

# Report of the Directors

The Board of Directors (the "Board") of China Telecom Corporation Limited (the "Company") is pleased to present its report together with the audited financial statements of the Company and its subsidiaries (the "Group") prepared in accordance with International Financial Reporting Standards for the year ended 31 December 2006.

## PRINCIPAL BUSINESSES

The principal businesses of the Group are: provision of comprehensive wireline telecommunications and other relevant services, including local telephone, domestic long distance telephone, international long distance telephone, Internet and managed data, leased line and other related services to its subscribers within the service area of the Group. The principal business of the Company is investment holding.

## RESULTS

Results of the Group for the year ended 31 December 2006 and the financial position of the Company and the Group as at that date are set out in the audited financial statements on pages 85 to 139 in this annual report.

## DIVIDEND

The Board proposes to declare a final dividend in the amount equivalent to HK\$0.085 per share, totaling

approximately RMB6,820 million for the year ended 31 December 2006. The dividend proposal will be submitted for consideration at the Annual General Meeting to be held on 29 May 2007. Dividends will be denominated and declared in Renminbi. Dividends on domestic shares will be paid in Renminbi. Dividends on H shares will be paid in Hong Kong dollars. The relevant exchange rate will be the mean of the average offer rate of Renminbi to Hong Kong dollars as announced by the People's Bank of China for the week prior to the date of declaration of dividends at the Annual General Meeting. The final dividends are expected to be paid around 15 June 2007 after its approval at the Annual General Meeting.

## ISSUE OF SHORT TERM COMMERCIAL PAPER BY THE COMPANY

On 10 April 2006, the Company successfully issued a short term commercial paper in the nominal amount of RMB20 billion, due in one year with an annual interest rate of 3.05%. The short term commercial paper was issued through a book-building and centralised placing process in the PRC inter-bank debenture market on a nominal value basis. All the proceeds from this issue of the short term commercial paper were used to satisfy the Company's funding needs of production and operations. The Company considers that the issue of the short term commercial paper will enable it to reduce its finance costs, to improve its capital-raising structure and to enhance its market image.

## DIRECTORS AND SENIOR MANAGEMENT OF THE COMPANY

The following table sets out certain information concerning the directors and senior management of the Company as at the date of this Report:

Name	Age	Position in the Company	Date of Appointment
Wang Xiaochu	49	Chairman and Chief Executive Officer	20 December 2004
Leng Rongquan	58	Executive Director, President and Chief Operational Officer	20 December 2004
Wu Andi	52	Executive Director, Executive Vice President and Chief Financial Officer	10 September 2002
Zhang Jiping	51	Executive Director and Executive Vice President	10 September 2002
Huang Wenlin	53	Executive Director and Executive Vice President	10 September 2002
Li Ping	53	Executive Director and Executive Vice President	10 September 2002
Yang Jie	45	Executive Director and Executive Vice President	20 October 2004
Sun Kangmin	50	Executive Director and Executive Vice President	20 October 2004
Li Jinming	55	Non-executive Director	20 December 2004
Zhang Youcai	66	Independent Non-executive Director	10 September 2002
Lo Hong Sui, Vincent	59	Independent Non-executive Director	10 September 2002
Shi Wanpeng	70	Independent Non-executive Director	20 June 2003
Xu Erming	57	Independent Non-executive Director	9 September 2005
Tse Hau Yin, Aloysius	59	Independent Non-executive Director	9 September 2005
Yung Shun Loy, Jacky	44	Assistant Chief Financial Officer, Qualified Accountant and Company Secretary	1 February 2005
Wang Qi	52	Controller	10 September 2002

In May 2006, Mr. Wei Leping resigned from the position of Executive Director due to age.

The following table sets out certain information concerning the senior management of the Company's subsidiaries at the provincial level as at the date of this Report:

<b>Name</b>	<b>Age</b>	<b>Position in the Company's subsidiaries at the provincial level</b>	<b>Date of Appointment</b>
Zhang Weihua	46	Chairman of Shanghai Telecom Company Limited	9 December 2005
Wang Wei	42	General Manager of Shanghai Telecom Company Limited	20 October 2004
Chen Dexing	51	Chairman and General Manager of Guangdong Telecom Company Limited	26 June 2006
Sun Jiuming	60	Chairman and General Manager of Jiangsu Telecom Company Limited	19 October 2002
Zhang Xinjian	51	Chairman and General Manager of Zhejiang Telecom Company Limited	2 March 2005
Tao Ping	49	Chairman and General Manager of Anhui Telecom Company Limited	14 February 2006
Liu Yaoming	55	Chairman and General Manager of Fujian Telecom Company Limited	19 August 2003
Ke Ruiwen	43	Chairman and General Manager of Jiangxi Telecom Company Limited	12 September 2003
Zhao Qiang	47	Chairman and General Manager of Guangxi Telecom Company Limited	7 September 2005
Zou Bingxuan	57	Chairman and General Manager of Chongqing Telecom Company Limited	19 August 2003
Liu Hongjian	46	Chairman and General Manager of Sichuan Telecom Company Limited	4 June 2004
Liao Renbin	47	Chairman and General Manager of Hubei Telecom Company Limited	5 March 2004
Wen Huiguo	53	Chairman and General Manager of Hunan Telecom Company Limited	5 March 2004
Jin Dongbin	52	Chairman and General Manager of Hainan Telecom Company Limited	7 September 2005
Liao Kang	44	Chairman and General Manager of Guizhou Telecom Company Limited	5 March 2004
Li Hua	43	Chairman of Yunnan Telecom Company Limited	5 November 2005
Yin Yiping	47	General Manager of Yunnan Telecom Company Limited	9 March 2005
En Guangli	59	Chairman of Shaanxi Telecom Company Limited	20 October 2005
Yang Jianqing	46	General Manager of Shaanxi Telecom Company Limited	3 March 2005
Ma Linfeng	51	Chairman and General Manager of Gansu Telecom Company Limited	5 March 2004
Gao Tongqing	43	Chairman and General Manager of Qinghai Telecom Company Limited	5 March 2004
		Chairman and General Manager of Ningxia Telecom Company Limited	5 March 2004
		Chairman and General Manager of Xinjiang Telecom Company Limited	5 March 2004

In June 2006, Mr. Chen Dexing was appointed as the Chairman and the General Manager of Guangdong Telecom Company Limited while Mr. Feng Xiong resigned from the position of Chairman and General Manager of Guangdong Telecom Company Limited.

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## SUPERVISORS OF THE COMPANY

The following table sets out certain information concerning the supervisors of the Company as at the date of this Report:

Name	Age	Position in the Company	Date of Appointment
Zhang Xiuqin	60	Chairperson of the Supervisory Committee	10 September 2002
Zhu Lihao	66	Independent Supervisor	10 September 2002
Li Jian	45	Supervisor	9 September 2005
Xu Cailiao	43	Supervisor	9 September 2005
Ma Yuzhu	53	Supervisor (Employee Representative)	9 September 2005

In March 2007, Ms. Zhang Xiuqin proposed to resign from the position of Supervisor and Chairperson of the Supervisory Committee due to age while Mr. Li Jian proposed to resign from the position of Supervisor due to a change in job responsibility. The Company has proposed to elect Mr. Xiao Jinxue and Ms. Wang Haiyun as the Supervisors of the Company.

The abovementioned resignations and appointments will be effective upon approval by the 2006 Annual General Meeting to be held on 29 May 2007.

## SHARE CAPITAL

The share capital of the Company as at 31 December 2006 was RMB80,932,368,321, divided into 80,932,368,321 shares of RMB1.00 each. As at 31 December 2006, the share capital of the Company comprised:

Shares	Number of shares as at 31 December 2006	Percentage of the total number of shares in issue as at 31 December 2006 (%)
Domestic shares (total):	67,054,958,321	82.85
Domestic shares held by:		
China Telecommunications Corporation	57,377,053,317	70.89
Guangdong Rising Assets Management Co., Ltd.	5,614,082,653	6.94
Zhejiang Financial Development Company	2,137,473,626	2.64
Fujian State-owned Assets Investment Holdings Co., Ltd.	969,317,182	1.20
Jiangsu Guoxin Investment Group Co., Ltd.	957,031,543	1.18
Total number of H shares (including ADSs)	13,877,410,000	17.15
Total	80,932,368,321	100.00

## MATERIAL INTERESTS AND SHORT POSITIONS IN SHARES AND UNDERLYING SHARES OF THE COMPANY

As at 31 December 2006, the interests or short position of persons who are entitled to exercise or control the exercise of 5% or more of the voting power at any of the Company's general meetings (excluding the Directors and Supervisors) in the shares and underlying shares of equity derivatives of the Company as recorded in the register required to be maintained under Section 336 of the Securities and Futures Ordinance (Cap 571 of the Laws of Hong Kong) (the "SFO") are as follows:

Name of shareholder	Number of shares held	Type of Shares	Percentage of the respective type of number shares (%)	Percentage of the total of shares in issue (%)	Capacity
China Telecommunications Corporation	57,377,053,317	Domestic shares	85.57	70.89	Beneficial owner
Guangdong Rising Assets Management Co., Ltd.	5,614,082,653	Domestic shares	8.37	6.94	Beneficial owner
JPMorgan Chase & Co.	1,006,391,826	H shares	7.25	1.24	Beneficial owner; investment manager; custodian
	640,031,300	H shares	4.61	0.79	Custodian — Licensed Corporation/Approved lending agent
Commonwealth Bank of Australia	1,248,848,000	H shares	9.00	1.55	Interest of a controlled corporation
Halbis Capital Management (Hong Kong) Limited	716,540,000	H shares	5.16	0.89	Investment manager

Save as stated above, as at 31 December 2006, in the register required to be maintained under Section 336 of the SFO, no other persons were recorded to hold any interests or short positions in the shares or underlying shares of the equity derivatives of the Company.

## DIRECTORS' AND SUPERVISORS' INTERESTS AND SHORT POSITIONS IN SHARES, UNDERLYING SHARES AND DEBENTURES

As at 31 December 2006, none of the directors and supervisors of the Company had any interests or short positions in the shares, underlying shares of equity derivatives or debentures of the Company or its associated corporations (within the meaning in Part XV of the SFO) as recorded in the register required to be maintained under section 352 of the SFO or as otherwise notified to the Company and The Stock Exchange of Hong Kong Limited pursuant to the Model Code for Securities Transactions by Directors of Listed Issuers.

As at 31 December 2006, the Company had not granted its directors or supervisors, or their respective spouses or children below the age of 18 any rights to subscribe for the shares or debentures of the Company or any of its associated corporations and none of them has ever exercised any such right to subscribe for the shares or debentures.

## PUBLIC FLOAT

As at the date of this Report, based on the information that is publicly available to the Company and within the knowledge of the Directors, the Company has maintained the prescribed public float under Rules Governing The Listing of Securities on The Stock Exchange of Hong Kong Limited (the "Listing Rules") and as agreed with The Stock Exchange of Hong Kong Limited.

# Report of the Directors

## DIRECTORS' AND SUPERVISORS' INTERESTS IN CONTRACTS

For the year ended 31 December 2006, none of the directors or supervisors of the Company had any material interest, whether directly or indirectly, in any significant contracts entered into by the Company, any of its holding companies or subsidiaries or subsidiaries of the Company's holding company, apart from their service contracts.

## EMOLUMENTS OF THE DIRECTORS AND SUPERVISORS

Please refer to note 26 of the audited financial statements for details of the emoluments of all Directors and Supervisors of the Company in 2006.

## PURCHASE, SALE AND REDEMPTION OF SHARES

Neither the Company nor any of its subsidiaries has purchased, sold or redeemed any securities of the Company during the reporting period.

## SUMMARY OF FINANCIAL INFORMATION

Please refer to pages 144 to 145 of this annual report for a summary of the operating results, assets and liabilities of the Group for each of the years in the five-year period ended 31 December 2006.

## BANK LOANS AND OTHER BORROWINGS

Please refer to note 13 of the audited financial statements for details of bank loans and other borrowings of the Company.

## CAPITALISED INTEREST

Please refer to note 24 of the audited financial statements for details of the Group's capitalised interest for the year ended 31 December 2006.

## FIXED ASSETS

Please refer to note 3 of the audited financial statements for movements in the fixed assets of the Group for the year ended 31 December 2006.

## RESERVES

Pursuant to Article 147 of the Company's articles of association (the "Articles of Association"), where the financial statements prepared in accordance with PRC accounting standards and regulations materially differ from those prepared in accordance with either International Financial Reporting Standards or those of the place outside the PRC where the Company's shares are listed, the distributable profit for the relevant accounting period shall be deemed to be the lesser of the amounts shown in those respective financial statements. Distributable reserves of the Company as at 31 December 2006, calculated on the above basis and before deducting the proposed final dividends for 2006, amounted to approximately RMB13,249 million.

In addition to the allocation to the statutory reserve funds, the Board proposes to make an allocation to a discretionary surplus reserve. The allocation proposal shall be submitted for consideration at the Annual General Meeting to be held on 29 May 2007.

Please refer to note 19 of the audited financial statements for details of the movements in the reserves of the Company and the Group for the year ended 31 December 2006.

## DONATIONS

For the year ended 31 December 2006, the Group made charitable and other donations to a total amount of RMB23 million.

## SUBSIDIARIES AND ASSOCIATED COMPANIES

Please refer to note 5 and note 6 of the audited financial statements for details of the Company's subsidiaries and the Group's interests in associated companies as at 31 December 2006.

## CHANGES IN EQUITY

Please refer to the consolidated statement of changes in equity contained in the audited financial statements (page 89 of this annual report).

## RETIREMENT BENEFITS

Please refer to note 34 of the audited financial statements for details of the retirement benefits provided by the Group.

## STOCK APPRECIATION RIGHTS

Please refer to note 35 of the audited financial statements for details of the stock appreciation rights offered by the Company.

## PRE-EMPTIVE RIGHTS

There are no provisions for pre-emptive rights in the Articles of Association requiring the Company to offer new shares to the existing shareholders in proportion to their shareholdings.

## MAJOR CUSTOMERS AND SUPPLIERS

For the year ended 31 December 2006, sales to the five largest customers of the Group represented an amount no more than 30% of the operating revenues of the Group.

For the year ended 31 December 2006, purchases from the five largest suppliers of the Group accounted for approximately 36.6% of the total annual purchases of the Group.

For the year ended 31 December 2006, purchases from the Group's largest equipment supplier accounted for approximately 12.7% of the total annual purchases of the Group. The amount of the Group's annual purchases includes equipment purchases, investments in infrastructure and pipelines.

To the knowledge of the Board, no director of the Company, their associates, or any person holding more than 5% of the issued share capital in the Company has any interests in such suppliers.

## CONTINUING CONNECTED TRANSACTIONS

The following table sets out the amounts of continuing connected transactions of the Group for the year ended 31 December 2006:

Transaction	Group (RMB million)	Annual monetary cap for continuing connected transactions (RMB million)
1. Share of expenses for centralised services	306	700
2. Net expenses for interconnection settlement	571	N/A <sup>1</sup>
3. Provision of comprehensive services by China Telecommunications Corporation and its subsidiaries (the "China Telecom Group")	1,143	1,440 <sup>2</sup>
4. Mutual leasing of properties	423	500
5. Provision of IT services by China Telecom Group	345	490 <sup>2</sup>
6. Provision of equipment procurement services by China Telecom Group	155	470
7. Provision of engineering services by China Telecom Group	7,871	8,327
8. Provision of community services by China Telecom Group	2,378	3,410
9. Provision of ancillary telecommunications services by China Telecom Group	3,238	3,900 <sup>2</sup>

<sup>1</sup> According to a waiver letter issued by The Stock Exchange of Hong Kong Limited on 18 May 2004, the Company is not required to set an annual monetary cap for the total amount under interconnection settlement agreements.

<sup>2</sup> As stated in the circular by the Company on 8 September 2006, the monetary cap for the reporting year is the revised amount.

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## Centralised Services Agreement

Centralised services includes the provision of management and operational services by the Company to China Telecommunications Corporation in relation to big corporate customers, its network management centre and business support centre, and also the provision of certain premises by the China Telecommunications Corporation to the Group. In addition, centralised services also includes the common use of international telecommunications facilities between both parties. The Centralised Services Agreement was renewed on 30 August 2006 with expiration on 31 December 2007, and may be automatically renewed for further periods of one year upon expiration without limit in the number of renewals, unless the Company provides a notice of non-renewal in writing to the China Telecommunications Corporation three months prior to the end of the relevant term. The aggregate costs incurred by the Company and China Telecommunications Corporation for the provision of management and operation services relating to big corporate customers, as well as the business support centre and the network management centre, and by any of the parties in this agreement for the provision of premises (including labour costs, depreciation of equipment and premises, daily expenses, costs relating to maintenance and research) will be apportioned between the Company and China Telecommunications Corporation on a *pro rata* basis according to the revenues generated by each party. The costs will be apportioned over a period of one year. In relation to the common use of international telecommunications facilities, the Company and China Telecommunications Corporation have agreed to apportion the costs associated with operating such assets on a *pro rata* basis according to the aggregate volume of the inbound international calls terminated by, and outbound international calls originating from, the Company and China Telecom Group, respectively.

## Interconnection Settlement Agreement

Pursuant to the Interconnection Settlement 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 MII, which is currently RMB0.06 per minute.

As stated in the public announcement by the Company on 25 October 2006, the independent shareholders of the Company resolved and approved at the Extraordinary General Meeting the further renewal of the Interconnection Settlement Agreement on 30 August 2006 in accordance with its provisions. The Agreement was renewed for another two years and will expire on 31 December 2008 and will be automatically renewed for a period of three years upon expiration, unless the Company provides notice of non-renewal in writing to the China Telecommunications Corporation three months prior to the end of the relevant term.

## Comprehensive Services Framework Agreement

The Comprehensive Services Framework Agreement governs the terms and conditions of transactions between the Company and China Telecommunications Corporation at two levels: (i) between the Group and certain associates held by China Telecommunications Corporation as long-term investments; and (ii) between the Group and certain subsidiaries of China Telecommunications Corporation operating in other provinces (the "Provincial Subsisting Companies"). Such transactions include procurement of the supply of telecommunications equipment (such as optic fibre), design, implementation and supervision of telecommunications (network) projects, software upgrade, system integration, manufacture of calling cards and so on. Prices under such agreement shall be determined in accordance with the government-prescribed prices. In the absence of government-prescribed prices, the government-guided prices (if any) shall apply. In the absence of both government-prescribed prices and government-guided prices, the market prices shall apply, that is, the prices at which the same types of services are provided by independent third party in the ordinary course of business. If none of the above prices is applicable, the prices shall be determined through negotiation between the two parties based on reasonable costs plus reasonable profit. In which "reasonable costs" shall mean the costs determined by the two parties after negotiations.

The Comprehensive Services Framework Agreement was renewed on 30 August 2006 and will expire on 31 December 2007, and will be automatically renewed for further periods of one year upon expiration without limit in the number of renewals, unless the Company provides notice of non-renewal in writing to the China Telecommunications Corporation three months prior to the expiration of the relevant term.

### **Listed Company — Parent Company Agreement**

As stated in the circular by the Company on 8 September 2006, for the purpose of organising the structure of the Group's connected transactions and ease of internal management, the subsidiaries of the Company, and China Telecommunications Corporation and/or its associates agree to adjust the major entities in the connected transactions agreements. Pursuant to this, the Company and China Telecommunications Corporation signed a series of Listed Company — Parent Company Agreement on 30 August 2006 as the framework agreement for each of Shanghai Telecom Company Limited, Guangdong Telecom Company Limited, Jiangsu Telecom Company Limited, Zhejiang Telecom Company Limited, Anhui Telecom Company Limited, Fujian Telecom Company Limited, Jiangxi Telecom Company Limited, Guangxi Telecom Company Limited, Chongqing Telecom Company Limited, Sichuan Telecom Company Limited, 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 under the Company (the "Twenty Provincial Telecom Companies"), which governs the terms of continuing connected transactions under the following six agreements. Pursuant to the Listed Company — Parent Company Agreement, the Company represented the Group while the China Telecommunications Corporation represented its associates, and the parties signing the contracts will be changed from individual subsidiaries of the Company and of the China Telecommunications Corporation to the Company and the China

Telecommunications Corporation. The terms and conditions in the relevant connected transactions agreements remain unchanged:

- (1) Property Leasing Framework Agreements;
- (2) IT Services Framework Agreements;
- (3) Equipment Procurement Services Framework Agreements;
- (4) Engineering Framework Agreements;
- (5) Community Services Framework Agreements;
- and
- (6) Ancillary Telecommunications Services Framework Agreements.

The followings are the Listed Company — Parent Company Agreements:

### **Property Leasing Framework Agreement**

Pursuant to the Property Leasing Framework Agreement, the Twenty Provincial Telecom Companies under the Company lease properties from the Provincial Subsisting Companies for use as business premises, offices, equipment storage facilities and sites for network equipment. In addition, the Twenty Provincial Telecom Companies also lease certain properties to the Provincial Subsisting Companies. The rent payable under the relevant leases shall be determined based on the market price with reference to the standards set forth by local pricing authorities.

The Property Leasing Framework Agreement will expire on 31 December 2007, and may be renewed for further periods of one year upon expiration without limit in the number of renewals, unless the Company provides notice of non-renewal in writing to the China Telecommunications Corporation three months prior to the end of the the relevant term.

### **IT Services Framework Agreement**

Pursuant to the IT Services Framework Agreement, the Provincial Subsisting Companies may participate in bids for the right to provide the Twenty Provincial Telecom Companies with information technology services, such as office automation, software testing and network upgrade. The charges payable for such IT services shall be determined by reference to market rates or as determined by prices obtained through the tender process.



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The IT Services Framework Agreement may be renewed for further periods of one year upon expiration on 31 December 2007, unless the Company provides notice of non-renewal in writing to the China Telecommunications Corporation three months prior to the expiry of the relevant term.

## **Equipment Procurement Services Framework Agreement**

Pursuant to the Equipment Procurement Services Framework Agreement, the Provincial Subsisting Companies have agreed to provide comprehensive procurement services, including management of tenders, verification of technical specifications and installation services. The maximum commission for such procurement services shall be calculated based on the followings: (1) not more than 1% of the contract value for procurement of imported telecommunications equipment; or (2) not more than 3% of the contract value for the procurement of domestic telecommunications equipment and other domestic non-telecommunications materials.

The Equipment Procurement Services Framework Agreement will expire on 31 December 2007, and may be renewed for further periods of one year upon expiration without limit in the number of renewals, unless the Company provides notice of non-renewal in writing to the China Telecommunications Corporation three months prior to the end of the relevant term.

## **Engineering Framework Agreement**

The Engineering Framework Agreement sets out the terms in respect of the supervision and management of services relating to construction, design, equipment installation and tests provided to the Twenty Provincial Telecom Companies through bids made by the Provincial Subsisting Companies, and/or services as the general contractors for the construction and supervision of engineering projects of the Twenty Provincial Telecom Companies. The charges payable for such engineering services shall be determined by reference to the market rates as reflected through the tender process. The charges payable for the design or supervision of engineering projects with a value over RMB500,000, or construction of engineering projects with a value over RMB2 million shall be determined by referring to the tender price.

As stated in the public announcement by the Company on 25 October 2006, the independent shareholders of the Company resolved and approved at the Extraordinary General Meeting that the Engineering Framework Agreement will expire on 31 December 2008, and may be renewed for periods of three years upon expiration without limit in the number renewals, unless the Company provides notice of non-renewal in writing to the China Telecommunications Corporation three months prior to the end of the relevant term.

## **Community Services Framework Agreement**

Pursuant to the Community Services Framework Agreement, the Provincial Subsisting Companies will provide the Twenty Provincial Telecom Companies with services relating to culture, education, property management, vehicle service, health and medical care, hotel and conference service, community and sanitary service. The pricing terms for such services are the same as those for comprehensive services.

The Community Services Framework Agreement will expire on 31 December 2007, and may be renewed for further periods of three years upon expiration without limit in the number of renewals, unless either party provides notice of non-renewal in writing to the opposite party three months prior to the end of the relevant term.

## **Ancillary Telecommunications Services Framework Agreement**

Pursuant to the Ancillary Telecommunications Services Framework Agreement, the Provincial Subsisting Companies agree to provide the Twenty Provincial Telecom Companies with certain repair and maintenance services, including repair of telecommunications equipment, maintenance of fire equipment and telephone booths, as well as other customer services. The pricing terms for such services are the same as those for comprehensive services.

The Ancillary Telecommunications Services Framework Agreement will expire on 31 December 2007, and may be renewed for further periods of three years upon expiration without limit in the number of renewals, unless either party provides notice of non-renewal in writing to the opposite party three months prior to the end of the relevant term.

The independent non-executive directors of the Company have confirmed that all continuing connected transactions for the year ended 31 December 2006 to which the Group was a party:

1. had been entered into, and the agreements governing those transactions were entered into, by the Group in the ordinary and usual course of business;
2. had been entered into either:
  - (i) on normal commercial terms; or
  - (ii) where there was no available comparison to judge whether they are on normal commercial terms, on terms no less favourable than those available to or (if applicable) from independent third parties; and
3. had been entered into on terms that are fair and reasonable so far as the overall interests of the independent shareholders of the Company are concerned.

The independent non-executive directors have further confirmed that:

The values of continuing connected transactions entered into between the Group and its connected persons which are subject to annual caps have not exceeded their respective annual caps.

The international auditor of the Group have reviewed the continuing connected transactions of the Group and have confirmed to the Board that the transactions:

1. have received the approval of the Board;
2. have been entered into in accordance with the pricing policies as stated in the relevant agreements; and
3. have been entered into in accordance with the terms of the agreements governing such transactions; and the values of continuing connected transactions entered into between the Group and its connected persons which are subject to annual caps have not exceeded their respective annual caps.

## Strategic Agreement

As stated in the public announcement by the Company on 25 October 2006, independent shareholders of the Company resolved and approved in the Extraordinary General Meeting, the signing of a Strategic Agreement between the Company and China Communications Services Corporation Limited, a fellow subsidiary of which China Telecommunications Corporation, our parent company, is the holding company, on 30 August 2006 with an effective period between 1 January 2007 and 31 December 2009. Both parties may negotiate the renewal of the Strategic Agreement upon the expiration, and the renewal is subject to the requirements of Chapter 14A of the Listing Rules (including disclosure and independent shareholders' approval requirements).

Pursuant to the Strategic Agreement, the business areas of the strategic alliance between the two parties governed by the terms and conditions in the agreement include: design, implementation and supervision of the communications engineering, maintenance management service, contents application service, sales channel service, usage of telecommunications and other new businesses arising from time to time which are appropriate for the collaboration between the two parties. China Communications Services Corporation Limited pledges its support to the strategic transformation of the Company from traditional basic telecommunications operator to comprehensive information service provider, its active support to the Company's business development, and its active use of the Company's products and services in its own business.

Such services shall comply with the related standards of China or the standards agreed by both parties, and shall be on terms no less favourable than those available to any third parties to which the same or similar services are provided by either party. Without breaching the requirements governed by PRC laws, in respect of the same services, where the terms and conditions of services provided by either party of the Strategic Agreement are the same as those provided by an independent third party, the party under the Strategic Agreement shall have the priority to be appointed as the service provider by the other party.

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Other important terms of the Agreement are listed in detail in the circular on 8 September 2006.

## COMPLIANCE WITH CODE ON CORPORATE GOVERNANCE PRACTICES

Please see the "Corporate Governance Report" set out in page 54 of this 2006 annual report of the Company for details of our compliance with the Code on Corporate Governance Practices.

## MATERIAL LEGAL PROCEEDINGS

As at 31 December 2006, the Company was not involved in any material litigation or arbitration, and as far as the Company is aware of, no material litigation or claims were pending or threatened or made against the Company.

## AUDITORS

KPMG and KPMG Huazhen were appointed as the international and domestic auditors of the Company for the year ended 31 December 2006. KPMG has audited the accompanying financial statements, which have been prepared in accordance with International Financial Reporting Standards. The Company has retained KPMG and KPMG Huazhen since the date of its listing. A resolution for the reappointment of KPMG and KPMG Huazhen as the international and domestic auditors of the Company for the year ending 31 December 2007 will be proposed at the Annual General Meeting of the Company to be held on 29 May 2007.

By Order of the Board

**Wang Xiaochu**

*Chairman and Chief Executive Officer*

Beijing, PRC  
26 March 2007