

Report of the Directors

The directors have pleasure in submitting their first annual report together with the audited accounts for the period from 3 September 1997 (date of incorporation) to 31 December 1997.

Group restructuring

The Company was incorporated in Hong Kong on 3 September 1997. In preparation for the public listing of the Company's shares, as part of the Group restructuring, the Company acquired the subsidiaries listed in Note 13 to the accounts on 27 September 1997.

The shares of the Company were listed on the New York Stock Exchange and The Stock Exchange of Hong Kong Limited on 22 October 1997 and 23 October 1997 respectively.

Principal activities

The principal activity of the Company is investment holding. The principal activities of the Group are the provision of cellular telephone and related services in Guangdong province and in Zhejiang province of the People's Republic of China ("PRC").

The turnover of the Group during the financial period is solely made up by the income generated from the provision of cellular telecommunication services.

Major customers and suppliers

The Group's five largest customers combined did not exceed 30 per cent of the Group's total turnover in 1997.

Purchases from the largest supplier for the current year represent 69 per cent of the Group's total purchases of network equipment. The five largest suppliers accounted for an aggregate of 95 per cent of the Group's network equipment purchases in 1997. Purchases from suppliers, other than suppliers of network equipment, were not a material component of the Group's total purchases.

At no time during the period have the directors, their associates or any shareholder of the Company (whom to the knowledge of the directors owns more than 5 per cent of the Company's share capital) had any interest in these major suppliers.

Subsidiaries and associated companies

Particulars of the Company's subsidiaries and associated companies at 31 December 1997 are set out in Note 13 and Note 14 respectively to the accounts.

Accounts

The profit of the Group for the period from 3 September 1997 (date of incorporation) to 31 December 1997 and the state of the Company's and the Group's financial affairs as at 31 December 1997 are set out in the accounts on pages 31 to 63.

The directors do not recommend the payment of a final dividend for the period ended 31 December 1997.

Charitable donations

Donations made by the Group during the period amounted to RMB230,265.

Fixed assets

Movements in fixed assets of the Group and the Company during the period are set out in Note 11 to the accounts.

Share capital and share option scheme

Details of changes in the share capital of the Company are set out in Note 19 to the accounts. Shares were issued during the period pursuant to the Group restructuring in preparation for the listing of the Company's shares on the New York Stock Exchange and The Stock Exchange of Hong Kong Limited.

Report of the Directors (cont'd)

The Group raised approximately RMB33,570,231,000 net of related expenses from the issue of shares. As at 31 December 1997, such proceeds have been placed with banks as short term deposits and will be applied as planned to fund the expansion of the Group's cellular networks in Guangdong province and in Zhejiang province, the implementation of a new management information system and billing, clearance and collection systems and strategic investments in the PRC telecommunications industry.

Details of the share option scheme of the Company are set out in Note 20 to the accounts.

Reserves

Movements in the reserves of the Group and the Company during the period are set out in Note 21 to the accounts.

Directors

The directors during the financial period were:

Executive directors:

Shi Cuiming (Chairman)	(appointed on 4 September 1997)
Chen Zhaobin	(appointed on 4 September 1997)
Li Ping	(appointed on 4 September 1997)
Ding Donghua	(appointed on 4 September 1997)
Lu Errui	(appointed on 4 September 1997)
Zhu Jianhua	(appointed on 4 September 1997)

Non-executive directors:

Cui Xun	(appointed on 4 September 1997)
Hu Wangshan	(appointed on 4 September 1997)

Independent non-executive directors:

Professor Arthur Li Kwok Cheung	(appointed on 17 September 1997)
Antony Leung Kam Chung	(appointed on 17 September 1997)

In accordance with Article 97 of the Company's Articles of Association, Chen Zhaobin, Li Ping and Ding Donghua retire by rotation and, being eligible, offer themselves for re-election. In accordance with Article 101 of the Company's Articles of Association, Professor Arthur Li Kwok Cheung and Antony Leung Kam Chung will retire at the annual general meeting of the Company and shall offer themselves for re-election.

Directors' service contracts

None of those directors proposed for re-election at the forthcoming annual general meeting have an unexpired service contract which is not determinable by the Company or any of its subsidiaries within one year without payment of compensation, other than normal statutory obligations.

Directors' interests in contracts

No contract of significance to which the Company or any of its subsidiaries was a party and in which a director of the Company had a material interest, whether directly or indirectly, subsisted at the end of the period or at any time during the period.

Report of the Directors (cont'd)

Directors' interests in shares

As at 31 December 1997, one of the directors of the Company, Li Ping, personally had an interest in 100 American depositary shares (representing 2,000 ordinary shares) in the Company. Apart from the foregoing, none of the directors had any personal, family, corporate or other interests in the securities of the Company or any of its associated corporations as defined in the Securities (Disclosure of Interests) Ordinance.

Directors' rights to acquire shares

On 8 October 1997, the Company adopted a share option scheme pursuant to which the directors of the Company may, at their discretion, invite employees, including executive directors, of the Company or any of its subsidiaries, to take up options to subscribe for shares up to a maximum aggregate number of shares equal to 10 per cent of the total issued share capital of the Company. According to the share option scheme, the consideration payable by a participant for the grant of an option will be HK\$1.00. The price of a share payable by a participant upon the exercise of an option will be determined by the directors of the Company at their discretion, except that such price may not be set below a minimum price which is the higher of:

- (i) the nominal value of a share; and
- (ii) 80 per cent of the average of the closing prices of shares on The Stock Exchange of Hong Kong Limited on the five trading days immediately preceding the date of grant of the option.

The period during which an option may be exercised will be determined by the directors at their discretion, except that no option may be exercised later than 10 years after the adoption date of the scheme.

During the period, no options were granted to the directors of the Company or any of its subsidiaries under the share option scheme.

On 9 March 1998, the Company granted options in favour of the following directors:

Directors	Number of share options
Shi Cuiming	2,900,000
Chen Zhaobin	2,600,000
Li Ping	2,400,000
Ding Donghua	2,100,000
Lu Errui	1,000,000
Zhu Jianhua	1,000,000

The share options are exercisable at a price of HK\$11.1 per share during the period from 9 March 1998 to 8 March 2006.

Other than the share option scheme adopted by the Company, at no time during the period was the Company, or any of its holding companies or subsidiaries, a party to any arrangement to enable the directors of the Company or any of their spouses or children under eighteen years of age to acquire benefits by means of the acquisition of shares in or debentures of the Company or any other body corporate.

Report of the Directors (cont'd)

Substantial interests in the share capital of the Company

The Company has been notified of the following interests in the Company's issued shares at 31 December 1997 amounting to 10 per cent or more of the ordinary shares in issue:

		Ordinary shares held	Percentage of total issued shares
(i)	The Ministry of Posts and Telecommunications of the PRC ("MPT")*	9,010,000,000	76.48
(ii)	Telpo Communications (Group) Limited ("Telpo")	9,010,000,000	76.48
(iii)	The Directorate General of Posts and Telecommunications ("DGT")	9,010,000,000	76.48
(iv)	China Telecom (Hong Kong) Group Limited ("CTHK (Group)")	9,010,000,000	76.48
(v)	China Telecom Hong Kong (BVI) Limited ("CTHK (BVI)")	9,010,000,000	76.48

Note: The register of substantial shareholders indicates that the interest disclosed by CTHK (BVI) includes the 9,010,000,000 shares disclosed by MPT, Telpo, DGT and CTHK (Group).

* 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. All government functions of the previous MPT were assumed by the newly established Ministry of Information Industry ("MII"). The MII became the Company's ultimate controlling entity.

Save as disclosed above, no person or corporation had any interest in the share capital of the Company as recorded in the registers required to be kept under section 16(1) of the Securities (Disclosure of Interests) Ordinance as having an interest in 10 per cent or more of the issued share capital of the Company.

Connected transactions which are the subject of exemption under the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited ("the Listing Rules")

Details of the transactions as set out in rule 14.23(2) of the Listing Rules are set out in Note 22 to the accounts. In the opinion of the independent non-executive directors, these transactions were entered into by the Group:

- (i) in the ordinary and usual course of its business;
- (ii) on terms that are fair and reasonable so far as the shareholders of the Company are concerned; and
- (iii) on normal commercial terms and either:
 - (1) in accordance with the terms of the agreements governing such transactions; or
 - (2) (where there is no such agreement) on terms no less favorable than terms available to third parties.

The Company has received from the auditors a letter stating that the above connected transactions have received the approval of the Directors and have been conducted in the manner as stated in (iii) above.

Purchase, sale or redemption of the Company's listed securities

During the period, neither the Company nor any of its subsidiaries has purchased, sold or redeemed any of the Company's listed securities.

Bank and other loans

Particulars of bank and other loans of the Group as at 31 December 1997 are set out in Note 17 to the accounts.

Report of the Directors (cont'd)

Financial summary

A summary of the proforma combined results of the Group for each of the four years ended 31 December 1994, 1995, 1996 and 1997 and the audited statements of the Group's assets and liabilities as at 31 December 1997, together with the proforma combined statements of the Group's assets and liabilities as at 31 December 1995 and 1996 are set out on pages 67 and 68.

Compliance with the code of best practice

The Company has complied throughout the period with the Code of Best Practice issued by The Stock Exchange of Hong Kong Limited as set out in Appendix 14 to the Listing Rules except that the non-executive directors were not appointed for a specific term but are subject to retirement by rotation and re-election at the Company's annual general meeting in accordance with the Company's Articles of Association.

Auditors

A resolution for the reappointment of KPMG Peat Marwick as auditors of the Company is to be proposed at the forthcoming annual general meeting.

By order of the board

Shi Cuiming

Chairman

Hong Kong, 14 April 1998

Notice of Annual General Meeting

Notice is hereby given that the Annual General Meeting of China Telecom (Hong Kong) Limited will be held on 3 June 1998 at 11:00 a.m. in the Conference Room, 8th Floor, New World Harbour View Hotel, 1 Harbour Road, Wanchai, Hong Kong, for the following purposes:

As Ordinary Business:

1. To receive and consider the financial statements for the period ended 31 December 1997 and the Reports of the Directors and the Auditors.
2. To elect Directors and fix their remuneration.
3. To re-appoint Auditors and authorise the Directors to fix their remuneration.

And as Special Business, to consider and, if thought fit, to pass the following as ordinary resolutions:

ORDINARY RESOLUTIONS

4. **“THAT:**
 - (a) subject to paragraph (b) below, the exercise by the Directors during the Relevant Period of all the powers of the Company to purchase shares of HK\$0.10 each in the capital of the Company including any form of depositary receipt representing the right to receive such shares (“Shares”) be and is hereby generally and unconditionally approved;
 - (b) the aggregate nominal amount of Shares which may be purchased on The Stock Exchange of Hong Kong Limited or any other stock exchange on which securities of the Company may be listed and which is recognised for this purpose by the Securities and Futures Commission of Hong Kong and The Stock Exchange of

Hong Kong Limited pursuant to the approval in paragraph (a) above shall not exceed or represent more than 10 per cent of the aggregate nominal amount of the share capital of the Company in issue at the date of passing this Resolution, and the said approval shall be limited accordingly;

- (c) for the purpose of this Resolution “Relevant Period” means the period from the passing of this Resolution until whichever is the earlier of:
 1. the conclusion of the next annual general meeting of the Company;
 2. the expiration of the period within which the next annual general meeting of the Company is required by law to be held; and
 3. the revocation or variation of the authority given under this Resolution by ordinary resolution of the shareholders of the Company in general meeting.”
5. **“THAT** a general mandate be and is hereby unconditionally given to the Directors to exercise full powers of the Company to allot, issue and deal with additional shares in the Company (including making and granting offers, agreements and options which might require shares to be allotted whether during the continuance of such mandate or thereafter) provided that, otherwise than pursuant to (i) a rights issue where shares are offered to shareholders on a fixed record date in proportion to their then holdings of shares, (ii) the exercise of options granted under any share option scheme adopted by the Company or (iii) any scrip dividend or similar arrangement providing for the allotment of

Notice of Annual General Meeting (cont'd)

shares in lieu of the whole or part of a dividend as shares of the Company in accordance with the Articles of Association of the Company, the aggregate nominal amount of the shares allotted shall not exceed the aggregate of:

- (a) 20 per cent of the aggregate nominal amount of the share capital of the Company in issue at the date of passing this Resolution, plus
- (b) (if the Directors are so authorised by a separate ordinary resolution of the shareholders of the Company) the nominal amount of the share capital of the Company repurchased by the Company subsequent to the passing of this Resolution (up to a maximum equivalent to 10 per cent of the aggregate nominal amount of the share capital of the Company in issue at the date of passing this Resolution), and the said mandate shall be limited accordingly.

Such mandate shall expire at the earlier of:

1. the conclusion of the next annual general meeting of the Company;
2. the expiration of the period within which the next annual general meeting of the Company is required by law to be held; and
3. the revocation or variation of the mandate given under this Resolution by ordinary resolution of the shareholders of the Company in general meeting."

6. **"THAT** the Directors of the Company be and they are hereby authorised to exercise the powers of the Company referred to in the resolution set out in item 5 in the notice of this meeting in respect of the share capital of the Company referred to in paragraph (b) of such resolution."

By order of the board
Chen Zhaobin Yung Shun Loy Jacky
Joint Company Secretaries

14 April 1998

Notes:

1. Any member entitled to attend and vote at the above Meeting is entitled to appoint one or more proxies to attend and, on a poll, vote in his stead. A proxy need not be a member of the Company.
2. In order to be valid, a form of proxy together with the power of attorney or other authority (if any) under which it is signed, or a notarially certified copy thereof, must be deposited at the Company's registered office at 16/F, Dah Sing Financial Centre, 108 Gloucester Road, Wanchai, Hong Kong at least 36 hours before the time for holding the above Meeting. Completion and return of a form of proxy will not preclude a member from attending and voting in person if he is subsequently able to be present.
3. Concerning item 4 above, the Directors wish to state that they will exercise the powers conferred thereby to repurchase shares of the Company in circumstances which they deem appropriate for the benefits of the shareholders. The Explanatory Statement containing the information necessary to enable the shareholders to make an informed decision on whether to vote for or against the resolution to approve the repurchase by the

Notice of Annual General Meeting (cont'd)

Company of its own shares, as required by the Listing Rules, will be set out in a separate letter from the Company to be enclosed with the 1997 Annual Report.

4. Concerning item 5 above, the Directors wish to state that they have no immediate plans to issue any new shares of the Company. Approval is being sought from the Members as a general mandate for the purposes of Section 57B of the Companies Ordinance and the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited ("the Listing Rules").

Auditors' Report



**Auditors' report to the shareholders of
China Telecom (Hong Kong) Limited**
(Incorporated in Hong Kong with limited liability)

We have audited the accounts on pages 31 to 63 which have been prepared in accordance with accounting principles generally accepted in Hong Kong.

Respective responsibilities of directors and auditors

The Companies Ordinance requires the directors to prepare accounts which give a true and fair view. In preparing accounts which give a true and fair view it is fundamental that appropriate accounting policies are selected and applied consistently, that judgements and estimates are made which are prudent and reasonable and that the reasons for any significant departure from applicable accounting standards are stated.

It is our responsibility to form an independent opinion, based on our audit, on those accounts and to report our opinion to you.

Basis of opinion

We conducted our audit in accordance with Statements of Auditing Standards issued by the Hong Kong Society of Accountants. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the accounts. It also includes an assessment of the significant estimates and judgements made by the directors in the preparation of the accounts, and of whether the accounting policies are appropriate to the Company's and the Group's circumstances, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance as to whether the accounts are free from material misstatement. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the accounts. We believe that our audit provides a reasonable basis for our opinion.

Opinion

In our opinion, the accounts give a true and fair view, in all material respects, of the state of affairs of the Company and of the Group as at 31 December 1997 and of the Group's profit and cash flows for the period from 3 September 1997 (date of incorporation) to 31 December 1997 and have been properly prepared in accordance with the Companies Ordinance.

KPMG Peat Marwick
Certified Public Accountants

Hong Kong, 14 April 1998