile subscribers that are carried over our long distance networks.

(2) *Sources:* Data in respect of the number of domestic long distance call minutes of the Company have been provided by the Company. Data in respect of the total number of domestic long distance call minutes in our service regions are derived from the Provincial Telecommunications Administrations in our service regions, except data for Zhejiang Province in 1999 and 2000, which are estimated by us.

The decrease in the market share of our domestic long distance services from 2000 to 2002 was mainly attributable to the expansion of mobile operators' long distance networks and their increased routing of long distance calls placed by their mobile subscribers through their own long distance networks as well as increased competition from other wireline long distance service providers.

Our VoIP services have experienced rapid growth since we began providing the services in 1999. The usage of our VoIP domestic long distance services as a percentage of the total usage of domestic long distance services increased from 8.1% in 2000 to 37.5% in 2001, and further increased to 52.8% for the six months ended June 30, 2002, mainly because of the lower tariffs for VoIP long distance services compared to those for long distance services using public switched telephone networks. However, the average VoIP call duration is generally longer than that of long distance calls using public switched telephone networks. We target VoIP services at price sensitive customers, such as small businesses, certain residential customers and non-resident persons.

Tariffs. The tariff adjustments in 2001 abolished the distance-based tariff structure, reduced the unit of billing from one minute to six seconds and eliminated long distance call surcharges.

The following table sets forth the tariffs for our domestic long distance telephone services before and after the tariff adjustments in 2001, which are based on state tariff rates:

	<u>Before Tariff Adjustments</u>	<u>After Tariff Adjustments</u>
	(RMB)	
Wireline telephone:		All at the unified rate of 0.07 per six seconds ⁽²⁾
Intra-provincial less than 300 km	0.50 per minute ⁽¹⁾	
Intra-provincial more than 300 km . . .	0.60 per minute ⁽¹⁾	
Inter-provincial less than 800 km	0.80 per minute ⁽¹⁾	
Inter-provincial more than 800 km . . .	1.00 per minute ⁽¹⁾	
VoIP services ⁽³⁾	0.30 per minute	Not regulated

- (1) A discount rate of 50% applied to calls made during off-peak hours, which were from 9:00 pm to 12:00 am for weekdays and from 7:00 am to 12:00 am on public holidays and weekends; a discount rate of 70% applied to calls made during 12:00 am to 7:00 am everyday.
- (2) A discount rate of up to 40% applies to calls made during off-peak hours, which are from 12:00 am to 7:00 am every day.
- (3) Does not include separate usage fees for local services when a VoIP call is placed. The local usage fee of a VoIP call is the same as the local usage fee of an intra-district local voice call.

The tariff adjustments in 2001 also deregulated the tariffs for VoIP services. We continue to use the general tariff rate of RMB0.30 per minute for our VoIP services after the tariff deregulation, but offer incentive programs and discounts from time to time. VoIP long distance services have lower tariff rates than those for long distance services using public switched telephone networks. However, we also charge local usage fees on VoIP long distance calls.

International Long Distance Services

We are the largest provider of both public switched telephone network and VoIP international long distance services in our service regions, with an 84.4% market share in 2001 and a 68.6% market share in the six months ended June 30, 2002 as measured by the total number of outgoing call minutes carried through international gateways of all wireline and mobile operators in our service regions. Our international long distance telephone services contributed 4.9% to our total operating revenue in 2001 and 4.3% in the six months ended June 30, 2002, compared to 9.2% in 1999. We began offering VoIP international long distance services, similar to our VoIP domestic long distance services, in 1999 in our service regions.

Service usage. The following table sets forth certain information related to the usage and market share of our international long distance services, including usage of international long distance services by mobile subscribers, for the periods indicated:

	Year Ended December 31,			Six Months Ended June 30,
	1999	2000	2001	2002
Outgoing call minutes (in millions):				
Public switched telephone networks	1,277.9	1,285.8	1,014.6	324.5
VoIP	0.2	130.9	391.1	285.5
Total	1,278.1	1,416.7	1,405.7	610.0
Market share by outgoing call minutes ⁽¹⁾ :				
Public switched telephone networks ⁽²⁾		98.8%	90.1%	66.4%
VoIP		94.9%	72.4%	71.3%
Overall market share		98.4%	84.4%	68.6%

(1) *Sources:* Data in respect of the number of outgoing call minutes of the Company have been provided by the Company. Data in respect of the total number of outgoing call minutes in our service regions are derived from the Provincial Telecommunications Administrations in our service regions, except data for Zhejiang Province in 1999 and 2000, which are estimated by us.

(2) Includes calls originated by mobile subscribers that are carried through our international gateway.

The total usage of our international long distance services declined in 2001, mainly because mobile operators established their own international gateways and diverted international calls previously placed by their mobile subscribers through our international gateways. International call traffic that originated from our wireline subscribers increased in 2001. The usage of our international long distance services has also been adversely affected by the increased use of leased lines for international communications.

Tariffs. The tariff adjustments in 2001 reduced the basic unit of billing from one minute to six seconds and simplified the rate schedule by abolishing the distance-based tariff structure. The following table sets forth our international long distance tariffs before and after the tariff adjustments:

	Before Tariff Adjustments (RMB)	After Tariff Adjustments
Public switched telephone networks services:		
To Hong Kong, Macau and Taiwan	5.00 per minute ⁽¹⁾	0.20 per 6 seconds
To all international destinations	5.30 – 15.00 per minute ⁽²⁾	0.80 per 6 seconds ⁽³⁾
VoIP services ⁽⁴⁾ :		
To Hong Kong, Macau and Taiwan	2.50 per minute ⁽⁵⁾	Not regulated
To all international destinations	4.80 per minute	Not regulated

(1) Lower rates of RMB1.65-3.45 per minute applied to calls made from Guangdong Province to Hong Kong and Macau. A discount rate of 40% applied to calls made during off-peak hours.

(2) Rates of RMB5.30-12.00 per minute applied to calls made to Asian countries and regions and a rate of RMB15.00 per minute applied to calls to all other international destinations. A discount rate of 40% applied to calls made during off-peak hours.

(3) A discount rate of up to 40% applies to calls made during off-peak hours.

(4) Does not include separate usage fees for local services when a VoIP call is placed. The local usage fee of a VoIP call is the same as the local usage fee of an intra-district local voice call.

(5) A lower rate of RMB1.50 per minute applied to VoIP calls made from Guangdong Province to Hong Kong and Macau.

We offer international long distance services through the international gateways of China Telecommunications Corporation. China Telecommunications Corporation negotiates bilateral settlement arrangements and rates based on the international settlement standards in the telecommunications industry, and those settlement arrangements and rates also apply to us. Since the tariff adjustments, we charge RMB1.50 per minute for VoIP long distance calls to Hong Kong, Macau and Taiwan and RMB2.40-4.60 per minute for VoIP long distance calls to international destinations, but offer various incentive programs and discounts from time to time.

Interconnection

We have interconnection arrangements with other telecommunications operators, including China Telecommunications Corporation, China Mobile and China Unicom, in our service regions. All interconnection and settlement arrangements among public wireline telephone, mobile, and Internet networks in China are governed by the Telecommunications Regulations and the rules on interconnection arrangements and settlement promulgated by the Ministry of Information Industry in 2001. See the Section headed “Regulation — Interconnection.”

China Telecommunications Corporation entered into interconnection agreements with other telecommunications service providers in our service regions. These agreements provide for interconnection settlement with respect to local calls and domestic and international long distance calls involving our networks. In connection with the Reorganization in preparation for this offering, China Telecommunications Corporation has assigned to us, and we have assumed, its rights and obligations under these agreements. We also entered into an interconnection agreement with China Telecommunications Corporation. The economic terms and the settlement procedures under that agreement are in accordance with the standards set forth in the interconnection rules and regulations, which are described in more detail under the Section headed “Regulation — Interconnection.” See also the Section headed “—Connected Transactions—Arrangements Relating to the Reorganization and the Global Offering—Apportionment of International Settlement.”

Value-added Voice and Information Services

Value-added voice services. In addition to basic local and long distance services, we offer a number of value-added telephone services, including caller ID, call forwarding, conference calling and toll-free services. We believe that these services allow us to enhance customer satisfaction and increase our revenue. For example, we introduced caller ID services in our service regions in 1999 at RMB6.00 per month and, as of the end of 2001, 27.9% of our subscribers used this service. We believe value-added telephone services are still at an early stage of development. As subscribers in China become more accustomed to these value-added telephone services, we expect significant growth potential in this area.

Telephone information services. We have significantly expanded the scope of our automated and operator-assisted telephone information and applications services in recent years. Our general information services allow users to access information at our standard telephone usage rates plus information usage fees. We also provide other specialized

telephone information and applications services, such as telephone banking and telephone advertising. Total usage of our telephone information services increased from 280.5 million minutes in 1999 to 398.7 million minutes in 2001. We intend to further expand the scope and usage of these services and develop flexible revenue sharing arrangements with content and application service providers.

Telephone directory services. We publish telephone directories, known as Yellow Pages, in our service regions. In addition, we have introduced online telephone directory and other related information services. We derive advertising revenue from our printed and on-line directories.

New service initiatives. We continue to leverage our extensive network resources, customer base and distribution channels and cooperate with other service providers to develop new revenue sources. For example, we have introduced call center out-sourcing, video conferencing and wireline short messaging services.

Data and Internet Services

We are the leading provider of data and Internet services in our service regions with a 75.4% market share in 2001 in terms of the number of subscribers. Our data and Internet services are supported by extensive local access networks in our service regions and the largest nationwide fiber optic backbone transmission network operated by China Telecom Group. Revenue from our Internet services was RMB2,150 million in 2001, representing 3.1% of our total operating revenue for that year, and reached RMB1,665 million in the six months ended June 30, 2002, representing 4.5% of our total operating revenue for that period. Revenue from our managed data services was RMB1,477 million in 2001, representing 2.2% of our total operating revenue for that year, and reached RMB846 million in the six months ended June 30, 2002, representing 2.3% of our total operating revenue for that period.

The following table sets forth selected information regarding our data, Internet and related services as of the dates or for the periods indicated:

	As of or for the Year Ended December 31,			As of or for the Six Months Ended June 30,
	1999	2000	2001	2002
	(in thousands, except minutes)			
Managed data services:				
Number of ports:				
DDN services	106.6	135.9	154.9	156.5
Frame relay services	9.4	15.1	21.1	26.5
ATM services	0.02	0.66	1.39	1.92
Bandwidth leased:				
DDN services (x64Kbps)	70.5	103.1	158.6	168.3
Frame relay services (x128Kbps)	6.1	11.2	20.4	25.1
ATM services (x2Mbps)	0.6	1.3	7.8	10.0
Dial-up and dedicated Internet access services:				
Dial-up subscribers	1,443.5	5,171.7	9,627.2	10,260.1
Dial-up on-line usage (minutes in billions)	5.6	22.2	45.5	20.3
Dedicated Internet access lines	2.5	5.2	5.1	4.3
Broadband access services:				
DSL subscribers	—	5.6	300.6	662.9
FTTx + LAN subscribers	—	4.3	87.6	151.6
Others	—	—	8.4	10.0

Managed Data Services

Our managed data services include DDN, frame relay and ATM services. We are the market leader in the managed data services in our service regions.

DDN services. Our DDN services provide high-quality and reliable transmission at speeds ranging from 64Kbps to 2Mbps and continue to meet the increasing demand for low-to medium-speed transmission capacity from enterprise customers. DDN systems are composed of optic fibers, digital transmission paths and digital cross multiplexing nodes. DDN systems are capable of providing high-quality private circuits and other services at various data rates to satisfy users' multimedia communications needs.

Frame relay/ATM services. We offer advanced high-speed data communications services based on frame relay and ATM technologies. These services enable flexible and cost-effective use of bandwidth resources. Frame relay is a type of connection-oriented packet switching technology that employs statistical multiplexing over a shared network. Frame relay offers both access to a network and transmission of data across a network and is used by customers with significant amounts of data traffic. ATM is a high bandwidth and multiplexing technology. ATM is developed for high data rates with a high quality of service, and can offer integrated voice, data and video services at various data rates.

We offer these services as part of our total telecommunications solutions to large enterprise customers, including government agencies, large corporations and institutions. Many of these customers choose frame relay and ATM services to form VPNs and link their local area networks at different locations. We also collaborate with a number of international telecommunications service providers to build global communications networks for multinational corporations.

Tariffs. We determine most of the tariffs for our data services within a price range set by the Chinese government. We generally charge an upfront fee for installation and testing for our data services and a fixed monthly fee. Tariffs for some of our data services have declined substantially in recent years. This decline has stimulated demand for our data services, especially for higher bandwidth services.

The following table sets forth the monthly fees for DDN services at the bandwidth of 64Kbps and 2Mbps for the periods indicated:

	Monthly Fee		
	1999	2000 (RMB)	2001
64Kbps			
Intra-district	1,680	1,680	1,500
Inter-district	2,520	2,520	2,000
Intra-provincial	4,050	3,640	3,500
Inter-provincial (less than 800 km)	5,040	4,530	3,500
Inter-provincial (more than 800 km)	6,300	5,350	3,500
2Mbps			
Intra-district	15,720	14,360	6,000
Inter-district	27,000	18,900	8,000
Intra-provincial	46,600	27,960	12,000
Inter-provincial (less than 800 km)	81,900	42,590	12,000
Inter-provincial (more than 800 km)	100,000	50,000	12,000

The following tables set forth the monthly fees in 2001 for frame relay and ATM services, which include monthly fees for port access and permanent virtual circuits, or PVCs:

<u>Bandwidth</u>	<u>Monthly Fee for Port Access</u>			
	<u>2Mbps</u>	<u>10Mbps</u>	<u>100Mbps</u>	<u>155Mbps</u>
Monthly fees	1,000	5,000	9,000	10,000

PVC monthly fees (RMB)⁽¹⁾:

<u>Bandwidth</u>	<u>PVC Monthly Fees</u>		
	<u>Intra-District</u>	<u>Inter-District</u>	<u>Domestic Long Distance</u>
		(RMB)	
256Kbps	800	1,150	2,200
2Mbps	1,500	2,200	4,000
10Mbps	5,000	11,500	15,500
155Mbps	14,500	39,000	130,000

(1) One-way tariff for PVC circuits of ATM services.

Dial-up and Dedicated Internet Access Services

We are the largest provider of dial-up and dedicated Internet access services in our service regions in terms of the number of subscribers. Our Internet access services have grown substantially in recent years. Our dial-up Internet access subscribers increased from 5.2 million as of the end of 2000 to 9.6 million as of the end of 2001 and 10.3 million as of June 30, 2002.

We classify our dial-up Internet access users into registered users, non-registered users and prepaid users. We provide a variety of dedicated Internet access services to our business and government customers. In addition, we provide Internet transit and access services to some international and domestic telecommunications operators. We also provide many business customers with direct fiber optic links between their local area networks and the Internet.

Tariffs. Registered dial-up Internet access users pay an Internet access fee as well as local communications fees. Dedicated Internet access users pay usage fees for the leased dedicated lines or fiber optic access.

The following table sets forth the tariffs for dial-up Internet access services for the periods indicated:

	<u>1999</u>	<u>2000</u>	<u>2001</u>
Dial-up Internet access fees	RMB4.00 per hour if less than 60 hours per month, and RMB8.00 per hour for hours exceeding the first 60 hours per month	RMB4.00 per hour	RMB3.00 per hour

The following table sets forth the tariffs for the dedicated Internet access services for the periods indicated:

Bandwidth	1999	2000 (RMB per month)	2001
64Kbps – 128Kbps . . .	24,000	13,000	4,000
1Mbps – 2Mbps	150,000	80,000	20,000

Broadband Internet Access

DSL services. We promote DSL services as the primary broadband Internet access means for residential customers and small- and medium-sized enterprise customers. DSL services can be offered over copper wires and are suitable for high-speed Internet access. Our DSL charges are based on bandwidth and whether the customer is a residential customer or enterprise customer. Our service fees include an upfront installation fee, monthly fees and overtime charges. We had 300,570 DSL subscribers as of the end of 2001 and 662,900 DSL subscribers as of June 30, 2002.

Fiber-Ethernet access services. We offer broadband access services through fiber optic cables that directly link Ethernet technology-based LANs in office buildings or high-end residential complexes to the Internet. Fiber-Ethernet access uses optic fiber technology and Ethernet protocol to connect residential users and business users to a telecommunications network and greatly expands capacity of the access network. As of the end of 2001 and June 30, 2002, we had 87,570 customers and 151,590 customers, respectively, using fiber-Ethernet access services.

Broadband application services. We continue to leverage our broadband access networks and distribution channels to develop various broadband application services, such as distance learning, distance medical services, video conferencing, on-line games, entertainment and video-on-demand.

Wireless LAN services. We provide fast and convenient wireless LAN services through our wireless local area networks in public places, such as airports, hotels, conference centers and office buildings.

Tariffs. The following table sets forth the tariffs for DSL services:

Type of Service	Connection Fee (RMB per Port)	Network Fee (RMB per Port)
Residential	400	200 per month if less than 120 hours and 4.00 per hour for every hour exceeding the 120-hour limit
Enterprise	1,000	800 per month if less than 180 hours, and 6.00 per hour for every hour exceeding the 180-hour limit

For customers connected through LANs, we charge either a monthly network fee plus a fiber optic access fee determined by bandwidth, or a monthly network fee plus an upfront

connection fee. The following table sets forth the guidance tariffs for our fiber-Ethernet access services:

Type of Customer	Port Bandwidth	Connection Fee ⁽¹⁾ (RMB per Port)	Network Fee (RMB per Port per month)
Residential	10Mbps	400	200
	100Mbps	—	300
Enterprise	10Mbps	1,000	1,000
	100Mbps	—	2,000

(1) Includes registration fee, installation fee and labor expenses, but does not include equipment fees incurred by customers.

System Integration and Other Value-Added Services

We offer system integration and solution services to our customers. Our system integration services encompass initial consulting, network planning, network implementation, application development and maintenance. Our current development focuses on system integration and information management such as network management and data mining and analysis services.

Our Internet data centers primarily offer co-location and web hosting services. We operate many large Internet data centers that together provide more than 18,000 square meters of rack space. As part of those services, we also lease to our customers various resources at these Internet data centers, such as servers and database storage capacity. In addition, we are developing a range of Internet-based services to meet increasing corporate outsourcing requirements for web site development and maintenance as well as Internet-based applications.

Leased Line Services

We also provide domestic and international leased line services in our service regions. In addition to leased lines, we also lease other network elements to business and government customers and other telecommunications service providers. We mainly lease digital circuits, digital trunk lines and optic fibers. The revenue from our leased line services is mainly derived from the lease of domestic and international digital circuits. Revenue from our leased line services was RMB2,862 million in 2001, representing 4.2% of our total operating revenue for that year, and reached RMB1,555 million in the six months ended June 30, 2002.

We offer these services as part of our total telecommunications solutions and market these services to large enterprise customers and other operators through our large enterprise customer service teams.

The following table sets forth the total amounts of bandwidth of our leased line service as of the dates indicated:

Leased Digital Circuits	As of December 31,			As of June 30,
	1999	2000	2001	2002
Total bandwidth (x2Mbps)	53,549	65,082	84,252	91,872

Tariffs. We charge monthly fees for leased lines based on tariff rates set by the Chinese government, which vary based on bandwidth and whether the leased line is local or

long distance. Leased line tariffs have generally decreased in recent years. The tariff adjustments in 2001 substantially reduced tariffs for leased line services.

The following table sets forth the tariffs for 2Mbps and 155Mbps digital circuits for the periods indicated:

	Monthly Fee		
	1999	2000 (RMB)	2001
2Mbps			
Intra-district	9,000	5,810	2,000
Inter-district	16,000	10,000	4,000
Intra-provincial ⁽¹⁾	23,000	14,180	6,000
Inter-provincial ⁽¹⁾ (less than 800km)	36,200	25,340	6,000
Inter-provincial ⁽¹⁾ (more than 800km)	45,300	31,710	6,000
155Mbps			
Intra-district	—	271,120	44,000
Inter-district	—	466,560	88,000
Intra-provincial ⁽¹⁾	—	661,610	132,000
Inter-provincial ⁽¹⁾ (less than 800km)	—	1,182,200	132,000
Inter-provincial ⁽¹⁾ (more than 800km)	—	1,479,530	132,000

(1) Does not include the tariffs for local digital circuits and access lines.

Marketing, Distribution and Customer Services

Marketing Initiatives

We market all of our telecommunications services under the “China Telecom” brand name, which is one of the best known brand names in China. We offer a full range of differentiated services to our customers to address their telecommunications needs. We offer individually tailored services to our large enterprise customers, specialized services to our small- and medium-sized enterprise customers and standardized services to our residential customers. In addition, we plan to increase our advertising activities to enhance customer awareness of our available services and promote brand loyalty.

Sales, Distribution and Customer Services

Dedicated customer manager system for large enterprise customers. We have implemented a large enterprise customer manager system. Under this system, our dedicated customer managers directly market our services to large enterprise customers. These customer managers form dedicated management teams based on the industry background or geographical locations of the customers. We conduct periodic performance reviews and evaluations of the performance of the customer managers based on several factors, including revenue growth, market share, customer satisfaction and customer retention. To strengthen our marketing efforts, we have increased the total number of our customer managers from 1,586 as of the end of 2001 to 2,682 as of the end of June 2002.

Community manager system. We offer integrated sales and maintenance services to small- and medium-sized enterprise customers through our community manager system and divide their community coverage responsibilities by geographical area. Our community

managers are responsible for customer development and customer care. We link their compensation mainly to the voice traffic in their coverage areas. In addition, our community managers are also responsible for gathering market and demand information.

Contract system in rural areas. We are the first operator in China to develop a contract system to serve customers in the rural areas. Under this system, we select certain local residents to be responsible for service promotion, customer development, equipment maintenance and fee collection. This system enables us to lower operational costs effectively while at the same time satisfying the needs of our rural customers.

Customer service hotlines. We provide customer services through our customer service hotlines with the uniform access number of “1000.” Our customer service hotlines offer unified electronic-based services to our residential and enterprise customers. Our customer service hotlines handle service inquiries and service applications, collect bill payments and receive customers’ complaints.

Billing services. We bill our residential customers on a monthly basis and provide a range of payment choices for the convenience of our customers, including direct-debit service, which automatically deducts the monthly payment from the subscriber’s designated bank or postal account. We also provide specially tailored billing and collection services to our large enterprise customers to help them more effectively plan and monitor their telecommunications needs.

Marketing and sales agencies and other wholesale channels. We market our services through our own retail outlets as well as agents and distributors. Our cooperation with third party agencies and distributors helps us to reach a broader customer base and reduce our operating expenses. As of December 31, 2001, we had a total of 3,541 authorized third-party agencies and distributors in addition to 4,928 retail outlets that we owned and operated directly.

We provide a range of wireline telecommunications services, including, among others, local and long distance telephone and data services, to government agencies and regulatory authorities at all levels as well as to many state-owned enterprises in our service regions. A number of these government entities and state-owned enterprises are among our largest customers. We provide these services in the normal course of business and do not offer them any special tariff discounts.

Our five largest customers accounted for approximately 10.1% of our total operating revenue for 2001. Our largest customer accounted for approximately 8.1% of our total operating revenue for 2001. None of our Directors or their respective associates (as defined by the Hong Kong Listing Rules), or our existing shareholders who to the knowledge of the Directors own more than 5% of our issued share capital, has any interest in any of our five largest customers.

Network System

We were able to realize significant economies of scale as a result of the extensive coverage and scale of our network. It employs a variety of advanced technologies and

suitable architecture and can be efficiently migrated to the next generation of network technology. Our network system is managed and operated by our experienced network management and maintenance teams and offers flexible functionality and reliable operation. It supports a comprehensive range of end-to-end wireline telecommunications services and enables customized products to be delivered for a variety of telecommunications needs. Our networks and services are supported by our strong research and development capabilities. We have formulated viable plans in light of future advances in technology to migrate our network system smoothly to the next generation of network technology in order to protect our existing investments.

Network Architecture

Our network system consists of transport networks, service networks, an application layer and support networks.

- *Transport networks:* Transport networks provide the transport functions of voice and data signals for all of our services.
- *Service networks:* Service networks include our wireline telephone network, data networks, Internet network and other service networks such as intelligent networks, and support our basic and value-added telecommunications services.
- *Application layer:* The application layer provides the platform for a variety of applications and services such as e-commerce, video-on-demand, and on-line games.
- *Support networks:* Support networks include signaling networks, digital synchronous networks and network management systems and support the reliable and effective operation of our networks at all levels.

Network Capacity and Technology

Local access networks. We own extensive local access networks in our service regions. As of December 31, 2001, our local access networks covered all cities, counties and rural villages in our service regions. As part of our strategic focus on the data and Internet market, we continue to expand our broadband local access networks utilizing our existing copper line resources. In addition, we continue to upgrade our existing local access lines using DSL technology. At the same time, we are selectively connecting additional large office buildings and business centers with fiber optic access. As of December 31, 2001, the total capacity of our DSL access ports reached 712,550 lines. We have also selectively developed PHS networks for wireless local telephone service to supplement our wireline access systems. Moreover, we are developing wireless LANs in airports and other commercial centers to provide business travelers with broadband access services.

Transport network. Our transport system is based on an advanced, high-speed, large-capacity, secure and reliable fiber optic network throughout our service regions. Our fiber optic transport network is also supplemented by satellite transmissions and digital microwave links. Our fiber optic network had a total cable length of 181,660 kilometers in our service regions as of the end of 2001. Our transport network is integrated with the fiber optic network of China Telecom Group outside our service regions, which, together with our

networks, forms the largest nationwide fiber optic transport network in China, and is connected with networks worldwide.

Our fiber optic transport network employs SDH architecture and DWDM technology extensively, both of which allow for simpler and more easily managed networks with enhanced reliability. We use DWDM technology on most of our long distance transmission routes to expand transmission capacity. The main routes of our backbone fiber optic networks in our service regions have been upgraded to 10Gbps-based DWDM systems and provide transmission bandwidth of up to 32 x 10Gbps or 160 x 10Gbps. As of the end of 2001, the total capacity of our long distance transport network reached 780Gbps. In addition, we have deployed self-healing, DXC, 1+1 protection and other protection technologies and provide customers with network services of various levels of reliability based on their requirements.

Wireline telephone networks. Our wireline telephone network has been substantially built in the last decade utilizing digital technology. It consists of 48 local switching networks and a long distance switching network. As of the end of 2001, the total capacity of local switches reached 69 million lines, and the capacity of long distance toll switches reached 1.6 million ports. In addition, China Telecom Group has built international gateways in Shanghai and Guangzhou with a total capacity of 59,500 access ports, and we utilize these international gateways for our international long distance telephone services. In developing our wireline telephone networks, we have adopted technologies that enable high capacity and fewer exchanges to reduce our construction and operating costs. We have installed advanced intelligent networks over our telephone networks. Intelligent networks combine advanced computer technologies with traditional switching techniques to provide flexible value-added services such as prepaid services, virtual private network services and toll free call services.

Data and internet networks. We have developed a large-capacity, high-quality, reliable and extensive data and Internet network system in our service regions. Our data and Internet networks allow us to provide services both at the network layer, such as Internet access, managed data and virtual private network services, and at the application layer, such as Internet data center, e-commerce and video-on-demand services.

Our data network system includes a DDN network, a frame relay network and an ATM network. These networks cover all cities and counties in our service regions. Our ATM network allows multi-service access and flexible bandwidth management and provides high-quality, integrated end-to-end services.

Our Internet network is part of ChinaNET, the largest public Internet network in China, operated by China Telecom Group. ChinaNET deploys mainstream Gbps routers as the main network technology. Most of its backbone routes allow high-speed transmission with the use of several 2.5Gbps circuits. The total bandwidth of the nationwide backbone network of ChinaNet reached 800Gbps and its international exit bandwidth reached 3.2Gbps as of the end of 2001.

Support networks. The operation of our wireline telephone, data and Internet networks depends on various support networks, including a signaling network based on a signaling technology known as Signaling System 7 protocol, a digital synchronous network and network management systems for various networks and services.

Equipment procurement. We purchase most of our network equipment from leading international suppliers or their joint ventures in China. We also purchase from local suppliers a variety of network equipment, such as transport equipment and local switches. We make most of our purchases through competitive tenders primarily based on product and service quality, system compatibility and price.

Our five largest suppliers of telecommunications equipment accounted for approximately 22.3% of our total capital expenditures for 2001. Our largest supplier of telecommunications equipment accounted for 7.0% of our total capital expenditures for 2001. All payments to our suppliers are in Renminbi. None of our Directors or their respective associates (as defined by the Hong Kong Listing Rules), or our existing shareholders who to the knowledge of the Directors own more than 5% of our issued share capital, has any interest in any of our five largest suppliers.

Research and Development

Our emphasis on research and development has contributed to the development of our advanced network system and the rollout of our new applications and services. Our research and development is carried out by over one thousand experts and researchers in our research centers. These researchers focus on network planning and support, new technology trials, market evaluation, investment-related financial analysis and other key areas. Specific areas of research include fiber optic transmission technology, mobile communications technology, next-generation networks, broadband access, data communications, operation and service support systems and development of value-added services.

Information Technology Systems

Our business support systems, operation support systems and management information systems form our overall enterprise information system.

- Our business support systems (BSS) include our business management system, billing and customer service systems and provide comprehensive and integrated support for various aspects of our business, such as customer relationship management, new service request responses, billing and network error reporting and correction.
- We have developed our operation support systems (OSS) and continue to enhance their functionality. These systems include an integrated network management system and a network resources system, and enable us to enhance network management capabilities, promptly correct network errors and improve resource utilization and network reliability. See the Section headed “— Support Networks.”
- Our management information systems (MIS) include financial information, procurement and human resources management systems. These systems gather and process various operational and financial data for management, marketing and customer service purposes. Operating and financial data gathered by these systems allow us to analyze network usage patterns, monitor service quality and customer satisfaction, understand market demand and trends, determine network expansion needs and investment plans and formulate marketing strategies. We

are in the process of further improving our management information systems and incorporating them into our enterprise resource planning (ERP) system.

Organizational Restructuring and Business Process Re-engineering

We have implemented various initiatives to restructure our organization and have undertaken a business process re-engineering, or BPR, project. At the headquarters level, we have integrated various points of interface with our customers and have established a dedicated large enterprise customer service department to better serve our large enterprise customers and coordinate internal responsibilities. At the local operational level, we have streamlined the organization of business by designating each of our 48 local networks as a basic business unit, of which the 30 most profitable basic business units are identified as the strategic business units. Our BPR project aims to effect organizational and operational changes in a number of areas, including organizational structure, network investment process, allocation of network resources, large customer management, billing and collection and employee evaluation and incentive schemes.

In addition, we have taken various steps to centralize and streamline the management of our business. For example, we have improved our capital budgeting process and centralized equipment procurement in order to reduce the cost of network expansion and maximize return on investment. We have also centralized network maintenance of local networks to optimize the network maintenance system and reduce maintenance cost. We have only recently begun to implement these restructuring initiatives and intend to implement such initiatives throughout our Company within two years. While the full effects of these initiatives on our operations are not yet clear, we believe that we will benefit greatly from these restructuring initiatives in terms of increased efficiency, reduced cost and, ultimately, enhanced competitiveness.

Competition

We compete with other telecommunications service providers in our wireline telephone, data, Internet, and leased line services. All of our principal competitors are wholly or majority owned by the Chinese government. The government encourages orderly and fair competition in the telecommunications industry in China. Currently, providers of basic telecommunications services must apply for a license from the Ministry of Information Industry. Only a limited number of providers have obtained licenses to provide basic telecommunications services in China. Until the mid-1990s, we were the sole provider of wireline telecommunications services in our service regions. There are currently two licensed mobile telecommunications service providers and four wireline service providers in China. The recent restructuring of China Telecom Group has introduced China Netcom Group, an experienced wireline telecommunications service operator, as our competitor. We expect to face increased competition in our service regions. See the Section headed “Regulation — Licensing.”

Competition in Wireline Telephone Services

Local telephone services. Mobile service substitution in our wireline telecommunications services has been the principal competition to our local telephone

services. Currently, China Mobile and China Unicom are the only licensed providers of mobile communications services in China. They have diverted some of the traffic from our wireline networks. Compared to these mobile service providers, we continue to offer better voice quality, higher communication consistency, reliability and lower cost. Mobile service providers, however, have the advantages of mobility and roaming capability.

Until the mid-1990s, we were the sole licensed wireline local telecommunications services provider in our service regions. Our local wireline services currently compete with the wireline services offered by China Railcom, which has been licensed to provide local telecommunications services in our service regions. We compete with these operators primarily on the basis of brand name, network coverage, service quality and service offerings. In addition, we have a large customer base, which allows us to compete through economies of scale and to cross-sell our services to our existing customers.

Long distance telephone services. We compete with China Unicom and China Railcom with respect to long distance telephone services using public switched telephone networks in our service regions. China Unicom and China Railcom are allowed to set their tariffs for long distance services using public switched telephone networks, subject to annual regulatory approval, and are therefore able to offer more competitive prices to customers. In addition, mobile telecommunications services have diverted some of the traffic from our long distance telephone services. We compete with these service providers on the basis of customer base, brand name, network resources, quality of service and marketing and distribution strength. Access to our long distance services does not require the dialing of any pre-set access number or personal identification number.

China Mobile, China Netcom Group, China Unicom and China Railcom provide VoIP services that compete with our public switched telephone network and VoIP long distance services in our service regions. We compete with these VoIP service providers on the basis of customer base, reliability, quality and coverage of networks and general service quality. The tariff adjustments in 2001 deregulated the tariffs of VoIP services. This has allowed us to combine price flexibility with bundled services to meet different customer needs and to attract customers.

Competition in Data and Internet Services

We compete with China Netcom Group and China Unicom for managed data services. We compete on the basis of end-to-end connectivity, network coverage, service quality and scale efficiency. We compete with other service providers of Internet access services on the basis of the coverage of access networks, customer base and cooperation with the providers of Internet content and applications.

Competition in Leased Line Services

We compete with China Netcom Group, China Unicom and China Railcom in leased line services. We compete with them on the basis of the coverage and quality of networks, ability to provide end-to-end connectivity, quality of network management and customer services.

Competitive Implications of China's Accession to WTO

Since China's accession to the WTO, foreign operators have been permitted to gradually increase their investments in the telecommunications industry in China. Like domestic service providers, foreign operators are subject to the licensing requirements of the Ministry of Information Industry. In addition, investments by foreign operators may not exceed limits set forth in relevant laws and regulations with respect to the amount of investment and percentage of total investment that foreign operators are permitted to make in telecommunications enterprises in China. For example, the foreign ownership percentage in basic telecommunications services will be subject to a maximum limit of 49%. See the Section headed "Regulation — Licensing."

Foreign operators may have competitive advantages over us in terms of financial and management resources, network management and technical expertise. On the other hand, because foreign operators currently are prohibited from establishing wholly owned subsidiaries in China, we believe that we are well positioned to establish strategic alliances with strong global operators. See the Section headed "Risk Factors—Risks Relating to Our Business—We face increasing competition, which may adversely affect our business growth and results of operations."

Employees

General

As of June 30, 2002, we had 105,952 employees. The table below sets forth the number of our employees by their functions as of June 30, 2002:

	<u>Number of Employees</u>	<u>% of Total</u>
Management, finance and administrative	18,828	17.8%
Sales and marketing	29,320	27.7%
Operations and maintenance	52,153	49.2%
Research and development	1,892	1.8%
Others	<u>3,759</u>	<u>3.5%</u>
Total	<u>105,952</u>	<u>100.0%</u>

As of June 30, 2002, we also employed approximately 29,400 temporary employees.

We have implemented a number of initiatives in recent years to enhance the qualifications and productivity of our employees. Our employees are selected through competition. We conduct periodical review of their performance, and their salaries and bonuses are determined based on their performance. In addition, we have implemented training programs tailored for different job requirements. We believe that these initiatives have contributed to our increased employee productivity. For instance, the number of our access lines in service per employee has increased, reaching 469 in 2001. We currently intend to increase our sales and marketing force to improve the quality of our customer service. We have not been subjected to any strikes or other labor disturbances that have interfered with our operations, and we believe that the relationship between our management and the labor union of our company is good.

Employee Benefits Plan

As stipulated by the regulations of the PRC, we participate in various defined contribution retirement plans organized by municipal and provincial governments for our staff. We are required to make contributions to the retirement plans at rates ranging from 16.5% to 20% of the salaries, bonuses and certain allowances of our staff. A member of the plan is entitled to a pension equal to a fixed proportion of the salary prevailing at his retirement date. We have no other material obligation for the payment of pension benefits associated with these plans beyond the annual contributions described above. Our contributions for the years ended December 31, 1999, 2000 and 2001 were RMB619 million, RMB648 million and RMB849 million, respectively.

Properties***Executive Offices***

Our principal executive offices are located in Beijing and we obtained the right to occupy and use these offices pursuant to an agreement we entered into with China Telecom Group in September 2002. See the Section headed “—Connected Transactions—Ongoing Connected Transactions between Us and China Telecommunications Corporation—Centralised Services Agreement.”

Owned Properties

We use approximately 18.0 million square meters of land and premises throughout our service regions as offices, retail outlets and machine rooms. Most of the land and building titles to these properties, which were acquired by us as part of the Reorganization, are still registered in the name of China Telecom Group. China Telecommunications Corporation has undertaken to us to have the land and building titles registered in our name within six months (or to assist us to have the land and building titles registered in our name within two years in respect of allocated land acquired during the period from December 31, 2001 to September 9, 2002 and transferred to us as part of the Reorganization) from the date of our incorporation on September 10, 2002 (or before the expiry of the relevant temporary title certificate). China Telecommunications Corporation has agreed to be responsible for any costs, expenses, claims and to indemnify us against any loss or claims arising from its application to have the land and building titles registered in our name. We have obtained a PRC legal opinion from Jingtian & Gongcheng, our legal adviser on PRC law, stating that there will be no legal impediment for us to acquire the relevant land titles. China Telecom Group has also agreed to indemnify us against any loss or damage incurred by us caused by or arising from any challenge of, or interference with, our right to use these properties. None of these properties are, singly, of material significance to our operations. In addition, as the specific locations of these properties are not of particular importance to us, we believe that we would, if necessary, be able to obtain alternative premises for use as offices, retail outlets and machine rooms without disrupting our business operations.

Leased Properties

We lease from China Telecom Group and/or its affiliates and third parties approximately 9,730 properties throughout our service regions. China Telecommunications Corporation has undertaken to us that it will indemnify us against any loss or damage caused by or arising from any challenge to, or interference with, such right. See the Section headed “—Connected Transactions—Ongoing Connected Transactions Between Us and China Telecom Group—Property Leasing Agreements.”

Chesterton Petty Limited, an independent valuer, has valued our owned property interests as of June 30, 2002 at RMB44,372 million, including those properties for which we have not yet obtained formal title certificates. The text of the letter and the valuation certificate issued by Chesterton Petty Limited are set out in Appendix IV—"Property Valuation."

We have obtained a legal opinion from Jingtian & Gongcheng, our legal adviser as to PRC law, on title matters relating to these properties. We did not obtain a valuation for those leased properties in respect of which we have not entered into formal lease agreements or the lessor does not have requisite title certificates as Chesterton Petty Limited is of the opinion that these properties are of no commercial value. To our knowledge, during the one year immediately prior to the reorganization of China Telecom Group, we did not appoint any independent surveyors for the purpose of preparing valuation reports for these properties. We believe that had there been a valuation of these properties as of June 30, 2002, there would not have been any material impact on our financial position or net asset value as of June 30, 2002 as a result of a valuation of these properties. Since June 30, 2002, there has been no material adverse change affecting these properties.

Trademarks

We conduct our business under the "China Telecom" brand name and logo. Currently, China Telecommunications Corporation owns certain trademarks in China, some of which have been registered with the Trademark Office of the PRC State General Administration for Industry and Commerce, or the Trademark Office, and some of which are in the process of being registered with the Trademark Office. China Telecommunications Corporation has executed a trademark licence agreement with us. Under this agreement, China Telecommunications Corporation agreed to grant to us and our subsidiaries the right to use these trademarks upon the completion of the registration on a royalty-free basis until December 31, 2004, which is automatically renewable at our option. See the Section headed "—Connected Transactions—Ongoing Connected Transactions between Us and China Telecommunications Corporation — Trademark Licence Agreement."

Legal Proceedings

We are involved in legal proceedings in the ordinary course of business. However, we are not involved in any litigation, arbitration or administrative proceedings that could have a material adverse effect on our financial condition or results of operations, taken as a whole. So far as we are aware, no such material litigation, arbitration or administrative proceedings are threatened.

CONNECTED TRANSACTIONS

In connection with the Reorganization, we have entered into various agreements with China Telecommunications Corporation and a number of its subsidiaries with effect from January 1, 2002 relating to the mutual provision of ongoing telecommunications and other services.

The mutual provision of ongoing telecommunications and other services between China Telecom Group and us will constitute connected transactions within the meaning of the Hong Kong Listing Rules. Such agreements include the following:

- Arrangements relating to the Reorganization and the Global Offering;
- Trademark Licence Agreement;

- Centralised Services Agreement;
- Interconnection Agreement;
- Optic Fibers Leasing Agreement;
- Engineering Agreements;
- Property Leasing Agreements;
- Third Party Properties Sub-Leasing Agreements;
- IT Services Agreements;
- Equipment Procurement Agreements;
- Community Services Agreements;
- Ancillary Telecommunications Services Agreements; and
- Special Communications Services Agreements.

We have set out in this section certain historical amounts for the three years ended December 31, 2001, in respect of connected transactions between China Telecom Group and us that occurred prior to the Reorganization. These historical amounts are based on our accountants' report which have been prepared to include, as of December 31, 2001, certain assets that were retained by China Telecom Group. As a result, the historical amounts do not reflect the terms of the agreements we entered into with China Telecom Group pursuant to the Reorganization. Accordingly, the historical amounts should not be read as an indication of future transaction amounts.

Arrangements Relating To The Reorganization And The Global Offering

The following arrangements or agreements have been entered into between China Telecom Group and us, the performance of which will technically be considered connected transactions after the listing of the H Shares on the Hong Kong Stock Exchange.

The Restructuring Agreement

To effect the Reorganization, China Telecommunications Corporation and us entered into a restructuring agreement whereby China Telecommunications Corporation agreed to transfer to us the assets and liabilities referred to in the Section headed "Our Reorganization—Our Reorganization" and after such transfer, China Telecommunications Corporation became the owner of our entire equity interest. Pursuant to the restructuring agreement, China Telecommunications Corporation will indemnify us for any actions, suits, proceedings, claims, losses, damages, payments or other expenses incurred in connection with or arising from, amongst others:

- (1) the assets transferred to us in the Reorganization and arising before December 31, 2001, except for claims specifically assumed by us;
- (2) all taxes payable in respect of the assets which have been transferred to us pursuant to the Reorganization arising on or before December 31, 2001 and were not included in our balance sheet as of December 31, 2001;
- (3) all taxes payable in respect of the assets, interests and liabilities which are retained by China Telecom Group after the Reorganization;

- (4) the negligence or default of China Telecom Group acting on our behalf in holding any assets, interests or liabilities that are to be transferred to us, pending third party consents on or after the Reorganization;
- (5) breach of the provisions of the restructuring agreement on the part of China Telecom Group;
- (6) any assets and liabilities which have been transferred to us pursuant to the restructuring agreement in respect of any period before December 31, 2001; and
- (7) the assets and liabilities retained by China Telecom Group after the Reorganization.

We have agreed to indemnify China Telecommunications Corporation for any claims or costs arising from our breach of the restructuring agreement.

In addition, China Telecommunications Corporation has also agreed to provide certain warranties and indemnities to us against all losses or damages suffered by us as a result of any defective titles of properties owned by independent third parties and leased by China Telecom Group to us. Please refer to the Section headed “—Connected Transactions—Third Party Properties Sub-leasing Agreements” below for a more detailed discussion of these properties.

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. Furthermore, in accordance with an approval of the MII, China Telecommunications Corporation shall hold and maintain all licences received from the MII in connection with our business for our benefit. In addition, China Telecommunications Corporation has given an undertaking to us to take all actions necessary to obtain, maintain, renew and otherwise extend to or for our benefit such governmental or regulatory licenses, consents, permits or other approvals as we shall require to continue to operate our businesses.

Letter of Undertakings

In connection with the Reorganization and the Global Offering, China Telecommunications Corporation has, by a letter of undertakings that is legally binding indefinitely, undertaken that it will support us in our existing operations and future development. China Telecommunications Corporation has also undertaken to us in the following specific areas that:

- (1) we will be the only basic telecommunications services provider under China Telecommunications Corporation’s control that will have its securities listed on a stock exchange in Hong Kong or outside of mainland China;
- (2) to the extent within China Telecommunications Corporation’s control, we will be treated equally with any other operators of wireline telephone, data and Internet, leased line or other related telecommunications services that are controlled by China Telecommunications Corporation with respect to all approvals, transactions and arrangements between us and China Telecommunications Corporation and/or operators controlled by China Telecommunications Corporation; and

- (3) we will have the option to provide additional telecommunications services in the service regions that fall within China Telecommunications Corporation's scope of business (including the testing and commercial operation of new telecommunications services and technologies) and we will have the preferential right to acquire China Telecommunications Corporation's interest in companies or other entities that provide telecommunications services.

We expect that China Telecommunications Corporation will implement its undertaking of extending support to us by honoring its specific commitments set forth above.

Non-competition Agreement

Pursuant to a non-competition agreement between us and China Telecommunications Corporation, China Telecommunications Corporation has undertaken that, so long as

- (1) it is our controlling shareholder (within the meaning of the Hong Kong Listing Rules or other applicable regulations); and
- (2) so long as our H Shares or ADSs or any other equity securities are listed on the Hong Kong Stock Exchange, the New York Stock Exchange, any other stock exchange or any automated trading system that our securities may be listed,

neither it nor any company, enterprise or entity controlled by it, (except us) will directly or indirectly participate or engage in any basic telecommunications services or selected value-added telecommunications services, including video conferencing, Internet access services, Internet data center services, Internet VPN services, Internet video conferencing and image communications services, and VPN services, which will be in competition with us within our service regions. Basic telecommunications services and value-added telecommunications services are both defined in the Telecommunications Regulations.

World Bank Loan

In 1994, the Ministry of Finance obtained a loan from the World Bank (the "World Bank Loan") which was subsequently novated to the former Ministry of Posts and Telecommunications. After a series of further novations made in conjunction with the restructuring of the telecommunications industry by the Chinese government (see the section headed "Our Reorganization—Restructuring of the Telecommunications Industry"), China Telecommunications Corporation, our promoter became the borrower of record of the World Bank Loan. A portion of the World Bank Loan has been advanced by China Telecommunications Corporation to, and utilised by, the business operated by Jiangsu Telecom Company Limited, one of our subsidiaries, and the cost of servicing the portion of the World Bank Loan advanced to Jiangsu Telecom Company Limited is borne by us. Therefore, upon the listing of our H Shares on the Hong Kong Stock Exchange, the portion of the World Bank Loan owing from Jiangsu Telecom Company Limited to China Telecommunications Corporation will constitute a connected transaction under the Hong Kong Listing Rules. As of September 30, 2002, the outstanding amount of the portion of the World Bank Loan we owe was US\$46.6 million.

Due to the time required to complete the negotiation between the World Bank and the Ministry of Finance to approve any early repayment, Jiangsu Telecom Company Limited is not expected to repay its portion of the World Bank Loan prior to the Listing Date. Instead, we

have undertaken to the Hong Kong Stock Exchange to use all reasonable efforts to cause the entire amount of the portion of the World Bank Loan outstanding from Jiangsu Telecom Company Limited to be repaid as soon as possible and, in any event, within a period of six months after the Listing Date.

Guarantees

In 1993 and 1994, the former Shanghai, Guangdong, Jiangsu and Zhejiang Posts and Telecommunications Administrations entered into various loan agreements with China Import and Export Bank for an aggregate loan amount of 38,436 million Japanese yen (US\$306 million based on the exchange rate of US\$1 = 125.52 Japanese yen, the noon buying rate of the Federal Reserve Bank of New York on October 18, 2002) to finance the development of telecommunications networks, including the development of inter-provincial transmission optic fibers. In conjunction with the restructuring of the telecommunications industry and our Reorganisation, these loans have been novated to our wholly-owned subsidiaries, Shanghai Telecom Company Limited, Guangdong Telecom Company Limited, Jiangsu Telecom Company Limited and Zhejiang Telecom Company Limited, respectively. As of September 30, 2002, 31,447 million Japanese yen (US\$251 million) remained outstanding on these loans. The entire amount of each of the loans is guaranteed by China Telecommunications Corporation. Upon the listing of our H Shares, the guarantees given by China Telecommunications Corporation will constitute connected transactions under the Hong Kong Listing Rules.

We are working with the China Import and Export Bank to have the guarantees given by China Telecommunications Corporation assumed by us in lieu of China Telecommunications Corporation as soon as possible. However, due to the length of time required to complete all relevant procedures, which could not commence until after the incorporation of all our subsidiaries in October, 2002, the assumption by our Company of the guarantees could not be effected prior to the Listing Date. We have undertaken to the Hong Kong Stock Exchange to use all reasonable endeavours to assume the guarantees as soon as possible and, in any event, within six months after the Listing Date.

Apportionment of International Settlement

Following the Reorganization, we, on behalf of ourselves and China Telecom Group, have agreed to settle any amounts due to or receive any amounts due from a foreign telephone operator in respect of international calls made between China and the relevant foreign country. Amounts will be due from a foreign telephone operator to us and/or China Telecom Group if over a period the volume of inbound calls originating from the relevant foreign country exceeds the volume of outbound calls. Conversely, amounts will be due to a foreign telephone operator from us and/or China Telecom Group if over a period the volume of outbound calls originating from us and China Telecom Group exceeds the volume of inbound calls. Any amounts due to or due from foreign telephone operators will upon receipt be settled between us and China Telecom Group on the basis of the net volume of telephone calls originating from and terminated in the respective service regions controlled by us and China Telecom Group respectively in relation to that foreign telephone operator.

We and China Telecommunications Corporation agree that such settlement between the parties shall be made every six months.

Inter-provincial Prepaid Telephone Card Settlement

We and China Telecom Group both engage in the sale of prepaid telephone cards for domestic or long distance calls such as integrated circuit cards and codified cards. Such cards have a roaming function in that they are capable of being used in provinces and municipalities other than those in which they were purchased and in which case the operator of the network in which the card is used incurs the expense of providing the service. Accordingly, when a customer purchases an inter-provincial pre-paid telephone card in one of our service regions and uses such card in any of the provinces outside our service regions and vice versa, revenue arising from the calls made by using such pre-paid telephone card including an integrated circuit card and a codified card is wholly for the account of the operator from whose service region the call was made.

We and China Telecom Group have agreed that the settlement shall be made once a month between us and China Telecom Group.

International calls are settled between China Telecom Group and foreign telecommunications operators on a six-monthly basis, while calls with regard to inter-provincial pre-paid telephone cards are settled on a monthly basis, as is consistent with industry practice. Therefore, it has been agreed between China Telecom Group and us that settlement periods will be based on the same periods for which calls are settled.

Ongoing Connected Transactions Between Us And China Telecommunications Corporation***Trademark Licence Agreement***

On September 10, 2002, we and China Telecommunications Corporation have entered into a trademark licence agreement (the “Trademark Licence Agreement”). The term of the agreement will expire on December 31, 2004, automatically renewed for further periods of three years unless we provide three months’ written notification to China Telecommunications Corporation of our intention not to renew the agreement at the expiration of its current term.

Pursuant to the Trademark Licence Agreement, China Telecommunications Corporation has granted to us the right to use the trademark bearing the China Telecom logo set out below, which is in the process of being registered at the Trademark Office under the PRC State General Administration for Industry and Commerce (the “Trademark Office”). The Trademark Licence Agreement is entered into on a royalty-free basis.



Pursuant to the same agreement, China Telecommunications Corporation has granted to us on a royalty-free basis the right to use certain other trademarks currently used by China Telecom Group in the provision of its telecommunications services. Some of these trademarks have been registered at the Trademark Office, while others are in the process of being registered. With respect to registered trademarks such as “宜通” to denote roaming

international telephone cards using the IP technology, and “一線通” to denote N-ISDN, a combined technology of providing voice, data and image simultaneously, China Telecommunications Corporation has granted us a right to use such trademarks in the course of its business. With respect to the trademarks which are pending registration, China Telecommunications Corporation has agreed not to object to our use of such trademarks and, upon completion of their registration, China Telecommunications Corporation will license the use of such trademarks to us on the same terms as those which have already been registered.

Centralised Services Agreement

Following the Reorganization, certain centralised operations, such as headquarter functions, will be jointly relied on by China Telecom Group and us. We believe that this arrangement will enhance efficiency for us on an operational level. These centralised services include:

- the provision of management services in relation to large enterprise customers of the headquarters of China Telecommunications Corporation;
- the operation of business support centre and network management centre; and
- the use of the international telecommunications transmission facilities.

(together the “Centralised Services”).

In order to formalise the arrangements relating to the Centralised Services, we and China Telecommunications Corporation entered into a centralised services agreement dated September 10, 2002 (the “Centralised Services Agreement”).

The term of the Centralised Services Agreement will expire on December 31, 2004, automatically renewed for further periods of three years unless we provide three months’ written notification to China Telecommunications Corporation of our intention not to renew the agreement. The Centralised Services Agreement stipulates that the settlement of any net amount due to or due from us shall be made once a year.

The provision of management services relating to certain large enterprise customers of the headquarters of China Telecommunications Corporation, and the operation of the business support centre and the network management centre

Following the Reorganization, we have agreed to perform management services to certain large enterprise customers of the headquarters of China Telecommunications Corporation, and to operate the business support centre and the network management centre. Under the Centralised Services Agreement, we and China Telecommunications Corporation also share certain overhead costs. In addition, we have agreed to provide human resources relating to administrative functions of China Telecom Group. Assets relating to the Centralised Services are used by both China Telecom Group and us. On the other hand, we have agreed to provide the necessary human resources responsible for the upkeep and maintenance with respect to these assets, in addition to providing maintenance services in relation to the international transmission system. The aggregate costs incurred by us and

China Telecommunications Corporation for the provision of the Centralised Services (which include salaries and benefits of our employees, depreciation of equipment and properties, maintenance fees and research and development fees) will be apportioned pro rata between us and China Telecommunications Corporation according to the revenues generated by each party.

For the three years ended December 31, 2001, our portion of the costs in respect of Centralised Services were RMB59 million, RMB78 million and RMB118 million respectively.

The use of the international telecommunications facilities

Following the Reorganization, China Telecommunications Corporation has retained the assets required for the international telecommunications facilities, such as international gateways, undersea cables and satellite facilities, and has agreed to license us to use such facilities. On the other hand, we have agreed to provide the necessary human resources responsible for the upkeep and maintenance with respect to the international telecommunications facilities. We and China Telecommunications Corporation have agreed to apportion the costs associated with operating such assets pro rata according to the aggregate volume of the inbound international calls terminated by, and outbound international calls originating from, us and China Telecom Group, respectively.

Prior to the Reorganization, no such arrangement in respect of the matters covered by the Centralised Services Agreement was in effect between China Telecom Group and us.

Interconnection Agreement

Pursuant to the Reorganization, China Telecommunications Corporation has transferred to us the domestic telephone networks within each of our service regions. These networks will interconnect with the domestic networks outside our service regions, allowing our subscribers to communicate with telephone and mobile subscribers outside our service regions. In order to facilitate interconnection between subscribers within our service regions and subscribers outside our service regions which are serviced by China Telecom Group, we and China Telecommunications Corporation entered into an interconnection settlement agreement dated September 10, 2002 (the “Interconnection Agreement”), to expire on December 31, 2004, but automatically renewed for another three-year period unless we provide three months’ written notification to China Telecommunications Corporation of our intention not to renew the agreement. The Interconnection Agreement does not provide for early termination or non-renewal by China Telecom Group. Furthermore, under Article 17 of the Telecommunications Regulations, a telecommunications operator cannot refuse to enter into interconnection arrangements with another operator if requested.

Pursuant to the Interconnection Agreement, the telephone operator terminating a telephone call made to its local access network shall be entitled to receive from the operator from which the telephone call originated a fee prescribed by the Ministry of Information Industry from time to time, which is currently RMB0.06 per minute. The formula for settlement is based on the net volume of telephone calls originating from us to China Telecom Group or originating from China Telecom Group to us multiplied by the Ministry of Information Industry prescribed settlement fee.

The Interconnection Agreement stipulates that settlement be made between us and China Telecom Group on a monthly basis, with the operator who has originated more calls paying the net amount to the operator who has terminated more calls.

Prior to the Reorganization, no such interconnection arrangement was in effect between China Telecom Group and us.

Optic Fiber Leasing Agreement

(A) Relevant Background

The provision of various telecommunications services by us to our subscribers is dependent, in part, on us leasing the inter-provincial transmission optic fibers within our service regions from China Telecom Group. The leasing of such optic fibers is a common and normal practice in the telecommunications industry, particularly given the significant development costs of such fibers. We and China Telecommunications Corporation entered into an optic fibers leasing agreement dated September 10, 2002 (the “Optic Fibers Leasing Agreement”) pursuant to which we, for ourselves and our subsidiaries, have agreed to lease the relevant parts of the inter-provincial transmission optic fibers within our service regions from China Telecom Group.

(B) Description of Arrangement

The Optic Fibers Leasing Agreement will expire on December 31, 2004, automatically renewed for further periods of three years unless we provide three months’ written notification to China Telecommunications Corporation of our intention not to renew the agreement at the end of its current period.

The amount payable by us to China Telecommunications Corporation for the leasing of the relevant parts of the inter-provincial transmission optic fibers within our service regions is based on the depreciation charge for the optic fibers within our service regions calculated on the basis of the carrying value of the optic fibers. For the year ended December 31, 2001, the depreciation charge would have been RMB75 million had the leasing arrangement taken effect on January 1, 2001. In addition, we have agreed to be responsible for the maintenance of these optic fibers within our service regions. For the year ended December 31, 2001, our maintenance cost relating to the optic fibers was approximately RMB40 million.

Prior to the Reorganization, no such lease arrangement was in effect between China Telecommunications Corporation and us.

Ongoing Connected Transactions Between Us And China Telecom Group

As part of the Reorganization, certain ancillary, and mostly non-telecommunications related businesses and assets within our service regions are operated or held by certain subsidiaries of China Telecommunications Corporation (the “Provincial Subsisting Companies”). Any transactions between the Provincial Subsisting Companies and us would constitute connected transactions under the Hong Kong Listing Rules.

Engineering Agreements**(A) Relevant Background**

It is expected that the Provincial Subsisting Companies would tender for the right to provide us with construction, design, equipment installation and testing services and/or would act as general contractors in relation to construction and supervision of engineering projects commissioned by us. Accordingly, we have entered into engineering framework agreements (the “Engineering Framework Agreements”) with the Provincial Subsisting Companies to govern the arrangements with respect to such engineering related services. The terms of the Engineering Framework Agreements will expire on December 31, 2004, automatically renewed for further periods of three years unless we provide three months’ written notification to the relevant Provincial Subsisting Company of our intention not to renew the agreements.

(B) Description of the Arrangements

The charges payable for engineering related services rendered under the Engineering Framework Agreements shall be determined by reference to market rates or as reflected by prices obtained through the tender process. According to the relevant regulations and under the Company’s internal policy, whenever the value of any engineering design and supervision project exceeds RMB500,000, or the value of any engineering construction project exceeds RMB2,000,000, the award of the project is required to be the subject of a tender process (with a minimum of three parties tendering bids). We do not accord any priority to any of the Provincial Subsisting Companies to provide such services, and the tender may be awarded to an independent third party. However, if the terms of an offer from a Provincial Subsisting Company are at least as favourable as those offered by another tenderer, it is expected that we would award the tender to the relevant Provincial Subsisting Company.

If the Provincial Subsisting Companies succeed in the bidding process, they would then enter into individual engineering agreements with us. The individual engineering agreements set out the terms and conditions under which specific engineering services are to be requested from us from time to time. The individual engineering agreements are expected to contain provisions which reflect the binding principles, guidelines, terms and conditions set out in the Engineering Framework Agreements. As the individual engineering agreements are simply further elaborations on the provision of engineering services contemplated by the Engineering Framework Agreements, as such, they do not constitute new categories of connected transactions.

For the three years ended December 31, 2001, our expenditures for engineering services made available by the Provincial Subsisting Companies to us were RMB1,909 million, RMB2,085 million and RMB2,856 million respectively.

Property Leasing Agreements***Mutual leasing of properties*****(A) Relevant Background**

Under property leasing framework agreements between us and the Provincial Subsisting Companies (the “Property Leasing Framework Agreements”), we have leased from

the Provincial Subsisting Companies a total of 4,374 properties covering an aggregate gross floor area of approximately 1.2 million square metres for use as our business premises, offices, equipment storage facilities and sites for network equipment. These properties are located throughout our service regions. Under the Property Leasing Framework Agreement and as part of the Reorganization, we also lease certain properties to the Provincial Subsisting Companies.

The terms of the Property Leasing Framework Agreements will expire on December 31, 2004, automatically renewed for further periods of three years unless we provide three months' written notification to the relevant Provincial Subsisting Company of our intention not to renew the agreements.

(B) Description of Arrangement

The rental charges in respect of each property are based on market rates, with reference to amounts stipulated by local price bureaus, taking into consideration the specific needs of the telecommunications industry when leasing properties. Rental charges are payable monthly in arrears and subject to review every three years.

The Provincial Subsisting Companies and us may enter into individual leases which set out the terms and conditions under which specific properties are to be leased by us from time to time. The individual leases are expected to contain provisions which reflect the binding principles, guidelines, terms and conditions set out in the Property Leasing Framework Agreements. As the individual service agreements are simply further elaborations on the provision of services as contemplated by the Property Leasing Framework Agreements, as such, they do not constitute new categories of connected transactions.

For the three years ended December 31, 2001, our expenditures for the rental charges were RMB92 million, RMB116 million and RMB94 million respectively. For the same period, the Provincial Subsisting Companies's expenditures for the rental charges were RMB1 million, RMB1 million and RMB13 million respectively.

Chesterton Petty Limited, an independent appraiser appointed by us for the purpose of the Global Offering, has reviewed the Property Leasing Framework Agreements and has confirmed that the rental rates payable under the Property Leasing Framework Agreements are fair and reasonable so far as we are concerned.

Third Party Properties Sub-Leasing Agreements

(A) Relevant Background

Following the Reorganization, the Provincial Subsisting Companies have sub-let to us certain properties owned by and leased from independent third parties for use as offices, retail outlets, spare parts storage facilities and sites for network equipment (the Third Party Properties). As a number of these independent third parties have not been able or willing to produce relevant title documents in respect of the sub-leased properties, China Telecom Group has agreed to give us an indemnity with respect to any claims or costs incurred by us in connection with any defect in the titles to any such Third Party Properties. In order to

formalise such arrangement, we and the Provincial Subsisting Companies have entered into sub-leasing agreements (the “Third Party Properties Sub-leasing Agreements”) which will expire on December 31, 2004, automatically renewed for further three-year periods unless we provide three months’ written notification to the relevant Provincial Subsisting Company of our intention not to renew the agreement.

(B) Description of the Arrangement

The amounts payable by us to the Provincial Subsisting Companies under the Third Party Properties Sub-leasing Agreements are the same as the amounts payable by China Telecom Group to the relevant third parties. The rental charges for the Third Party Properties are based on market rates negotiated between the Provincial Subsisting Companies and the relevant third party on an arm’s length basis.

Prior to the Reorganization, no such sub-leasing arrangement was in effect between the Provincial Subsisting Companies and us.

Chesterton Petty Limited, an independent appraiser appointed by us for the purpose of the Global Offering, has confirmed that the rental amounts payable for each of the Third Party Property under the Third Party Properties Sub-leasing Agreements is fair and reasonable so far as we are concerned, and do not exceed market rents.

Information Technology Services Agreements

We have entered into framework agreements with the Provincial Subsisting Companies in each of our service regions pursuant to which the Provincial Subsisting Companies have agreed to provide us with certain information technology services such as office automation and software adjustment (the “IT Services Framework Agreements”). The terms of the agreements will expire on December 31, 2004, automatically renewed for further periods of three years unless we provide three months’ written notification to the relevant Provincial Subsisting Company of our intention not to renew the agreement.

The Provincial Subsisting Companies are entitled to tender for the right to provide us with information technology services. The charges payable for such information technology services under the IT Services Framework Agreements shall be determined by reference to market rates as reflected by prices obtained through the tender process. We do not accord any priority to the Provincial Subsisting Companies to provide such services, and the tender may be awarded to an independent third party. However, if the terms of an offer from an Provincial Subsisting Company are at least as favourable as those offered by another tenderer, we may award the tender to the relevant Provincial Subsisting Company.

The Provincial Subsisting Companies and us providing or requiring the information technology services may enter into specific agreements which set out the terms and conditions under which such information technology services are to be provided. The individual service agreements are expected to contain provisions which reflect the binding principles, guidelines, terms and conditions in accordance with which such services are required to be provided in the IT Services Framework Agreements. As the individual service agreements are simply further elaborations on the provision of services as contemplated by

the IT Services Framework Agreements, as such, they do not constitute new categories of connected transactions.

For the three years ended December 31, 2001, our expenditures for the information technology services made available by the Provincial Subsisting Companies to us were RMB20 million, RMB20 million and RMB28 million respectively.

Equipment Procurement Services Agreements

(A) Relevant Background

Following the Reorganization, the Provincial Subsisting Companies in each of our service regions have agreed to provide equipment procurement services to us and continue to handle the procurement of foreign and domestic telecommunications equipment and other domestic non-telecommunications materials required by us. Pursuant to the equipment procurement framework agreements entered into between us and the Provincial Subsisting Companies in each of our service regions (the “Equipment Procurement Framework Agreements”), the Provincial Subsisting Companies have agreed to provide comprehensive procurement services, including the management of tenders, verification of technical specifications and installation services. These specialised functions do not form part of our core business, and therefore we consider it more economical to outsource these functions. In addition, this arrangement results in volume discounts to the extent China Telecom Group also places orders for the same equipment and ensures the standardization of equipment supplied to both us and China Telecom Group.

(B) Description of the Arrangements

Pursuant to the Equipment Procurement Framework Agreements between us and the Provincial Subsisting Companies, we may request that the Provincial Subsisting Companies act as our agents in procuring foreign and domestic telecommunications equipment and other domestic non-telecommunications materials. The terms of the Equipment Procurement Framework Agreements will expire on December 31, 2004, automatically renewed for further periods of three years unless we provide three months’ written notification to the relevant Provincial Subsisting Company of our intention not to renew. We may give priority to the Provincial Subsisting Companies if the terms and conditions of the services provided by them are at least as favourable as those offered by independent third parties.

The Provincial Subsisting Companies and us providing or requiring the services may enter into specific agreements which set out the terms and conditions under which such services are to be provided. The individual service agreements are expected to contain provisions which reflect the binding principles, guidelines, terms and conditions in accordance with which such services are required to be provided in the Equipment Procurement Framework Agreements. As the individual service agreements are simply further elaborations on the provision of services as contemplated by the Equipment Procurement Framework Agreements, as such, they do not constitute new categories of connected transactions.

Commission charges for these services are calculated at the maximum rate of:

- (1) 1% of the contract value, in the case of imported telecommunications equipment
- or

- (2) 1.8% of the contract value, in the case of domestic telecommunications equipment and other domestic non-telecommunications materials.

We believe that the above charges are the same as market rates or those rates which we would be required to pay had we appointed an independent third party to perform the same procurement services.

Prior to the restructuring, most of our equipment was first purchased from suppliers by China Telecom Group and then resold to us. Accordingly, China Telecom Group acted primarily as a principal rather than as an agent earning commissions, and no historical figures of a comparable nature are available. For the six months ended June 30, 2002, expenses incurred under the equipment procurement agreements were RMB87 million.

Community Services Agreements

(A) Relevant Background

China Telecom Group, through the Provincial Subsisting Companies, provides certain cultural, educational, property management, vehicles services, health and medical services, hotel and conference services, community and sanitary services to us. The arrangements are set out in the community services framework agreements between us and the Provincial Subsisting Companies in each of our service regions (the “Community Services Framework Agreements”) which will expire on December 31, 2004, automatically renewed for further periods of three years unless terminated by either party with at least three months’ written notification to the other party. However, if we cannot, without incurring significant cost and expense, obtain these services from a third party after such termination, the Provincial Subsisting Companies cannot terminate the provision of such services.

(B) Description of the Arrangement

Although the Community Services Framework Agreements are on a non-exclusive basis, the following conditions are to apply:

- (1) we may give priority to the Provincial Subsisting Companies in using the services, provided that the terms and conditions offered by independent third parties to us are no more favourable than those offered by the Provincial Subsisting Companies for the same services;
- (2) in return, the Provincial Subsisting Companies have undertaken to us that the Provincial Subsisting Companies shall not provide services to us on terms which are less favourable than those offered by the Provincial Subsisting Companies to third parties;
- (3) the Provincial Subsisting Companies are only entitled to provide the relevant services to third parties provided that it would not affect the provision of services to us under the Community Services Framework Agreements; and
- (4) if the Provincial Subsisting Companies cannot satisfy our needs for the services to be provided under the Community Services Framework Agreements or the terms offered by independent third parties are more favourable, we may obtain such services from other independent third parties.

We have agreed to provide to the Provincial Subsisting Companies on an annual basis an assessment of the community services that it requires in the coming year. It is envisaged that from time to time and as required, individual community services agreements be entered into between subsidiaries of China Telecommunications Corporation providing the relevant services and us. Each community services agreement contains the specific services to be provided by the Provincial Subsisting Companies. The individual community services agreements are expected to contain provisions which reflect the binding principles, guidelines, terms and conditions in accordance with which such services are required to be provided in the Community Services Framework Agreements. As the individual community services agreements are simply further elaborations on the provision of services as contemplated by the Community Services Framework Agreements, as such, they do not constitute new categories of connected transactions. Consequently the Community Services Framework Agreements form the basis for the general waiver applied for herein in relation to these types of connected transactions.

The Community Services Framework Agreements stipulate that the above community services be provided at:

- (1) the government prescribed price;
- (2) where there is no government-prescribed price but where there is a government-guided price, the government-guided price applies;
- (3) where there is neither a government prescribed price nor a government-guided price, the market price applies. The market price is defined as the price at which the same type of services are provided by independent third parties in the ordinary course of business; or
- (4) where none of the above is applicable, the price is to be agreed between the relevant parties for the provision of the above services, which shall be the reasonable cost incurred in providing the same plus a reasonable marginal profit (For this purpose, "reasonable costs" means the costs confirmed by both parties after negotiations).

We believe that the services provided by China Telecom Group under the Community Services Agreements will be on commercial terms which are no less favourable than those provided by independent third parties.

For the three years ended December 31, 2001, our expenditures for community services made available by the Provincial Subsisting Companies to us were RMB612 million, RMB684 million and RMB742 million respectively.

We anticipate that our expenditures on community services made available by the Provincial Subsisting Companies will be further increased in the following years due to our corresponding business expansion, the shift by Shanghai Telecom Company Limited from the purchase of all office equipment to the lease of all office equipment, the increase in property required by us and the subsequent increase in property management fees.

Ancillary Telecommunications Services Agreements**(A) Relevant Background**

Following the Reorganization, the Provincial Subsisting Companies have agreed to provide certain repair services to us, such as the repair of certain telecommunications equipment, the maintenance of the fire prevention equipment and telephone booths and other customers' services (the "Ancillary Telecommunications Services") on a non-exclusive basis.

(B) Description of Arrangement

Under the framework agreements between us and the Provincial Subsisting Companies in each of our service regions for the provision of Ancillary Telecommunications Services (the "Ancillary Telecommunications Services Framework Agreements"), the Provincial Subsisting Companies have agreed to provide Ancillary Telecommunications Services to us, such agreements to expire on December 31, 2004, automatically renewed for further periods of three years unless either party notifies the other at least three months prior to the expiration of the term in writing of its intention to terminate the relevant agreement. However, if we cannot, without incurring significant cost and expense, obtain these services from a third party, the Provincial Subsisting Companies cannot terminate the provision of such services.

The Provincial Subsisting Companies and us providing or requiring the services may enter into specific agreements which set out the terms and conditions under which such services are to be provided. The individual service agreements are expected to contain provisions which reflect the binding principles, guidelines, terms and conditions in accordance with which such services are required to be provided in the Ancillary Telecommunications Services Framework Agreements. As the individual service agreements are simply further elaborations on the provision of services as contemplated by the Ancillary Telecommunications Services Framework Agreements, as such, they do not constitute new categories of connected transactions. Consequently the Ancillary Telecommunications Services Framework Agreements form the basis for the general waiver applied for herein in relation to these types of connected transactions.

The Ancillary Telecommunications Services Agreements contain the following conditions:

- (1) we may give priority to the Provincial Subsisting Companies in using the Ancillary Telecommunications Services, provided that the terms and conditions offered by independent third parties to us are no more favourable than those offered by the Provincial Subsisting Companies and their subsidiaries for the same services;
- (2) in return, the Provincial Subsisting Companies have undertaken to us that the Provincial Subsisting Companies cannot provide the Ancillary Telecommunications Services to us on terms which are less favourable than those offered by the Provincial Subsisting Companies to third parties;
- (3) the Provincial Subsisting Companies are only entitled to provide the Ancillary Telecommunications Services to third parties provided that it would not affect the provision of such services to us; and

- (4) if the Provincial Subsisting Companies cannot satisfy our needs for the Ancillary Telecommunications Services to be provided under the Ancillary Telecommunications Services Agreements, we may obtain such services from other independent third parties.

The Ancillary Telecommunications Services under the Ancillary Telecommunications Services Framework Agreements are provided in accordance with the same pricing policy as that of the Community Services Framework Agreements.

For the three years ended December 31, 2001, our expenditures for Ancillary Telecommunications Services made available by the Provincial Subsisting Companies to us were RMB383 million, RMB544 million and RMB613 million respectively.

Special Communications Services Agreements

Subsequent to the Reorganization, the Provincial Subsisting Companies continue to be responsible for providing network services which are of a sensitive nature (such as services dedicated to the Chinese government and the emergency network services) (the “Special Communications Services”).

In order to provide the Special Communications Services throughout China, we and the Provincial Subsisting Companies have entered into special communications services agreements (the “Special Communications Services Agreements”) pursuant to which the Provincial Subsisting Companies have agreed to lease from us the infrastructure in connection with the Special Communications Services within our service regions in return for the Provincial Subsisting Companies paying us for the leasing of such infrastructure on a basis prescribed by Ministry of Information Industry.

On the other hand, we have agreed to provide the necessary human resources to maintain and operate the Special Communications Services within our service regions in return for China Telecom Group reimbursing us our actual cost, including cost for the network operation support, general and administrative expenses and certain other operating expenses. The term of the arrangement will expire on December 31, 2004, automatically renewed for further periods of three years unless either party provides three months’ written notification to the other party of its intention not to renew the arrangement at the end of the current period.

Prior to the Reorganization, no such arrangement was in effect between the Provincial Subsisting Companies and us.

Application For Waivers

Scope of Waivers

Following the completion of the Global Offering, we will continue to enter into or carry out the transactions described above. Such transactions would constitute connected transactions for us under the Hong Kong Listing Rules once our H Shares are listed on the Hong Kong Stock Exchange and for so long as members of the China Telecom Group remains a connected person within the meaning of the Hong Kong Listing Rules.

The Directors (including the independent non-executive Directors) and the Supervisors are of the opinion that the transactions relating to the provision of the services described above have been entered into, and will be carried out, in our ordinary and usual course of business and on normal commercial terms which are fair and reasonable so far as the interests of the independent shareholders of our Company would be concerned.

Pursuant to the Hong Kong Listing Rules, each of the transactions described under the paragraphs headed “Interconnection Agreement,” “Engineering Agreements,” “Community Services Agreements” and “Ancillary Telecommunications Services Agreements” referred to above would normally require full disclosure and prior approval by independent shareholders. It is considered that such disclosure and approval in full compliance with the Hong Kong Listing Rules would be impracticable. We have requested, subject to the conditions set out below, a waiver from strict compliance with the requirements of Chapter 14 of the Hong Kong Listing Rules, in relation to such transactions.

Conditions of Waiver

(A) Arm’s Length Basis

The conditions referred to in our waiver above are that the transactions, and the respective agreements (if any) governing such transactions, shall be:

- (1) entered into by us in the ordinary and usual course of our business; and
- (2) either:
 - (i) on normal commercial terms, or
 - (ii) where there is no available comparison to judge whether they are on normal commercial terms, on terms no less favourable than those available to or from independent third parties,
 - (iii) on terms that are fair and reasonable so far as the independent shareholders of the Company are concerned, and
 - (iv) if applicable, with the annual aggregate value of each category of connected transactions not exceeding the relevant annual caps.

(B) Disclosure

In our annual report and accounts for each year, we shall disclose brief details of the transactions in such year as required by Rule 14.25(1)(A) to (D) of the Hong Kong Listing Rules, i.e.:

- (1) the date or period of the transaction,
- (2) the parties thereto and a description of their connected relationship,
- (3) a brief description of the transaction and the purpose of the transaction,
- (4) the total consideration and the terms, and
- (5) the nature and extent of the interest of the connected person in the transaction.

(C) Independent Directors' Review

Our independent non-executive Directors shall review annually the transactions and confirm, in our annual report and accounts for the year in question, that such transactions have been conducted in the manner stated in conditions (1) and (2) in paragraph (A) above.

(D) Auditors' Review

Our auditors shall carry out review procedures annually on the transactions and shall confirm to our Directors in writing (with a copy to the Hong Kong Stock Exchange at least ten business days prior to the bulk print of our annual report) whether, based on those procedures, the transactions:

- (1) have received the approval of our Directors;
- (2) have been entered into in accordance with the pricing policies as stated in the relevant agreements, where applicable;
- (3) have been entered into in accordance with the terms of the agreements governing the transactions; and
- (4) have not exceeded the caps specified in paragraph (E) below.

For the purpose of the above review by our auditors, China Telecommunications Corporation has undertaken to us to provide our auditors with access to its accounting records, as well as (where possible) those of its subsidiaries and associates.

(E) Caps

The aggregate annual value of the following categories of connected transactions shall not exceed the limits set out below:

Transactions	Proposed Annual Caps
(1) Engineering Agreements	RMB4,392 million
(2) Community Services Agreements	RMB2,639 million
(3) Ancillary Telecommunications Services Agreements	RMB1,510 million

We have undertaken that if any of the material terms of the agreements referred to above are altered (unless as provided for under the terms of the relevant agreement or arrangement) or if we enter into any new agreements or arrangements with any connected persons (within the meaning of the Hong Kong Listing Rules) in the future under which the aggregate consideration paid or payable by us in each year exceeds the limits referred to above, we will comply with the provisions of Chapter 14 of the Hong Kong Listing Rules dealing with connected transactions unless we apply for and obtain a separate waiver from the Hong Kong Stock Exchange.

Confirmation from the Joint Sponsors

Based on the information (including historical figures) and documents provided by us relating to the connected transactions described under the headings "Interconnection

Agreement”, “Engineering Agreements,” “Community Services Agreements” and “Ancillary Telecommunications Services Agreements,” and relying upon confirmations and representations made by us, our Directors and Supervisors, the Joint Sponsors are of the view that the terms of the Interconnection Agreement, the Engineering Framework Agreements, the Community Services Framework Agreements and the Ancillary Telecommunications Services Framework Agreements, are fair and reasonable as far as our shareholders are concerned.

It should be noted that the Joint Sponsors have, in reaching their above opinion, assumed and relied very significantly, without conducting any independent verification, confirmation, evaluation, appraisal or investigation, upon the accuracy and completeness of such documentation, information, representations and confirmations at the time they are supplied, and that they will continue to be so at the time of this prospectus. The Joint Sponsors’ above opinion represents their views as at the date of this prospectus and such views are necessarily based on, and assume no change in, economic, market and other conditions in effect on, and the information made available to them for the purposes hereof and as at, the date of this prospectus.

Our Directors believe that it is in our interests to have the above arrangements in place after the listing of H Shares on the Hong Kong Stock Exchange.