



Dear Shareholders,

In the first half of 2003, we achieved a strong financial performance and maintained upward trends in our core businesses. We placed the accelerated expansion of our businesses on top of our agenda and consolidated the implementation of our strategies during this period. While improving our internal management, we fine-tuned our operating tactics in response to market changes. As a result, we maintained healthy and stable growth in our core businesses in the period.

### FINANCIAL RESULTS

In the first half of 2003, our revenue sustained stable growth, increasing 7.2% over the same period last year to a total of RMB39,536 million. Growth was driven by the continued expansion of our local subscriber base, the rapid growth in broadband subscribers, and the advancement of new value-added services. Strengthened management contributed to greater resource utilization and disciplined control over operating expenses. Our operating expenses for the period were RMB27,338 million, representing a 5.3% increase over the same period last year. EBITDA<sup>(1)</sup> grew 10.2% to RMB23,057 million, with an EBITDA margin of 58.3%. Net profit grew 9.2% to RMB9,260 million, with a net profit margin of 23.4%. Capital expenditure was RMB9,553 million in the first half of 2003.

### BUSINESS REVIEW

Our local telephone service sustained rapid expansion of its subscriber base in the first half of 2003, with wireless local access service accounting for a higher percentage of total local telephone subscribers. Our broadband service continued its fast growth and has been an

(1) Our EBITDA represents profit before net finance costs, investment income, share of profit from associates, taxation, depreciation and amortisation and minority interests.

increasingly important contributor to our revenue growth. Long distance services remained stable. Wire-line value-added services and new services experienced noticeable development.

### Local voice service

Local voice service, our pillar product, experienced steady growth in the first half of this year. Local voice revenue increased 5.5% to RMB18,488 million, accounting for 46.8% of our total revenue for the first half of 2003.

Our local subscriber base expanded by 5.34 million, increasing 9.4% from year-end 2002 to 62.20 million. The continually growing local telephone subscriber base constitutes a solid base for all of the services we offer. We intensified our efforts in developing public and enterprise telephone subscribers that yield a greater return on investment than other types of local subscribers, and added 1.03 million such new subscribers, representing 19.4% of total new subscribers, to further improve the structure of our subscriber base.

As an extension of and supplement to our local wire-line telephone service, wireless local access service provides personal communication at an attractive price, thereby enjoying strong demand in niche markets. Wireless local access subscribers reached 5.37 million, representing 8.6% of total subscribers. The continued decline in the price of local wireless access equipment has made this service a more profitable business.

Revenue from local usage increased 2.5% over the same period last year to RMB11,239 million for the first half of 2003. Local voice usage (excluding dial-up Internet access usage) was 88.7 billion pulses, representing a 3.9% increase over the same period last year. Dial-up Internet access usage totaled 22.0 billion pulses, decreased 16.2% from the same period last year.



Increasing local traffic is one of the key means by which we ensure the high quality development in our local business. We will continue to stimulate local traffic and revenue growth through enhancement of our distribution channels, provision of bundled services and flexible pricing packages, as well as the accelerated development of public telephone, calling card and new value-added services.

### Internet and Data services

Internet service performed strongly in the first half of this year. Driven by the rapid growth of our broadband service, our Internet revenue grew 60.3% to RMB2,669 million, representing 6.8% of our total revenue, an increase of 2.3 percentage points compared with the first half of 2002. Internet service has become an increasingly important revenue contributor.

We focused heavily on the development of our broadband service, continuing the implementation of active market development strategies, so as to sustain fast growth. A variety of broadband access service such as "Network Express" (ADSL access service), "Broadband Highway" (FTTX+LAN access service), and "Wing of Sky" (wireless LAN access service) were offered to meet different customers' needs, driving the fast growth of broadband subscribers. We expanded our broadband subscriber base by 85.8% between the end of 2002 and the end of June 2003, adding 1.18 million new subscribers to a total of 2.56 million subscribers. We positioned our broadband service as a premium product and the revenue per user per month remained stable in the period. Centralization of equipment procurement and economies of scale have further reduced per-line investment costs for broadband service. As such, the return on investment for our broadband service continued to increase.

While promoting our various broadband access products, we also placed special emphasis on

broadband content and applications. We strengthened cooperation with Internet content and application providers and computer manufacturers to advance their integration into our CHINAVNET platform. The value chain between end users, content and application providers and us has taken form.

Dial-up Internet subscribers numbered 11.70 million at the end of June this year, up 0.7% from the end of 2002. Total dial-up usage generated from our subscribers declined 20.9% from the same period last year to 16.1 billion minutes. The major reason for this decrease was the migration of high-end narrowband dial-up users to our broadband service. Our dial-up Internet service fosters customers' affinity for the Internet and meets the demand of a specific customer group with its ease and convenience of use. We will focus on achieving concerted development of both our dial-up and broadband services based on the dynamics between them.

Managed data service experienced fast growth over the past six months. Revenue grew 15.1% to RMB974 million, accounting for 2.5% of our total revenue. The bandwidth volume of Digital Data Network (DDN), Frame Relay (FR) and Asynchronous Transfer Mode (ATM) managed data services grew by 41.5%, 54.3% and 20.7%, respectively, over the same period last year.

### Long Distance services

Facing an increasingly competitive market situation, we adopted more flexible and effective marketing strategies for our long distance services in the first half of this year. Total domestic long distance traffic transmitted by us amounted to 19.1 billion minutes, representing a 16.8% increase over the same period last year. Our market share for domestic long distance service was 52.6% for the first half of this year, which was at a similar level to the second half of 2002. Revenue from domestic long distance



service decreased by 2.3% to RMB6,985 million, in line with our expectations. Domestic long distance revenue as a share of our total revenue decreased 1.7 percentage points from the same period last year to 17.7%. We believe the risk in our domestic long distance business was therefore further moderated.

International, Hong Kong, Macau and Taiwan long distance services recorded RMB1,668 million in revenue in the first half of 2003, up 4.2% from the same period last year. Total traffic grew 16.7% to 712 million minutes. We consolidated our market position with a market share of 63.4%, up 4.4 percentage points from the end of 2002.

#### Leased line, Interconnection and VAS services

Revenue from leased line service decreased by 9.4% to RMB1,409 million, representing 3.6% of our total revenue. In the first half of this year, we leased out a total of 88,000 digital circuits (in 2Mbps equivalents), down 6.8% from the same period last year. The major reason for this decrease was the substantial change in the demand structure for our leased line service in the first half of this year: as other telecom operators rolled out their own networks, they reduced the number of circuits leased from us. On the other hand, both the number of non-telecom operator enterprise customers and their usage have increased, partly offsetting the adverse impact of telecom operators' decreased use of our services. The risk in leased line service was reduced.

Revenue from interconnection in the first half of this year was RMB2,253 million, remaining close to the figure for the same period last year and representing 5.7% of our total revenue. Revenue from inbound local calls saw an increase while both revenue from, and expense for, long distance interconnection decreased. As a result, net interconnection income showed an increase over the same period last year.

Our wire-line value-added services experienced noticeable development. We enhanced our promotional activities for caller ID display service and increased its penetration rate by 5.2 percentage points during the first half of 2003. Meanwhile, we also made great efforts to boost our call-up information, information telephone, video conference and 17901 direct dial VoIP services and to introduce new services such as "Telephone QQ" and "Walk With Me". Revenue from value-added services rose significantly and its weight in our total revenue also increased in the first half of this year.

#### SUMMARY AND OUTLOOK

Our major services displayed stable growth trends in the first half of 2003: our local subscriber base experienced fast growth and wireless local access service became a more profitable business. Our broadband service yielded outstanding results. Businesses under heavy competitive pressure, such as long distance services, saw reduced risks and solid market positions for our company. We achieved robust financial performance in the first half of 2003: operating expenses were further optimized while operating profitability was steadily improved with strong free cash flow. In the meantime, we are still facing fierce competition: local voice traffic is affected by greater mobile substitution and long distance market competition is still intensive. We will take full advantage of the opportunities presented by the strong demand for telecom services in China's domestic market and further improve our management system and the execution of our strategies. Having achieved the strong performance in the first half, we intend to continue the development of our services by focusing on the following:

***We will continue to improve our management system and to implement management innovation.*** We will adhere to our market-oriented, customer-centered and return-driven



business model, and strive to realize a business characterized by efficient management, unified and centralized resource deployment, timely response to market developments, and effective incentive schemes. We will further boost our business powered by our reform initiatives.

***We will fine-tune our operating tactics in response to market situations.***

While strengthening our distribution channels, we will establish a comprehensive service network that combines distribution channels and network operations and maintenance. We will boost traffic growth through active marketing activities, improve customer satisfaction through quality customer service, and foster new markets for telecom consumption by developing and introducing new products and services, all aimed at maintaining high revenue growth.

***We will adhere to our goals of value creation for shareholders.*** We are committed to maintaining rapid revenue growth outpacing growth in our expenses. We will further optimize cost and capital expenditure structures and strive to improve our return on investment.

***We will strengthen the overhaul of our human resource management.*** On one hand, we will adopt market practices to recruit the employees necessary for the continued healthy development of our business. On the other hand, we will strengthen our performance evaluation and compensation systems. Our goal is to establish a first-class staff team for the Company.

***We will accelerate our IT systems upgrade.*** The upgrading of our MBOSS system will provide the necessary support for our financial management and business operation analysis. Meanwhile, we will continue to improve our front-end business analysis system to help realize improved market responsiveness and higher quality customer service, as well as to support the reinforcement of our distribution channels.

Under adherence to our overriding principle of maximizing shareholder value, we will comprehensively improve our services, making every effort to operate in the best interest of our shareholders.

**Zhou Deqiang**  
Chairman and CEO

Shenzhen, PRC  
10 September 2003