

## Financial Review

The information set out below presents the results of the Group with effect from 1 January 1996 or since the respective dates of incorporation of the Company, Guangdong Mobile Communication Corporation and Zhejiang GSM Mobile Communication Company Limited (before restructuring), where this is a shorter period on a proforma combined basis as if the current group structure had been in existence throughout the years ended 31 December 1996 and 1997.

	<b>Proforma combined 1997 RMB'000</b>	Proforma combined 1996 RMB'000	Percentage change
Turnover	<b>15,487,779</b>	10,367,241	49
Operating expenses	<b>(10,073,592)</b>	(5,404,804)	86
Operating profit	<b>5,414,187</b>	4,962,437	9
Other income	<b>84,954</b>	48,976	73
Non-operating income	<b>629,519</b>	96,490	552
Interest expense	<b>(175,335)</b>	(167,144)	5
Profit before tax and minority interests	<b>5,953,325</b>	4,940,759	20
Income tax	<b>(991,019)</b>	(427,543)	132
Profit before minority interests	<b>4,962,306</b>	4,513,216	10
Minority interests	<b>(6,925)</b>	(4,058)	71
Net profit	<b>4,955,381</b>	4,509,158	10

Proforma earnings per share	<b>RMB52 cents</b>	RMB50 cents	4
EBITDA (RMB million)	<b>8,180</b>	6,436	27
Capital expenditure (RMB million)	<b>8,719</b>	5,778	51

### Management's discussion and analysis

The current structure of the Group was established pursuant to the corporate restructuring completed in September 1997. As part of the corporate restructuring, the Group entered into certain arrangements to improve the Group's overall operational efficiency. Most of these arrangements became effective during 1997 and the Group's financial results for 1997 reflect the impact of such arrangements as from the dates they became effective. Turnover and profit after tax and minority interests for 1997 are well above those of

the preceding year and the forecast included in the prospectus issued at the time of the Company's listing.

### Turnover

Proforma combined turnover for 1997 was RMB15,488 million. This represented an increase of 49 per cent from RMB10,367 million in 1996. It was also 3 per cent higher than the RMB14,970 million forecast in the prospectus issued at the time of the Company's listing. This increase is primarily due to the rapid subscriber growth, leading to corresponding increases in usage fees, connection fees and monthly fees. The Group's total number of subscribers increased by 67 per cent from 2.043 million at the end of 1996 to 3.405 million at the end of 1997.

Usage fees increased by 58 per cent from RMB5,528 million in 1996 to RMB8,718 million in 1997. This increase is mainly due to the increase in the number of subscribers and the continuing growth in total subscriber usage as a result of the expansion and improvement of fixed line and cellular networks in China. In addition, effective from 20 October 1997, the Group's accounts reflected amounts billed to its subscribers for calls interconnected with the posts and telecommunications system's PSTN fixed-line network as operating revenue. This also contributed to the rise in usage fees.

Revenue from connection fees in 1997 was RMB3,174 million, an increase of 19 per cent from RMB2,673 million in 1996. This is due to the increase in total subscribers. Average connection fee for each new subscriber decreased by 31 per cent from RMB3,396\* in 1996 to RMB2,330\* in 1997. The management believes that reduction of connection fees has helped to expand the Group's subscriber base and has resulted in increased total subscriber usage of the Group's cellular services.

\* net of PRC business tax, government surcharges and central irrigation construction levy

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As a result, usage fees as a percentage of turnover increased from 53 per cent in 1996 to 56 per cent in 1997.

Revenue from monthly fees increased 62 per cent from RMB1,658 million in 1996 to RMB2,692 million in 1997. This is due to the increase in total subscribers.

Other operating revenue amounted to RMB904 million for 1997, a 78 per cent increase from RMB508 million in 1996. This is largely the result of the increase in revenue from fees charged to non-subscribers for roaming into the Group's service areas, interconnection income and fees charged to subscribers for value-added services such as call forwarding and incoming call display functions.

### Operating expenses

Operating expenses increased from RMB5,405 million in 1996 to RMB10,074 million in 1997. This is primarily due to the increase in leased line charges, depreciation charges, interconnection expenses, personnel expenses as well as selling, general and administrative and other expenses.

Total leased line charges increased by 42 per cent from RMB2,214 million in 1996 to RMB3,134 million in 1997. This is mainly due to network expansion to include new coverage areas and the leasing of more transmission lines to increase network capacity within existing coverage areas. Leased line charges represented 31 per cent of the total operating expenses for 1997.

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Depreciation charges for 1997 amounted to RMB2,681 million, an 88 per cent increase from RMB1,424 million in 1996. This reflects the additional depreciation charges resulting from network expansion and the valuation of the subsidiaries' fixed assets as at 31 May 1997. Depreciation charges represented 27 per cent of the total operating expenses for 1997.

Interconnection expenses (including roaming out expenses) amounted to RMB1,214 million for 1997, as compared with the RMB196 million reported in 1996. This increase is mainly due to the Group recording approximately RMB739 million payable to the provincial posts and telecommunications administrations for calls made by the Group's subscribers which interconnected with the posts and telecommunications system's PSTN as interconnection expenses in accordance with the new interconnection agreement. As a percentage of operating expenses, interconnection expenses increased from 4 per cent in 1996 to 12 per cent in 1997.

Personnel expenses increased by 81 per cent from RMB416 million in 1996 to RMB756 million in 1997. This is primarily due to the hiring of additional employees and the maintenance of competitive salary packages to retain experienced employees to support network expansion and operation growth in 1997. As a percentage of operating expenses, personnel expenses remained at approximately 8 per cent in 1996 and 1997.

The Group's selling, general and administrative and other expenses ("SG&A") for 1997 were RMB2,289 million, 98 per cent higher than the RMB1,154 million reported in 1996. This is primarily due to the increase in selling and promotion expenses, provision for doubtful accounts as well as network maintenance costs.

As a percentage of operating expenses, SG&A expenses increased from 21 per cent in 1996 to 23 per cent in 1997.

Selling and promotion expenses for 1997 amounted to RMB623 million, a 44 per cent increase from RMB434 million reported in 1996. This is the result of the Group's increased efforts in strengthening marketing and distribution. A successful marketing programme introduced during 1997 in Zhejiang province has added 130,000 new subscribers to the subscriber base of Zhejiang Mobile Communication Company Limited. As a percentage of turnover, selling and promotion expenses remained at approximately 4 per cent in 1996 and 1997.

Provision for doubtful accounts increased by 97 per cent from RMB227 million in 1996 to RMB449 million in 1997, primarily due to the increase in illegal cloning activities on the TACS network. Despite this, provision for doubtful accounts as a percentage of turnover only increased slightly from 2.2 per cent in 1996 to 2.9 per cent in 1997 which is still low compared with other international cellular telephone operators. In order to minimise losses on doubtful accounts as a result of cloning activities, the Group has implemented various procedures on admission of subscribers such as identity and background checking for subscribers and imposing credit limits for high usage subscribers. Further, the Group has started to implement procedures to monitor regular high usage subscribers to reduce potential losses caused by cloning activities. As a result, as a percentage of turnover, provision for doubtful accounts decreased from 3.1 per cent for the first five months ended 31 May 1997 to 2.9 per cent for the year ended 31 December 1997.

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### Other income, non-operating income and interest expense

Other income increased by 73 per cent, primarily due to increased sales of SIM cards resulting from the increase in the number of GSM subscribers.

Non-operating income mainly included interest income and penalty income on overdue accounts. The substantial increase from RMB96.49 million in 1996 to RMB630 million in 1997 is primarily due to the interest income arising from the proceeds from the initial public offering ("IPO") of the Company's shares in October 1997.

The Group's interest expense amounted to RMB175 million, 5 per cent higher than the RMB167 million in 1996. This is primarily due to increased borrowings to finance the network expansion plan prior to the Company's IPO. Capitalised interest amounted to RMB112 million in 1997, compared with RMB46.58 million in 1996.

### Income tax

Income tax rose by 132 per cent from RMB428 million in 1996 to RMB991 million in 1997. This is primarily due to full tax liability being imposed on connection fees and certain surcharges of the Group upon completion of the Company's IPO.

### Net profit

Net profit increased by 10 per cent from RMB4,509 million in 1996 to RMB4,955 million in 1997. This increase is primarily attributable to the expanded subscriber base resulting from the increased efforts on promotion and marketing activities undertaken by the Group and the high quality services offered to subscribers. Further, in order to maximise return, the Group adopted a prudent but effective cash management policy with regard to the proceeds from the Company's IPO which led to the increase in profit attributable

to shareholders. Proforma earnings per share increased by 4 per cent from RMB50 cents in 1996 to RMB52 cents in 1997. This also represented a 13 per cent increase of RMB6 cents compared with the forecast included in the prospectus issued at the time of the Company's listing.

### EBITDA

EBITDA represents earnings before interest income, interest expense, non-operating income, income tax, depreciation and amortisation. While EBITDA is commonly used in the telecommunications industry worldwide as an indicator of operating performance, leverage and liquidity, it is not presented as a measure of operating performance in accordance with generally accepted accounting principles and should not be considered as representing net cash flows from operating activities.

EBITDA increased 27 per cent from RMB6,436 million in 1996 to RMB8,180 million in 1997. This is primarily due to the increase in income from strong subscriber growth.

### Liquidity and capital resources

Due to the receipt of the proceeds from the Company's IPO, net current assets of the Group increased from RMB1.5 billion in 1996 to RMB36.5 billion as at 31 December 1997. The Group's short term and long term borrowings as at 31 December 1997 were RMB2,148 million and RMB2,870 million respectively. The ratio of total borrowings to total assets as at 31 December 1997 was 8 per cent, lower than the ratio of 19 per cent at the end of 1996. The ratio for 1997 is low compared with the ratio of other rapidly growing cellular telephone operators. The Group's borrowings are primarily denominated in Renminbi and US dollars.

The Group's cash and bank balances (including fixed deposits with banks at year end), amounting to RMB40.1 billion, are denominated in Hong Kong dollars, Renminbi and US dollars.

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The Group's capital expenditures in 1997 amounted to RMB8,719 million, representing a 51 per cent increase over the RMB5,778 million reported in 1996. Given the Group's healthy financial position and stable business growth, the management believes that the Group will be able to raise capital to finance its cash requirements for network expansion and business development.

Looking forward, the Group will continue to maintain a sound and prudent financial management strategy and funding policies in relation to its liquidity and capital resources to support the continuing network expansion and business development, and to maximise the return on shareholders' funds.