Discussion of Selected Items in the Interim Results

1. Robust cash flow and solid capital structure

As a result of encouraging business growth, active cost controls, the realisation of the benefits of economies of scale, effective controls over capital expenditure and the cash flow contribution from the ten mobile telecommunications companies and other telecommunications assets that were acquired in 2004, the Group continued to record strong free cash flow in the first half of 2005. The Group's free cash flow (net cash flow from operating activities after deducting capital expenditure incurred) for the first six-month period of 2005 was RMB40,770 million. As at 30 June 2005, the total cash and bank balances of the Group were RMB95,198 million, of which 88.7 per cent., 6.6 per cent. and 4.7 per cent. were denominated in RMB, US dollars and Hong Kong dollars, respectively. As at 30 June 2005, the Group's debt to capitalisation ratio (capitalisation represents the sum of total debt and total equity) was approximately 14.8 per cent.

At the end of June 2005, short-term and long-term borrowings of the Group totaled RMB43,479 million, representing a decrease of RMB3,078 million from year-end 2004. Of the Group's total borrowings, 15.9 per cent. will mature within one year, 6.9 per cent. will mature after two years but within five years, and 77.2 per cent. will mature after five years. 32.4 per cent. and 67.6 per cent. of the borrowings were denominated in RMB (mainly included RMB denominated bonds, bank loans,etc) and US dollars (mainly represented by convertible notes and the balance of deferred consideration for the acquisitions of assets in 2002 and 2004), respectively. 66.4 per cent. of the total borrowings of the Group were made at floating interest rates. The average interest rate of borrowings (ratio of interest expenses to the average balance of borrowings, including capitalised interest) of the Group was approximately 3.01 per cent. in the first half of 2005, whereas the interest coverage multiple (ratio of profit before interest and tax to interest expenses) amounted to 52 times.

The Group will continue to pursue prudent financial policies, strictly control financial risks, maintain its strong cash-flow generating capability, realise its competitive advantages, allocate its resources in a scientific manner, maintain a prudent debt policy, lower its overall cost of capital and reinforce and develop favourable economic efficiency, with a view to generating greater returns for our shareholders.

2. Capital expenditure

The Group's capital expenditure for the first half of 2005 totaled approximately US$3.1 billion, which was mainly used for the construction of GSM networks, support systems, transmission facilities, infrastructure buildings and for the development of new technologies and new businesses. Capital expenditure was financed primarily by cash flow generated from operations. The Group will continue to pursue rational investments and cautiously consider the cost efficiency of any capital investment, with a view to ensuring favourable investment returns.

3. Personnel expenses

The Group augmented its efforts in human resources reform and enhanced closed-loop management of budget, performance evaluation and remuneration. While retaining and attracting talented staff, personnel expenses were satisfactorily controlled. The Group employed a total of 93,415 employees as of 30 June 2005. Personnel expenses for the first half of 2005 were RMB6,723 million, represented 5.9 per cent. of the Group's total operating revenue. In order to align the interests of staff with those of shareholders, the Group adopted a share option scheme to grant share options to employees, the Group retrospectively recognised such share options as personnel expenses at fair value as required under Hong Kong Financial Reporting Standard 2 — "Share-based Payment". After deducting the expenses recognised in the first half of 2005 for share options amounted to RMB697 million, personnel expenses of the Group for the period were RMB6,026 million, represented 5.3 per cent. of the Group's total operating revenue. Further details of the share option scheme and the share options granted are set forth in Note 18 of the "Notes on the Unaudited Interim Financial Report" and in the section "Other Information — Directors', Chief Executive's and Employees' Rights to Acquire Shares" in this interim report.