

Chairman's Statement

1997 was an important year in the history of China Telecom (Hong Kong) Limited. The Company's shares were successfully listed on both the New York Stock Exchange and The Stock Exchange of Hong Kong Limited in October of that year. The Company achieved significant development in its operations during the year, laying a solid foundation from which to exploit new and significant market opportunities in the telecommunications industry in China.

Following its incorporation and restructuring in September 1997, the Company is now the leading provider of cellular telecommunications services in Guangdong province and in Zhejiang province in China. Although China Telecom (Hong Kong) Limited's initial public offering and listing in October last year coincided with the Asian economic turmoil which presented a major challenge to, and caused extreme volatility in, the Hong Kong stock market, the confidence in and the support for the Company by investors were not hampered. The reaction to the offering was extremely positive.

The Company's initial public offering was approximately 35 times over-subscribed, while the institutional placing was approximately 18 times over-subscribed. The offering succeeded in raising a total of approximately HK\$32 billion, a record for funds raised in public offerings in Asia (excluding Japan).

The listing of the Company attracted major interest and goodwill from international financial markets. It was selected as "The Best Transaction in Asia of 1997" by *Global Securities*, and as "The Best Securities Transaction in Asia" by *Euroweek*. The Company also became a constituent stock of the Hang Seng Index in Hong Kong after being listed for only three months.

The overwhelmingly positive response from investors, the high regard paid by the finance industry and the strong support from the market

have been very encouraging to the management and employees of the Company. This successful beginning serves as a solid foundation for the long-term development of the Company as we approach the new millennium.

I am pleased to report that, as at 31 December 1997, the Group had an aggregate subscriber base of 3.405 million in Guangdong province and Zhejiang province. This represented a growth rate of approximately 67 per cent from the subscriber base of 2.043 million as at 31 December 1996. The Group's subscriber base accounted for over 97.5 per cent of total cellular subscribers in the two provinces and about 26 per cent of total cellular subscribers in China as at the end of 1997.

For the year ended 31 December 1997, the Group's proforma combined turnover was RMB15.488 billion (HK\$14.471 billion), an increase of RMB5,121 million (HK\$4,785 million) from RMB10.367 billion (HK\$9.686 billion) in 1996. This represented an increase of approximately 49 per cent. Proforma combined profit after tax for the year ended 31 December 1997 increased by RMB446 million (HK\$417 million) to RMB4.955 billion (HK\$4.630 billion) from RMB4.509 billion (HK\$4.213 billion) in 1996. This represented a 10 per cent increase. Proforma earnings per share for the year ended 31 December 1997 were RMB0.52 (HK\$0.49), which is higher than the RMB0.46 (HK\$0.43) forecast in the prospectus issued at the time of listing of the Company's Shares. This was mainly due to the rapid growth of subscribers and the effective use of capital by the Company.

The Board of Directors observe that the Company was established in September and listed in October 1997 and had therefore been listed for only two full months as at 31 December 1997. Moreover, the Group is experiencing a period of rapid growth and the retention of capital for future investment, expansion of the Company's telecommunications network and acquisition of

Chairman's Statement (cont'd)

quality assets could provide a better return to shareholders. The Board therefore recommends that no final dividend should be paid for the 1997 financial year.

The continued opening up of China and its aggressive pursuit of reform, the high level of social economic activities and the continuing growth in its people's income created favourable conditions for the Group. The rapid development of the cellular telecommunications industry in China and the enormous potential of the telecommunications market provides the Group with substantial room for further development.

I am fully confident about the future prospects of the telecommunications market in China. The Group is committed to increasing capital investment substantially, introducing advanced technologies, enhancing corporate management, improving the quality of its employees, promoting production efficiency and improving customer service in order to reinforce our competitive advantage, accelerate the expansion of the subscriber base and encourage telecommunications usage, thereby further enhancing the revenues of the Group.

The Group will actively explore strategic investment opportunities in the telecommunications industry in China to acquire quality telecommunications assets. The Group is currently in discussions with relevant parties about acquiring the assets of the cellular telecommunications network in Jiangsu province.

At the first session of the Ninth National People's Congress in March 1998, a motion was passed to implement the restructuring of government bodies. The Ministry of Information Industry was established to assume all the government functions of the previous Ministry of Posts and Telecommunications. The Group believes that this institutional reform, which created a demarcation between government and enterprise functions,

will help to establish a fairer and a more orderly competitive environment. This is not only beneficial to the overall development of the telecommunications industry in China, but will also contribute towards improving the management, operations and service quality of the Group. The Group has received reassurance that the Ministry of Information Industry will assume all undertakings given by the previous Ministry of Posts and Telecommunications at the time of listing of the Company's shares.

The Company accepted an invitation from the government of the Hong Kong Special Administrative Region to jointly sponsor the Chinese New Year fireworks display in early 1998 in conjunction with Hongkong Telecom to convey our thanks and best wishes to the people of Hong Kong.

Finally, I would like to take this opportunity to express my sincere thanks for the loyal support of our shareholders and investors, the valued contribution of our Board of Directors and the hard work of all our employees.

Shi Cuiming

Chairman and Chief Executive Officer

14 April 1998

President's Report

1997 was a significant year in the history of China. The whole country was excited to witness the reunification of Hong Kong with China, an event that attracted global attention.

1997 was also a year in which China Telecom (Hong Kong) Limited achieved a number of milestones. This year, the Group completed its corporate restructuring to unify its cellular telecommunications businesses in Guangdong province and Zhejiang province under China Telecom (Hong Kong) Limited, thereby making them a part of the Hong Kong community. In addition, the Company successfully accessed the international capital markets by listing on both the New York and Hong Kong stock exchanges. Management and staff of the Group intend to pursue future business developments in a similarly positive and innovative manner.

It is evident from the 1997 annual report that the Company has achieved impressive results both in its performance in the international capital markets and in its business development.

As a publicly listed company offering public cellular telecommunications services, China Telecom (Hong Kong) Limited has as its goals the provision of quality telecommunications services for its subscribers and the creation of the best possible return for its investors.

Through the continued opening up of its market, and the aggressive pursuit of reform, China has maintained a stable and fast-growing economy. We believe that the continuing improvement in the overall living standards of the people in China will stimulate stronger demand for cellular telecommunications services. The country is beginning to benefit from economies of scale after a 10-year effort to develop its cellular telecommunications industry. Although we have secured a subscriber base of one quarter of all cellular users in China, the current penetration rates in Guangdong province and Zhejiang

province are only 3.57 per cent and 2.04 per cent respectively. There is therefore much scope for future development. To meet the demand for cellular telecommunications, the Company will continue to increase its investment in both Guangdong province and Zhejiang province to expand network capacity.

The Group believes that our subscribers are the key to creating the best return for our shareholders. Our goals are to actively expand our subscriber base, while simultaneously encouraging higher network usage. We will build on the strong financial results achieved in 1997 to further improve the quality of customer services and to actively introduce advanced technology. We will also strive to improve and enhance our management systems in the areas of sales and distribution, maintenance and repairs and after-sales service, in order to provide flexibility in registering new subscribers, accuracy in billing and efficiency in resolving network and service problems. We are determined to establish a world-class network with excellent customer service, so as to maximise our appeal to new subscribers, to significantly increase the subscriber base and to promote subscriber loyalty and minimise churn.

In addition to our aggressive plan to expand network capacity and increase our subscriber base, the Company will make full use of the creativity and enthusiasm of our employees to promote the use of cellular services. We will implement comprehensive network optimisation to improve the connection rate during peak hours and we will follow international standards closely in developing value-added services to stimulate usage.

The management team unanimously believes that the effective use of capital, coupled with tight cost control, is the key to achieving maximum profitability. Although operating expenses rose in 1997 as a result of the business growth, the corporate restructuring and the growing

President's Report (cont'd)

competition among mainland cellular operations, the Company's balance sheet was maintained within prudent limits. This is attributable in large part to our strong management team, whose efficiency, devotion and leadership is matched by the professionalism, responsibility and hard work of our staff.

Cultivating our unique position as the first telecommunications provider in China to access the international capital markets, the Company will seek opportunities to acquire cellular and other telecommunications businesses so as to expand the areas of our service and produce better results.

The Group's management and its staff are motivated by the pursuit of excellence. The Group intends to actively introduce advanced management information technologies and operating systems to match the standard of international cellular service providers, to provide world-class services to subscribers, to provide satisfactory return on investment to shareholders, and to create real value.

Finally, I would like to thank the Board of Directors for their excellent leadership as well as the management and all members of staff for their hard work and their contributions to our success.

Chen Zhaobin

President

14 April 1998