A person in a white kayak is positioned in the lower center of the frame, facing away from the viewer towards a calm body of water. The sky above is a mix of orange, pink, and purple hues, suggesting a sunset or sunrise. A bright sun is visible in the upper center, with numerous thin white lines radiating outwards from it across the sky. The water reflects the colors of the sky and the kayak. The overall mood is serene and contemplative.

# PIONEERING

The following table sets out our key operating data in 2002, 2003 and 2004.

Key Operating Data					
	Unit	2002	2003	2004	Change 2004 over 2003
Local wireline access lines in service	thousand	133,056	160,988	186,648	15.9%
Local voice usage	million pulses	360,986	384,496	429,150	11.6%
Total dial-up usage	million minutes	98,333	70,621	37,665	-46.7%
Domestic long distance usage	million minutes	59,492	67,312	81,960	21.8%
International (including Hong Kong, Macau and Taiwan)					
long distance usage	million minutes	1,546	1,670	1,654	-1.0%
Broadband subscribers	thousand	2,411	7,231	13,839	91.4%
Dial-up usage	million minutes	81,648	54,886	30,046	-45.3%
DDN ports (in 64K equivalents)	thousand	378.2	471.2	493.3	4.7%
FR ports (in 128K equivalents)	thousand	48.1	88.3	156.3	77.0%
ATM ports (in 2M equivalents)	thousand	16.6	19.0	23.8	24.9%
2M digital circuits leased	thousand	164.5	163.1	169.5	3.9%
Volume of inbound local calls	million minutes	53,464	76,210	94,747	24.3%
Caller ID service subscribers	thousand	51,539	82,461	109,031	32.2%
Telephone information service usage	million minutes	932	1,743	2,419	38.8%

On 30 June 2004, the Company acquired from China Telecommunications Corporation the entire equity interests in Hubei Telecom Company Limited, Hunan Telecom Company Limited, Hainan Telecom Company Limited, Guizhou Telecom Company Limited, Yunnan Telecom Company Limited, Shaanxi Telecom Company Limited, Gansu Telecom Company Limited, Qinghai Telecom Company Limited, Ningxia Telecom Company Limited and Xinjiang Telecom Company Limited. As a result of the acquisition, the Company's service coverage expanded from 10 to 20 municipalities, provinces and autonomous regions. For comparison purposes, the operational and financial data for 2002, 2003 and 2004 is presented in this section on such basis as if the Group has been

operating in the enlarged service areas (20 municipalities, provinces and autonomous regions) since 1 January 2002.

Our core businesses yielded good results in 2004 with total operating revenue of RMB161,212 million, an increase of 6.4% from 2003. If amortised upfront connection fees were excluded, operating revenue in 2004 was RMB152,754 million, with an annual growth rate of 7.7%. Revenue growth in our local telephone services, Internet services and value-added services are the prominent drivers. Our business development featured the following in 2004: local telephone subscribers experienced relatively high growth; local voice usage grew faster than previous years;

broadband subscribers maintained its strong growth and became a growing revenue growth driver with increasing importance in our revenue structure; domestic long distance services recorded both usage and revenue growth; value-added services portfolio was further expanded.

Benefited from the continuous rapid growth of China's economy and accelerated social informationalisation, our core businesses maintained rapid growth over the past three years. However, with increasingly intensified competition in the Chinese telecommunications market, the further expansion and price fluctuation of mobile services, mobile substitution became more apparent in 2004. It adversely affected the growth potential of our wireline telephone service. Although wireline usage sustained a favourable growth trend, revenue growth was significantly lower than the usage growth. Therefore, our operating revenue growth rate is expected to slow down.

After years of effort, we have already built up our foundation for sustained growth and continuing innovation. This foundation consists of our extensive, advanced and multi-dimensional basic telecommunications networks, our huge customer base, our well functioning distribution channel system, our well-known corporate brand and professional network maintenance team.

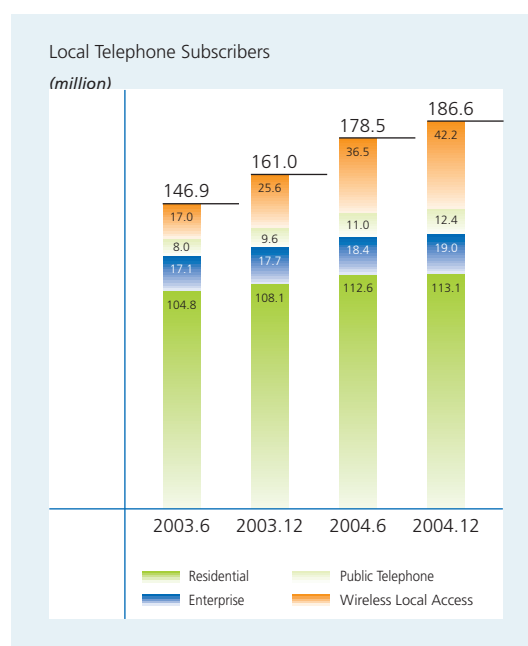
## BUSINESS ANALYSIS

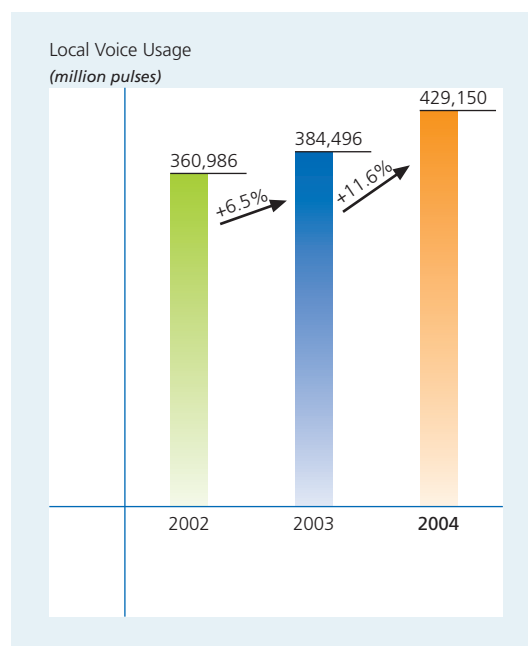
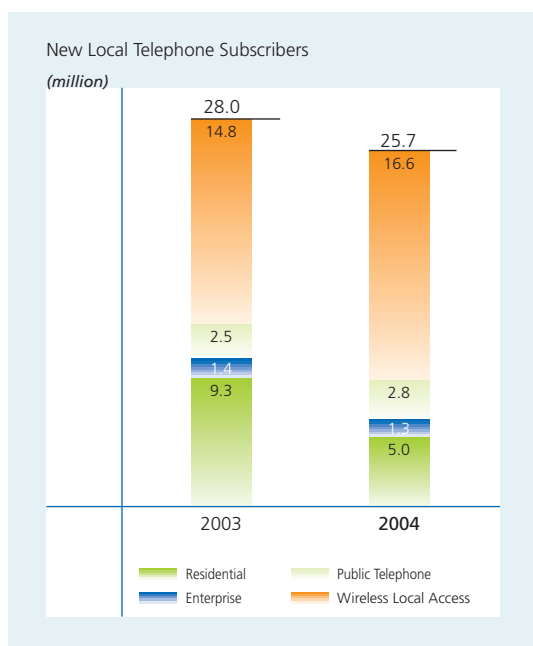
### Local telephone services

Revenue from our local telephone services, our fundamental resource-type business, reached RMB80,338 million in 2004 with an

increase of 5.8% from 2003 and represented 52.6% of our operating revenue (excluding amortisation of upfront connection fees) in 2004.

We have aggressively expanded our local telephone subscribers and the total number of our subscribers reached 186.65 million at the end of 2004, an increase of 25.66 million, or 15.9% from 2003. Wireless local access service and public telephone service subscribers grew relatively faster. As of the end of 2004, wireless local access service subscribers and public telephone service subscribers reached 42.17 million and 12.39 million, increasing 16.60 million and 2.78 million, or 64.9% and 29.0%, respectively, from 2003. In the local telephone services market, urban residential subscribers growth has slowed down and the subscribers and usage diversion exacerbated, while wireless local access service demand was comparatively stable and the rural telecommunications market exhibited a strong growth potential.





Local usage fees reached RMB47,646 million, an increase of 4.0% from 2003. Local voice usage grew 11.6% to 429,150 million pulses, a higher growth rate than that in previous years. Wireless local access service made a substantial contribution to the usage growth. Due to the increasing mobile substitution, our local voice service usage was under ever-greater pressure of usage diversion. We have optimised our distribution channel management and accentuated targeted marketing activities to enhance customer loyalty. Based on customer segmentation, we implemented various promotion measures, in particular packaging our services and providing a variety of tariff plans, to effectively mitigate our local voice service usage diversion.

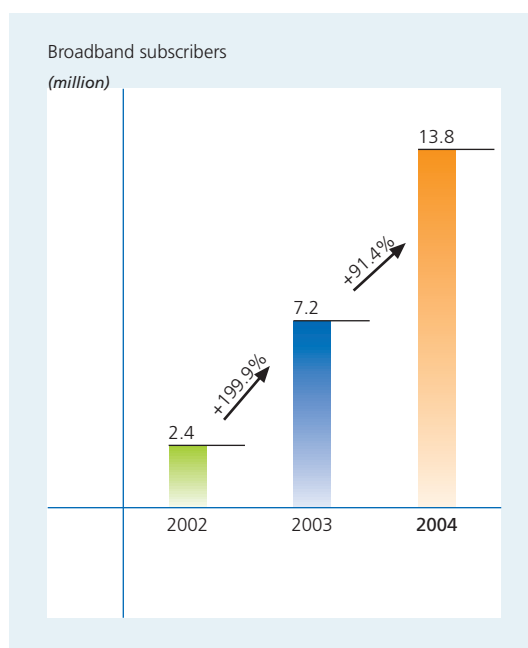
In 2005, we will continue to explore the growth potential of our wireline services subscribers and promote the upgrade of wireline telephone terminals to adapt to mobile, broadband and tailored services. We will utilise our current wireless local access service network coverage to effectively develop the subscriber base. Also, we will continue to optimise our network and further improve our network quality to enhance customer satisfaction and reduce churn rate. We will also expend great effort in the development of value-added services such as 'SMS over PHS' and 'Color Ring Tone'. On the premise of ensured investment returns, we will further develop the rural telecommunications market and actively explore potential opportunities for our wireline services.

## Internet services



Internet services are our strategically expanding business. Revenue from Internet services was RMB14,109 million in 2004, up 41.0% from 2003 and represented 9.2% of our operating revenue (excluding amortisation of upfront connection fees), an increase of 2.2 percentage points from 2003. It reflected our improved overall revenue structure. Broadband business became a key strategic driver for our sustainable development. In 2004, our broadband subscribers grew by 6.61 million or 91.4% from the end of 2003 to 13.84 million in 2004, with a market share of 92.6%<sup>1</sup> in our service regions, further consolidated our leading position in the broadband access service market.

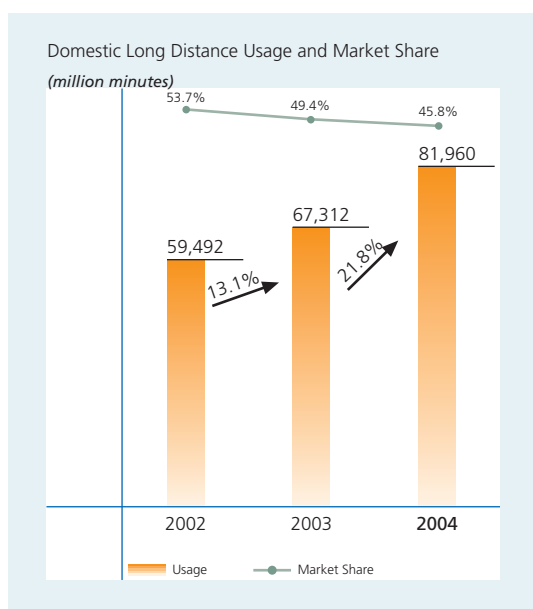
The development of our broadband business is significant to our strategic transformation. In 2005, we will keep our emphasis on, and strengthen our efforts on, broadband services. We will push forward the integration of broadband access with home appliances and actively explore opportunities for broadband and video services packaging to expand the applications of our broadband services. We will introduce customised broadband solutions to small and medium-sized enterprises based on their demands and in line with the situation of the industry. We will continue to improve and expand our



cooperation with content providers to further enrich the contents of the ChinaVnet platform and to develop it into a one-stop broadband information and entertainment service center. At the same time, we will actively promote upgrades to broadband for our customers to adapt to "streaming media" and other broadband video application content, so as to satisfy the diverse demands of our customers.

<sup>1</sup> Calculated based on statistical data from the Ministry of Information Industries ("MI").

## Long distance services



Revenue from our domestic long distance services reached RMB26,231 million, an increase of 3.0% from 2003. Total domestic long distance usage was 81,960 million minutes, representing an annual growth rate of 21.8%. Our domestic long distance services had a market share of 45.8%<sup>2</sup>, which was down 3.6 percentage points from 2003. Facing ever-intensified competition in the long distance services market and in order to maximise our revenue, we adopted a more effective pricing strategy and accelerated the development of public telephone supermarkets. Meanwhile, we further streamlined phone cards distribution channels to diversify long distance usage volume from mobile services. Our efforts were rewarded with increases in both domestic long distance usage and revenue. We will endeavor to maintain stable revenue

from our domestic long distance services through measures such as further promotion of services packaging.

Revenue from our international, Hong Kong, Macau and Taiwan long distance services, amounted to RMB3,788 million in 2004, down 3.9% from 2003. Usage in the year was 1,654 million minutes, approximately the same level as 2003. Our market share in this sector was 56.3%<sup>2</sup>, 4.9 percentage points down from 2003. Nevertheless, we maintained our leading position in this market.

## Managed data and leased line services

Revenue from our managed data services was RMB3,015 million, a decrease of 6.1% from 2003. Our leased bandwidth of our DDN, FR, and ATM services were 493.3 thousand, 156.3 thousand and 23.8 thousand at the end of 2004, increasing 4.7%, 77.0% and 24.9% from the end of 2003, respectively.

Revenue from our leased line services was RMB4,154 million in 2004, a decrease of 18.6% from 2003. As of the end of 2004, we leased out a total of 169.5 thousand digital circuits (in 2Mbps equivalent), an increase of 3.9% from 2003. Due to increasingly intensified competition, unit prices in the leased line market were substantially lowered. As a result, revenue from leased line services decreased despite increasing digital circuits leased out.

2 Calculated based on statistical data from MII.



We will further explore the potential demand of other domestic telecommunications operators based on our comparative advantages on our extensive network coverage and technical maintenance. We will take greater initiatives to promote our leased line services and effectively capitalise on our redundant network resources to increase our network value. By doing so, we will be able to provide other domestic telecommunications operators economical, reliable leased line services with premium quality. With respect to other corporate customers, we will further investigate their demand for information technology services and move towards the higher-end of the value chain. We will provide our customers with one-stop comprehensive solutions through services such as system integration and outsourcing network maintenance. Our efforts to create value for customers will at the same time help us explore future development potential.

#### Interconnection service

Revenue from our interconnection service reached RMB10,719 million in 2004, indicating an increase of 28.1% from 2003. Net interconnection revenue amounted to RMB6,624 million, an increase of 25.9% from 2003. As a result of our continuously expanding customer base and the growing Chinese telecommunications industry, the volume of inbound local calls through our

networks reached 94,747 million minutes in 2004, an increase of 24.3% from 2003. The volume of inbound long distance calls also recorded an increase.

#### Value-added services

Value-added services, our crucial sources of organic growth, are important for us to exploit the potential market and transform our growth model. We accelerated the development of our wireline value-added services in 2004. As a result, their contribution to our total operating revenue increased significantly. Subscribers of our caller ID services reached 109 million, with a penetration rate of 58.4%, by the end of 2004, an increase by 7 percentage points from 2003. The traffic volume of the telephone information services amounted to 2,419 million minutes, an increase of 38.8% from 2003. Usage of 'SMS over PHS' grew rapidly after achieving interconnection with other wireline and mobile services operators, presenting a greater market potential for further growth.

To accelerate the development of value-added services is a critical step in our strategic transformation. We will upgrade our existing networks into intelligent networks, and will integrate and optimise our network platform for value-added services. We will adhere to our win-win business development model to forge a healthy industry value chain, cooperate with



application and content providers in the development and promotion of value-added services, and thereby develop our value-added services into an important driving force for our revenue growth.

### Management innovation

In 2004, adhering to our “market-oriented, customer-centered and return-driven” business model, we consolidated our advantages in network scale, distribution channels, human resources and corporate culture, and further strengthened management innovation. As a result, our marketing capability, corporate management and network support were all improved significantly.

We established our China Telecom brand strategy and commenced our China Telecom brand promotion scheme in 2004. While integrating and optimising our existing distribution channels, we managed to develop customer-segmentation focused distribution channels. As of 31 December 2004, we had 9,298 managers for major customers, 10,405 managers for corporate customers and 38,304 managers for community customers nationwide. Moreover, in order to meet customers’ increasingly diversified demands for telecommunications services, we further optimised our products and services development and marketing mechanisms, and established a ‘total solution’ service system for major customers. These measures facilitated our business transformation from a provider of telecommunications network services to an integrated telecommunications solutions provider.

In order to reduce operating risks, we continued to promote and improve our centralised financial management system. By making use of the establishment of our internal control system, we standardised our operating activities and enhanced our comprehensive corporate management capabilities. We have made achievements in the establishment of internal control system by preliminarily completed the preparation of an internal control handbook in accordance with COSO\* framework and rolled out the internal control handbook on trial basis. With respect to financial management, an accountability budget

\* COSO, or The Committee of Sponsoring Organisations of the Treadway Commission, is an organisation in the United States of America dedicated to improving the quality of financial reporting through business ethics, effective internal controls and corporate governance. The COSO framework is currently one of the widely-recognised internal control frameworks for international businesses community.





system combining responsibility and authority was basically formulated. The performance assessment system played an even more prominent role in motivating employees. A cash flow controlling mechanism with the integration of budgeting, monitoring and assessment was also put in place. As a result, our external investment was put under effective control, our asset management process was optimised, and our long-term investment management was improved. We made a breakthrough in our application of information technology in financial management, with MSS (ERP) systems available on line for use by some of our provincial subsidiaries. Our accounting

system was further improved, revenue and cost management became more comprehensive, supervision and review of financial affairs was strengthened and the quality of our accounting personnel further improved.

In 2004, we further strengthened our management on network maintenance, which steadily improved our network operating quality and supporting capabilities. The implementation of a network optimisation project which covered our entire service regions promoted our integrated and centralised local network maintenance mode to the top level in China. Our optimisation of wireless local access services, broadband and other networks also achieved remarkable results. As of the end of 2004, over 96% of failures of broadband access service were timely responded and resolved within the committed time frame. Successful connection rates of long distance telephone networks were over 96%. Wireless local access service call drop rate decreased to 1.4%, showing a much better performance than the beginning of the year. Finally, we improved our response system for major customers. We achieved 98.4% of timely provision of end-to-end services to our major customers nationwide and 98.9% of failures were timely responded, with only 0.8% of failure response complaints. At the same time, the average time for provision of services was substantially lowered.

In 2005, we will steadily implement our strategic transformation from a traditional basic network operator to a modern integrated services and information provider. While maintaining the steady development of our traditional wireline voice business, we will take active measures to launch mobile businesses. Meanwhile, in line with the trend of integration of telecommunications and information technology and based on our traditional transmission network services and customers' diversified demands on one-stop

services, we will actively extend our services towards both ends of the industry value chain to achieve win-win effect through cooperation. In doing so, we will be able to enrich the contents of our services, create more opportunities for further development, and consistently increase the revenue from our non-voice businesses, such as broadband and value-added services, and percentage of such revenue in our total revenue, so as to realise healthy and sustainable growth of our business as a whole.

