

Management's Discussion and Analysis of Financial Condition and Results of Operations

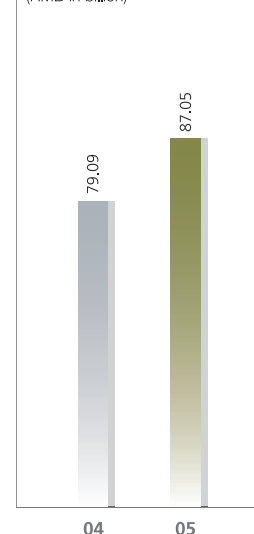
I. Overview

In 2005, we adhered to the market-oriented approach and effectively accelerated our business development. Revenue saw steady growth and earnings also increased. Free cash flow (i.e. net cash inflow from operating activities minus capital expenditures) and liabilities-to-assets ratio continued to improve.

Total revenue increased by 10.1% from 2004 to RMB87.05 billion in 2005. EBITDA (note 1) increased by 5.4% from 2004 to RMB28.44 billion. Profit for the year increased by 9.7% from 2004 to RMB4.93 billion. Basic earnings per share were RMB0.392, an increase of RMB0.034 from RMB0.358 in 2004. Capital expenditures for the whole year were RMB17.61 billion. Free cash flow improved from RMB5.43 billion in 2004 to RMB13.19 billion in 2005.

Note 1: EBITDA represents profit for the year before interest income, finance costs, net other income, income tax expense, depreciation and amortisation and minority interests. As the telecommunications business is a capital intensive industry, capital expenditure and finance costs may have a significant impact on the profit for the year of the companies with similar operating results. Therefore, we believe EBITDA may be helpful in analyzing the operation results of a telecommunications service provider like our company. Although EBITDA has been widely applied in the global telecommunications industry as a benchmark to reflect the operating performance, financial capability and liquidity, it is not regarded as a measure of operating performance and liquidity under generally accepted accounting principles. It also does not represent net cash from operating activities. In addition, our EBITDA may not be comparable to similar indicators provided by other companies.

Revenue
(RMB in billion)



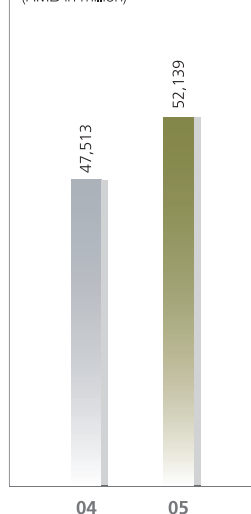
II. Revenue

Growth in the revenue of the Company continued to remain steady in 2005. The total revenue was RMB87.05 billion, up by 10.1% from 2004. Of the total revenue in 2005, service revenue was RMB84.29 billion, up 8.9% from 2004.

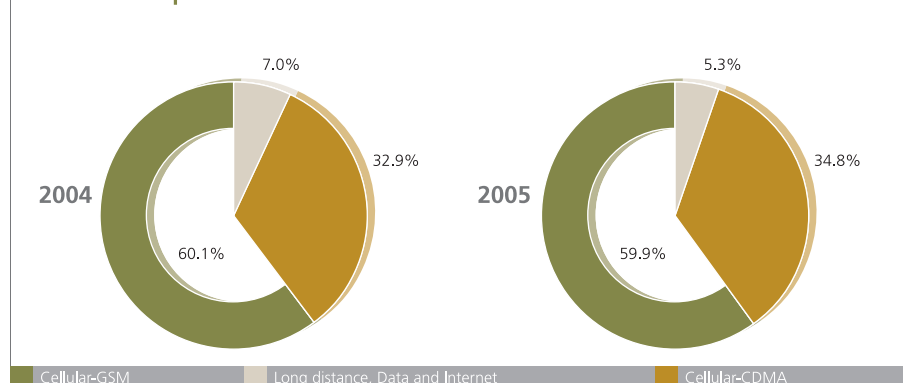
The table below sets forth the changes in revenue composition and the percentage of total revenue for each of our business segments for the years of 2004 and 2005.

	2004 (Restated)		2005	
	RMB in million	As percentage of total	RMB in million	As percentage of total
Revenue				
Cellular	73,559	93.0%	82,459	94.7%
include: GSM	47,513	60.1%	52,139	59.9%
CDMA	26,046	32.9%	30,320	34.8%
Long Distance, Data and Internet	5,528	7.0%	4,590	5.3%
Total revenue	79,087	100.0%	87,049	100.0%

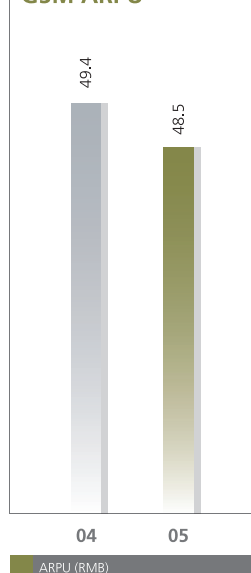
Revenue of GSM Cellular Business
(RMB in million)



Revenue composition



GSM ARPU



1. GSM Cellular Business

As our GSM subscriber base further expanded, revenue from the GSM Cellular Business continued to grow steadily. Revenue increased by 9.7% from 2004 to RMB52.14 billion in 2005. ARPU decreased slightly from RMB49.4 in 2004 to RMB48.5, down by RMB0.9.

The table below sets forth the revenue composition of our GSM Cellular Business and their respective share of revenue from GSM Cellular Business for the years of 2004 and 2005.

	2004 (Restated)		2005	
	RMB in million	As percentage of total	RMB in million	As percentage of total
Revenue	47,513	100.0%	52,139	100.0%
(1) Service revenue	47,509	100.0%	52,136	100.0%
Include: Usage fee	31,997	67.3%	32,078	61.5%
Monthly fee	6,922	14.6%	6,841	13.1%
Interconnection revenue	2,614	5.5%	3,466	6.7%
Others	5,976	12.6%	9,751	18.7%
(2) Sales of telecommunications products	4	0.0%	3	0.0%

Service revenue from GSM Cellular Business was RMB52.14 billion in 2005. Of the total, usage fees reached RMB32.08 billion, representing 61.5% of the total revenue from GSM Cellular Business. Monthly fees reached RMB6.84 billion, representing 13.1% of the revenue from GSM Cellular Business. Interconnection revenue was RMB3.47 billion, accounting for 6.7% of the revenue from GSM Cellular Business.

As we continuously promoted our value-added services such as SMS, Cool Ringtone in 2005, revenue from GSM value-added services amounted to RMB7.91 billion in 2005, with its share of the GSM service revenue increased from 10.2% in 2004 to 15.2%.

2. CDMA Cellular Business

In 2005, the Company continued the transformation of marketing model for CDMA Cellular Business and effectively controlled the increase of marketing expenses, particularly reducing the handset subsidy costs so as to realize effective growth. Revenue from CDMA Cellular Business was RMB30.32 billion in 2005, an increase of 16.4% from 2004. Due to the expanding subscriber base, ARPU for our CDMA Cellular Business decreased by RMB10.2 from RMB85.3 in 2004 to RMB75.1 in 2005.

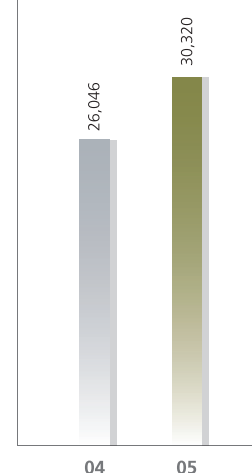
The table below sets forth the revenue composition of our CDMA Cellular Business and their respective share of revenue from CDMA Cellular Business in the years of 2004 and 2005.

	2004 (Restated)		2005	
	RMB in million	As percentage of total	RMB in million	As percentage of total
Revenue	26,046	100.0%	30,320	100.0%
(1) Service revenue	24,378	93.6%	27,577	91.0%
Include: Usage fee	16,164	62.0%	16,727	55.2%
Monthly fee	4,638	17.8%	4,905	16.2%
Interconnection revenue	927	3.6%	1,399	4.6%
Others	2,649	10.2%	4,546	15.0%
(2) Sales of telecommunications products	1,668	6.4%	2,743	9.0%

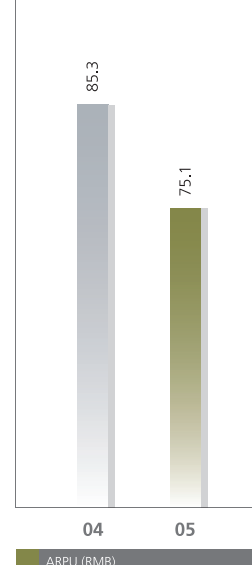
Service revenue as a percentage of the revenue from CDMA Cellular Business was 91.0% in 2005. CDMA usage fee reached RMB16.73 billion, representing 55.2% of the revenue from CDMA Cellular Business. Monthly fee totaled RMB4.91 billion, accounting for 16.2% of the revenue from CDMA Cellular Business. Interconnection revenue amounted to RMB1.40 billion, representing 4.6% of the revenue from CDMA Cellular Business.

Revenue of CDMA Cellular Business

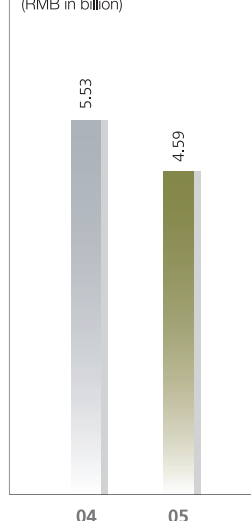
(RMB in million)



CDMA ARPU



Revenue of Long Distance, Data and Internet Business
(RMB in billion)



Based on its CDMA1X business and technology superiority, the Company devoted great efforts to the development of the CDMA wireless data business so as to continuously increase the revenue contribution of this value-added business. Revenue from the value-added business of the CDMA Cellular Business reached RMB4.05 billion, and accounted for 14.7% of the service revenue from CDMA Cellular Business in 2005, an increase from 9.8% in 2004.

3. Revenue from the Long Distance, Data and Internet Business

Because of intensified market competition and increased marketing efforts by other operators, tariffs for businesses such as outgoing long distance calls and leased lines fell relatively faster. The total minutes of outgoing international and domestic long distance calls grew by 4.8% from 2004. However, revenue totaled RMB4.59 billion in 2005, down 17.0% from 2004.

III. Costs and Expenses

Our costs and expenses in 2005 were RMB79.95 billion, up by 10.1% from 2004.

The table below illustrates the major cost items from 2004 and 2005 and their respective share of total revenue.

	2004 (Restated)		2005	
	RMB in million	As percentage of total operating revenue	RMB in million	As percentage of total operating revenue
Total costs and expenses	72,617	91.8%	79,947	91.8%
include:				
Leased lines and network capacities	7,398	9.4%	8,747	10.0%
Interconnection charges	7,517	9.5%	8,372	9.6%
Depreciation and amortisation	19,011	24.0%	20,368	23.4%
Employee benefit expenses	4,615	5.8%	5,616	6.5%
Selling and marketing	19,523	24.7%	20,558	23.6%
General, administrative and other expenses	10,500	13.3%	11,742	13.5%
Cost of telecommunication products sold	2,563	3.2%	3,575	4.1%
Net finance costs	1,593	2.0%	1,003	1.2%

1. Leased lines and network capacities

The aggregate lease expense for leased lines and network capacities of the Company reached RMB8.75 billion, up 18.2% from 2004, and as a percentage of the total revenue increased from 9.4% in 2004 to 10.0%. Network capacities lease expense for the CDMA Cellular Business increased from RMB6.59 billion in 2004 to RMB7.92 billion. Under the new CDMA Network Capacities Leasing Agreement, lease expense for the network capacities in 2005 was calculated as 29% of the service revenue from our CDMA Cellular Business in 2005.

2. Interconnection charges

Due to the increase in interconnection traffic volume, interconnection charges increased to RMB8.37 billion in 2005, up 11.4% from 2004. Interconnection charges for the GSM Cellular Business increased by 11.7% from 2004. Interconnection charges for the CDMA Cellular Business increased by 19.7% from 2004. Interconnection charges for the Long Distance, Data and Internet Business decreased by 14.9% from 2004. Interconnection charges as a percentage of the total revenue was 9.6% in 2005, representing a slight increase from 2004.

3. Depreciation and amortisation

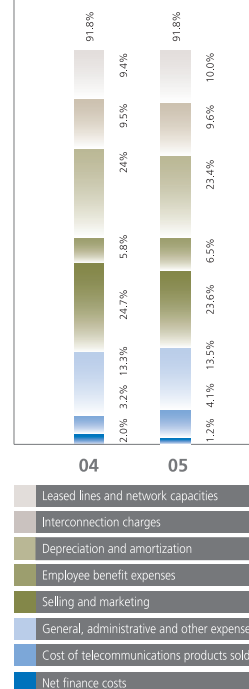
Because of the increased assets scale, depreciation and amortisation expenses increased by 7.1% from 2004 to RMB20.37 billion in 2005. However, due to a greater increase in total revenue, depreciation and amortisation expenses as a percentage of total revenue decreased from 24.0% in 2004 to 23.4% in 2005.

4. Employee benefit expenses

In 2005, due to various factors including a general increase in the employee insurance premium expenditure, the introduction of certain new social insurance items and the adoption of the new Hong Kong Financial Reporting Standards which required the share-based payments arising from share option granted to be amortised over the vesting periods and recognised as personnel expenses, employee benefit expenses recorded an increase. Employee benefit expenses for the whole year was RMB5.62 billion, up 21.7% from 2004, and represented 6.5% of the total revenue, up from 5.8% in 2004.

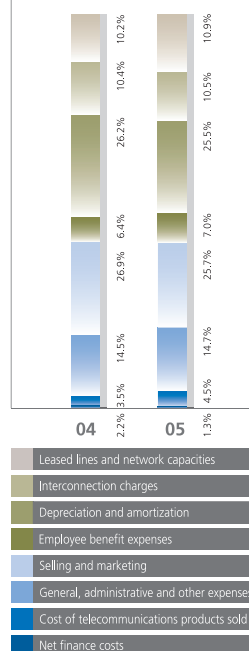
Analysis of costs and expenses

Percentage of costs and expenses to total revenue (%)



Analysis of costs and expenses

Composition of costs and expenses (%)



5. Selling and marketing expenses

Our selling and marketing expenses primarily included sales commissions, promotion and advertising expenses, amortisation of the capitalised customer acquisition costs of contractual CDMA subscribers and customer retention costs. Selling and marketing expenses totaled RMB20.56 billion in 2005, an increase of 5.3% from 2004, which was lower than the growth rate in the total revenue by 4.8 percentage points. Amortisation of capitalised customer acquisition costs on contractual CDMA subscribers was RMB5.95 billion. The balance of unamortised capitalised CDMA customer acquisition costs decreased from RMB4.75 billion as of 31 December 2004 to RMB2.94 billion as of 31 December 2005, easing the pressure from subsequent amortisation charges on CDMA subscribers acquisition costs.

In 2005, the Company put emphasis on enhancing cost effectiveness through reinforcing the transformation of the marketing model. Selling and marketing expenses as a percentage of the total revenue was 23.6%, down 1.1 percentage points from 24.7% in 2004.

6. General, administrative and other expenses

Affected by factors such as the successive expiration of the warranty periods for the Company's network equipment, a significant increase in the renewal maintenance fees, a relatively fast growth in the consumption of water and electricity at our base stations due to the increase in the scale of the Company's network and in energy prices, general, administrative and other expenses were RMB11.74 billion in 2005, up 11.8% from 2004. General, administrative and other expenses as a percentage of the total revenue increased from 13.3% in 2004 to 13.5%. In 2005, the Company strengthened effective control over bad debts and the provision for bad debts for the whole year was RMB1.50 billion, down 31.6% from 2004. The overall bad debt ratio decreased from 2.8% in 2004 to 1.8%.

7. Cost of telecommunications products sold

In 2005, the cost of telecommunications products sold was RMB3.58 billion, up by 39.5% from 2004, representing 4.1% of the total revenue.

8. Interest income and finance costs

Interest income in 2005 fell to RMB96 million, down 6.5% from 2004. Finance costs were RMB1.10 billion, down 35.2% from 2004. Net finance costs decreased by 37.0% from RMB1.59 billion in 2004 to RMB1.00 billion in 2005, primarily due to an

effective reduction in interest expense as a result of the issuance of RMB10 billion short-term bonds. In addition, the Company recorded an exchange gain of RMB0.274 billion due to the revaluation of RMB during 2005.

IV. Earnings

1. Profit before income tax

The Company made efforts to strengthen cost and expense control and strived to realize the coordinated development of “Quantity, Earnings and Effectiveness”. In 2005, our profit before income tax was RMB7.10 billion, an increase of 9.8% from 2004.

Profit before income tax for the GSM Cellular Business continued to grow steadily to RMB7.28 billion, up 6.5% from 2004. Profit before income tax for the CDMA Cellular Business improved quarter on quarter. Profit before income tax for the CDMA Cellular Business for the second half of 2005 reached RMB0.28 billion. Loss for CDMA Cellular Business for the whole year was RMB0.20 billion, a reduction of RMB0.36 billion in loss from 2004. Profit before income tax for the Long Distance, Data and Internet Business was RMB0.14 billion.

2. Income tax expenses

Our income tax expenses increased to RMB2.17 billion in 2005, up by 9.8% from 2004. The effective tax rate was 30.6%.

3. Profit for the year

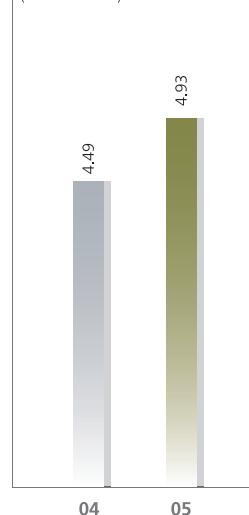
Our profit for the year reached RMB4.93 billion in 2005. Basic earnings per share in 2005 were RMB0.392, an increase of 9.6% from RMB0.358 in 2004.

V. EBITDA

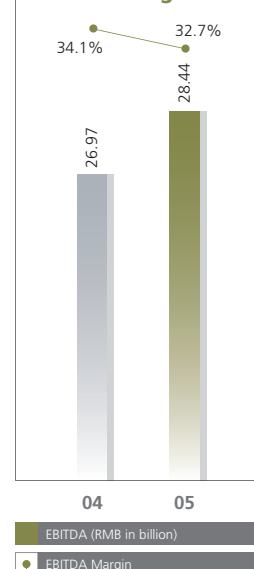
EBITDA of the Company increased by 5.4% from 2004 to RMB28.44 billion in 2005. EBITDA margin (EBITDA as a percentage of the revenue) was 32.7%, down 1.4 percentage points from 2004.

EBITDA for the GSM Cellular Business was RMB25.45 billion, up 4.0% from 2004. EBITDA margin decreased from 51.3% in 2004 to 48.8%. EBITDA for the CDMA Cellular Business increased from -RMB0.14 billion in 2004 to RMB0.44 billion. EBITDA for the Long Distance, Data and Internet Business was RMB2.68 billion, an decrease of 4.4% from 2004.

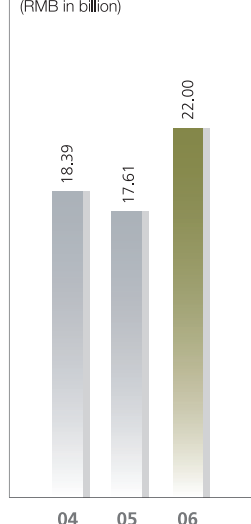
Profit for the year
(RMB in billion)



EBITDA and EBITDA margin



Capital expenditure and projected capital expenditure
(RMB in billion)



VI. Capital expenditures and free cash flow

Our capital expenditures totaled RMB17.61 billion in 2005. Capital expenditures attributable to the Cellular Business were RMB7.33 billion. Capital expenditures for the Long Distance, Data and Internet Business were RMB1.18 billion. Capital expenditures for local gateway and infrastructure network were RMB2.95 billion. Capital expenditures for billing system, customer services and information technology system and buildings were RMB6.15 billion.

Free cash flow improved further from RMB5.43 billion in 2004 to RMB13.19 billion in 2005.

The table below illustrates the capital expenditures of various major segments in 2005 and the planned expenditures in 2006.

	2005 RMB in billion	2006 Planned RMB in billion
Total	17.61	22.00
Cellular	7.33	10.80
Long Distance, Data and Internet	1.18	1.47
Gateway and infrastructure network	2.95	3.78
Others	6.15	5.95

Capital expenditures planned for 2006 are RMB22.0 billion. Capital expenditures planned for the GSM Cellular Business are RMB10.8 billion which will be used to satisfy our subscribers' demand, improve the quality of network coverage and increase the network capacity as appropriate, as well as to upgrade the GPRS networks in some major cities. Capital expenditures planned for Long Distance, Data and Internet Business are RMB1.47 billion. Capital expenditures planned for local gateway and infrastructure network are RMB3.78 billion. Capital expenditures planned for billing system, customer services and information technology system and buildings and others are RMB5.95 billion.

The Company plans to rely largely on cash generated from operating activities to satisfy our capital expenditures needs in 2006.

VII. Balance Sheet

In 2005, the Company's balance sheet structure remained sound and its financial position further improved. Total assets changed from RMB149.04 billion as of 31 December 2004 to RMB142.63 billion as of 31 December 2005. Total liabilities decreased from RMB76.60 billion as of 31 December 2004 to RMB66.34 billion as of 31 December 2005. The liabilities-to-assets ratio decreased from 51.4% as of 31 December 2004 to 46.5% of 31 December 2005.

As of 31 December 2005, we had net current liabilities (i.e. current assets minus current liabilities) of RMB35.59 billion, representing an increase of RMB6.71 billion from RMB28.88 billion at the end of 2004. Taking into account available financing and continuous net cash inflows from our operating results, we believe that the Company has sufficient funds to meet its working capital requirements and debt obligations.

Please refer to Notes 2 and 4 to the financial statements for the Company's significant accounting policies and critical accounting estimates and judgements.