



中国电信  
CHINA TELECOM

# China Telecom (Hong Kong) Limited

(Incorporated in Hong Kong with limited liability under the Companies Ordinance)

ANNUAL REPORT 1998



China Telecom (Hong Kong) Limited (the “Company” or “CTHK” or, including subsidiary companies, the “Group”) was incorporated in Hong Kong on 3 September 1997. It was listed on the New York Stock Exchange and the Stock Exchange of Hong Kong on 22 October 1997 and 23 October 1997, respectively, and succeeded in raising a total of approximately US\$4.2 billion in its initial public offering.

The Company owns Guangdong Mobile Communication Company Limited (“Guangdong Mobile”), Zhejiang Mobile Communication Company Limited (“Zhejiang Mobile”), and Jiangsu Mobile Communication Company Limited (“Jiangsu Mobile”), and operates cellular telephone services in Guangdong Province, Zhejiang Province and Jiangsu Province in the People’s Republic of China (“P.R. China”) through these three subsidiaries.

At 31 December 1998, the Group had an aggregate staff of 12,530 employees and an aggregate cellular telecommunications subscriber base of 6.531 million.

The Company’s major shareholder is China Telecom (Hong Kong) Group Limited, which is under the control of the Ministry of Information Industry (“MI”) and which indirectly held an equity interest of 76.48 per cent at 31 December 1998 through a wholly-owned subsidiary, China Telecom Hong Kong (BVI) Limited. The remaining 23.52 per cent equity interest in the Company was held by public investors, including investors in Hong Kong, Asia, North America and Europe.

The Company was admitted as a constituent stock of the Hang Seng Index in Hong Kong on 27 January 1998.

**Executive directors**

Mr. WANG Xiaochu  
(Chairman & President)  
Mr. LI Ping  
(Vice Chairman & Executive Vice  
President, Chief Operating Officer)  
Mr. DING Donghua  
(Director & Chief Financial Officer)  
Mr. LU Errui (Director & Vice President)  
Mr. ZHU Jianhua  
(Director & Vice President)  
Mr. HE Ning (Director & Vice President)

**Non-executive directors**

Mr. CUI Xun (Vice Chairman)  
Mr. HU Wangshan (Vice Chairman)  
Mr. ZHANG Bingyin (Vice Chairman)

**Independent non-executive directors**

Professor Arthur LI Kwok Cheung  
Mr. Antony LEUNG Kam Chung

**Joint company secretaries**

Mr. LI Ping  
Mr. Jacky YUNG Shun Loy

**Corporate counsel**

Mr. David Laurence KREIDER  
(Licensed attorney in the United States  
and Hong Kong)

**Auditors**

KPMG

**Legal advisers**

Linklaters & Paines  
Livasiri & Co.  
Sullivan & Cromwell

**Registered office**

16/F Dah Sing Financial Centre  
108 Gloucester Road, Wanchai,  
Hong Kong

*Public and investor relations:*

Telephone: 852 2877 3332  
Fax: 852 2511 9092  
Website: www.cthk.com  
Stock code: (Hong Kong) 941  
(New York) CHL

**Subsidiaries offices****Guangdong Mobile Communication  
Company Limited**

728, Dong Feng Road East, Guangzhou,  
Guangdong Province, P.R. China  
Postal code: 510080  
Tel: 86 20 87770000  
(Chinese Secretary)  
86 20 87607717  
(Foreign Affairs Secretary)

**Zhejiang Mobile Communication  
Company Limited**

406, Ti Yu Chang Road, Hangzhou  
Zhejiang Province, P.R. China  
Postal code: 310006  
Tel: 86 571 5060230

**Jiangsu Mobile Communication  
Company Limited**

51 Hu Ju Road, Nanjing  
Jiangsu Province, P.R. China  
Postal code: 210003  
Tel: 86 25 6668120

**Share registrar**

HKSCC Registrars Limited  
2/F Vicwood Plaza  
199 Des Voeux Road Central, Hong Kong

**American Depositary Receipts  
depository**

Bank of New York  
101 Barclay Street, New York,  
NY 10286, USA  
Telephone: 1 888 269 2377  
(toll free in USA)

**Publications**

As required by the United States securities laws, the Company will file an annual report on Form 20-F with the US Securities and Exchange Commission before 30 June 1999. Copies of the annual report as well as the Form 20-F, once filed, will be available at:

*Hong Kong:*

**China Telecom (Hong Kong) Limited**  
16/F Dah Sing Financial Centre  
108 Gloucester Road, Wanchai,  
Hong Kong

*United States:*

**Bank of New York**  
101 Barclay Street, New York,  
NY 10286, USA



#### Executive directors

**Mr. Wang Xiaochu**, age 41, Chairman and President of the Company. Mr. Wang is in charge of the overall management of the Company. He is also the Chairman and President of Telpo Communications (Group) Limited. Prior to joining the Company, Mr. Wang served as the Director General of the Tianjin Posts and Telecommunications Administration. He also served as Director and Deputy Director of the Hangzhou Telecommunications Bureau in Zhejiang Province. He was responsible for the development of China Telecom's telephone network management systems and various other information technology projects. Mr Wang graduated from the Beijing University of Posts and Telecommunications in 1980 and has over 18 years of management experience in the telecommunications industry.

**Mr. Li Ping**, age 45, Vice Chairman, Executive Vice President and Joint Company Secretary of the Company. Mr. Li is in charge of the Company's business operations and investor relations. He has served as Deputy Director General of the Directorate General of Telecommunications ("DGT") of the Ministry of Posts and Telecommunications, and Deputy Director General of the Heilongjiang Posts and Telecommunications Administration. He graduated from the Beijing University of Posts and Telecommunications in 1976 and received an MBA degree from the State University of New York in 1989. Mr. Li has over 20 years' operational and management experience in the telecommunications industry.



**Mr. Ding Donghua**, age 62, Director and Chief Financial Officer of the Company. Mr. Ding is in charge of the financial management of the Company. He was previously the Chief Economist, Chief Accountant, Deputy Chief Economist and Department Director of the Guangdong Posts and Telecommunications Administration. He graduated from the Beijing University of Posts and Telecommunications in 1961 and has 37 years' management experience in the telecommunications industry, as well as in economics and finance.

**Mr. Lu Errui**, age 59, Director and Vice President of the Company. Mr. Lu is responsible for the mobile telecommunications operations in Guangdong province. He previously served as the Director and President of Guangdong Mobile Communication Company Limited and Director of Guangdong Mobile Communications Bureau. Mr. Lu graduated from the Chinese University of Science and Technology. He has over 20 years' experience in the telecommunications industry.





**Mr. Zhu Jianhua**, age 45, Director and Vice President of the Company. Mr. Zhu is responsible for the mobile telecommunications operations in Zhejiang province. He is also the Director and President of Zhejiang Mobile Communication Company Limited. Mr. Zhu previously served as Deputy Director and Chief Engineer of the Hangzhou Posts and Telecommunications Bureau. He graduated from the Nanjing Institute of Posts and Telecommunications in 1985 and received a master's degree in computer science from Zhejiang University in 1992. Mr. Zhu has many years of experience in the telecommunications industry.

**Mr. He Ning**, age 37, Director and Vice President of the Company. Mr. He is responsible for the mobile telecommunications operations in Jiangsu province. He is also the Director and President of Jiangsu Mobile Communication Company Limited. Mr. He previously served as the Director and Deputy Director of Jiangsu Mobile Communications Bureau, and Deputy Director of the Zhejiang Posts and Telecommunications Bureau. He graduated from the Nanjing Institute of Posts and Telecommunications in 1983, and has 15 years' experience in the telecommunications industry.



#### Non-executive directors



**Mr. Cui Xun**, age 60, Vice Chairman of the Company. Mr. Cui is currently the Director General of the Guangdong Posts and Telecommunications Administration and Chairman of Guangdong Mobile Communication Company Limited. He has served as Deputy Director General and Chief Engineer of the Guangdong Posts and Telecommunications Administration as well as Chief Engineer, Deputy Director and Deputy Chief Engineer of the Guangzhou Posts and Telecommunications Bureau. Mr. Cui graduated from the Beijing University of Posts and Telecommunications in 1962. He has 36 years' experience in the telecommunications industry.

**Mr. Hu Wangshan**, age 55, Vice Chairman of the Company. Mr. Hu is the Director General of Zhejiang Posts and Telecommunications Administration and Chairman of Zhejiang Mobile Communication Company Limited. He previously served as Deputy Director General of Zhejiang Posts and Telecommunications Administration as well as Director and Deputy Director of Shaoxing Posts and Telecommunications Bureau in Zhejiang province. Mr. Hu graduated from the Beijing University of Posts and Telecommunications in 1968. He has over 30 years' experience in the telecommunications industry.





**Mr. Zhang Bingyin**, age 60, Vice Chairman of the Company, is also the Director General of the Jiangsu Posts and Telecommunications Administration and Chairman of Jiangsu Mobile Communication Company Limited. Previously, Mr. Zhang was the Deputy Director General of the Jiangsu Posts and Telecommunications Administration and Director and Deputy Director of the Changzhou Posts and Telecommunications Bureau in Jiangsu. He graduated from the Posts and Telecommunications Institute for Managerial Personnel in 1987. Mr. Zhang has more than 40 years' experience in the telecommunications industry.

#### Independent non-executive directors

**Professor Arthur Li Kwok Cheung**, age 53, Director. Professor Li is the Vice Chancellor of the Chinese University of Hong Kong, a Non-Executive Director of Glaxo Wellcome plc, a Director of the Bank of East Asia Limited and a Non-Executive Director and Chairman of the Board of Regal Hotel Group plc. He holds a doctorate degree in medicine from Cambridge University and an honorary doctorate degree in science. He previously served as Board Member of the Hong Kong Hospital Authority and President of the College of Surgeons of Hong Kong. Professor Li is an Advisor on Hong Kong Affairs to the People's Republic of China, a Member of the Basic Law Consultative Committee, a Member of the Preparatory Committee of the Hong Kong Special Administrative Region of the National People's Congress, a Member of the Selection Committee of the First Government of the Hong Kong Special Administrative Region and a Committee Member of the Ninth Annual Chinese People's Political Consultative Conference.



**Mr. Antony Leung Kam Chung**, age 47, Director. Mr. Leung is the Managing Director and Regional Manager for Greater China and the Philippines of Chase Manhattan Bank. He graduated from the University of Hong Kong and completed the Program for Management Development at the Harvard Business School. Mr. Leung's public service appointments include Member of the Executive Council of the Hong Kong Special Administrative Region, Chairman of the Education Commission, Member of the Exchange Fund Advisory Committee and Board Member of the Airport Authority.

China Telecom (Hong Kong) Limited achieved significant progress in 1998. The Company successfully acquired Jiangsu Mobile, extending the Group's business coverage to an additional province. During 1998 the Group sustained steady growth in its cellular telecommunications business in Guangdong, Zhejiang and Jiangsu provinces.

In 1998, the Group's subscriber base and network usage volume grew rapidly and the Group maintained its leading market position in the three provinces. As of 31 December 1998, the Group's aggregate subscriber base reached 6.531 million, representing an increase of 2.246 million subscribers and a growth rate of 52.42 per cent from the Group's pro forma combined\* aggregate subscriber base of 4.285 million at the end of 1997. The pro forma total cumulative minutes of usage of the Group's subscribers in 1998 was 25.0 billion minutes, representing a growth rate of 42.05 per cent from the pro forma combined 17.6 billion aggregate minutes of usage volume in 1997. According to the Group's estimates, the Group's aggregate market share was 94.5 per cent in the three provinces and 26.1 per cent of the mainland China cellular telecommunications market as a whole at the end of 1998.

I am pleased to report that the Group also achieved satisfactory financial results in 1998. In 1998, the Group recorded consolidated turnover of RMB26.345 billion (HK\$24.672 billion) and profit attributable to shareholders of RMB6.9 billion (HK\$6.462 billion). Basic earnings per share was RMB59 cents (HK\$55 cents). In 1998, the Group's pro forma combined turnover was RMB28.528 billion (HK\$26.717 billion), representing an increase of RMB9.406 billion (HK\$8.809 billion) and a growth rate of 49.19 per cent from the pro forma combined turnover of RMB19.122 billion (HK\$17.908 billion) in 1997. The pro forma combined profit before exceptional item and income tax for 1998 was RMB8.267 billion (HK\$7.742 billion), representing an increase of RMB1.728 billion (HK\$1.618 billion) and a growth rate of 26.42 per cent from RMB6.539 billion (HK\$6.124 billion) in 1997.

The Board of Directors does not intend to recommend the payment of a dividend for the year ended 31 December 1998. As the Group is experiencing a period of rapid growth, the Board deems it desirable that capital be retained for additional investments, network expansion and optimization, as well as potential acquisitions of quality assets, in order to obtain a better return for the shareholders.

In August 1998, Mr. Zhang Bingyin and Mr. He Ning were invited to contribute their considerable business acumen as new members of the Company's Board of Directors.

\* The Group's current structure was established in June 1998 following the completion of the acquisition of Jiangsu Mobile. For ease of comparison, unless otherwise specified, the pro forma combined results of operations described herein assume that the current Group structure existed during all periods discussed.

In March 1999, Mr. Shi Cuiming and Mr. Chen Zhaobin resigned from the posts of Chairman, and of Vice Chairman and President, respectively. It was my great pleasure to be appointed by the Board of Directors as Chairman and President of the Company. I thank the Board of Directors for their trust, and will endeavor to prove worthy of that trust. In addition, on behalf of the Board, I am very pleased to welcome Mr. Zhang Bingyin and Mr. He Ning. I would also like to express my high regards and sincere thanks to Mr. Shi Cuiming and Mr. Chen Zhaobin for their hard work and contributions to the Company's incorporation and initial development.

The Year 2000 is near at hand, and the Company has devoted close attention to the Year 2000 issue. Both during and at the end of 1998, the Company announced a compliance programme and the budget for its implementation. All subsidiaries of the Company are implementing the compliance programme as proposed and the progress is satisfactory. We expect that the project will be completed on schedule.

Looking ahead, we are confident about the Group's prospects for further strong growth. Moving into the new millennium, we view the information industry as one of the key industries in the information-based global economy, and the telecommunications industry as its very heart. As a core information industry, there can be no doubt about the telecommunications industry's vast growth potential.

We believe that the ongoing restructuring of mainland China's telecommunications industry will create an environment conducive to orderly, transparent, healthy and fair competition among cellular telecommunications providers, which will further enhance the Group's opportunities for growth and development.

According to the draft plan for the restructuring of the telecommunications industry, China Telecom will be reorganized based on business lines, and it is anticipated that the Group may come under the control of the China mobile telecommunications company to be established.

In line with its rapid economic development during the last three years, mainland China's cellular telecommunications market grew at an average compound annual growth rate of 84 per cent over the same period. However, the overall cellular penetration rate in mainland China is only about 2 per cent and is low compared to other international markets, which suggests that the mainland China cellular telecommunications market has significant potential for further growth.

With its robust financial profile, advanced network infrastructure, leading market position and sound management expertise, we believe that the Group enjoys considerable competitive advantages within China's expansive telecommunications sector.

The Group has adopted a customer-orientated management philosophy centered on providing high quality telecommunications services tailored to subscriber needs, with the primary goal of maximizing shareholder value. The Group will endeavor to apply management and operating standards in line with international best practice in the telecommunications industry and run the Group's business in a professional manner.



We appreciate that the talents of our employees are an invaluable asset. We aim to establish a diversified corporate culture by building on this most important asset, fostering respect for ability and talent, promoting specialization and internationalization and encouraging individual initiative.

The Group continues to focus on expanding and optimizing its integrated network, which utilizes GSM 900 MHz and compatible DCS 1800 MHz digital technologies. Concurrently, the Group will continue to closely follow commercial applications of "third generation" mobile telecommunications technology.

In keeping with our resolve to build a world-class telecommunications company, we will continue to enhance our competitive edge and competency. We will do so by emphasizing organic growth through the adoption of aggressive marketing strategies and specialized operations management based on international best practice, and by promoting external growth and exploring opportunities to acquire high-quality cellular and other telecommunications businesses in China.

Finally, I would like to thank our shareholders and investors for their unwavering support, the Board of Directors for their valuable leadership, and staff members for their hard work.

**Wang Xiaochu**

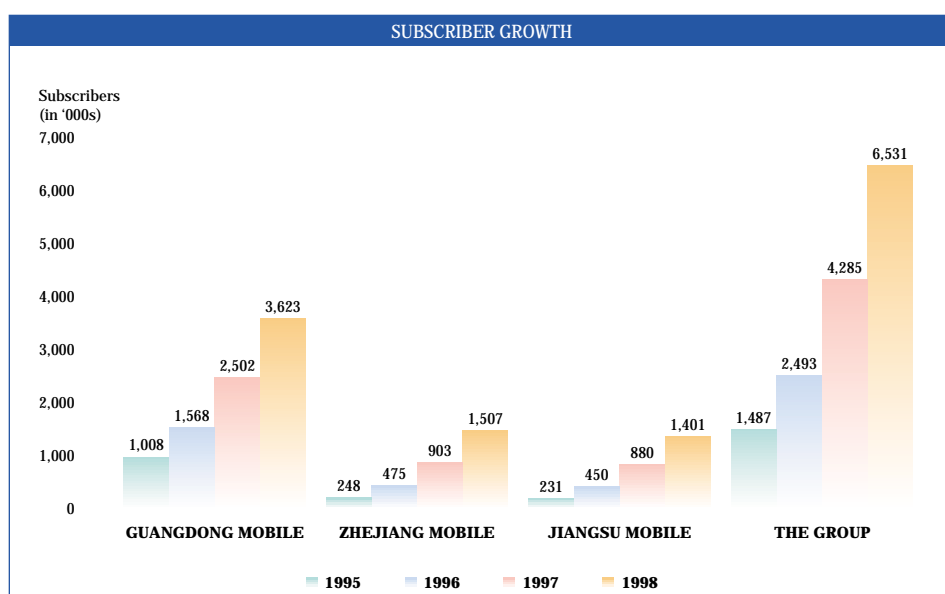
*Chairman and President*

28 April 1999

In 1998, the Group achieved favorable operational performance and expanded its business coverage. Through the acquisition of Jiangsu Mobile in June 1998, the Group extended its business coverage to an additional province. There was significant growth in the Group's aggregate cellular subscriber base and usage volume in 1998, and the Group maintained its leading market position as a provider of cellular telecommunications services in Guangdong, Zhejiang and Jiangsu provinces.

**Subscribers, Market and Sales**

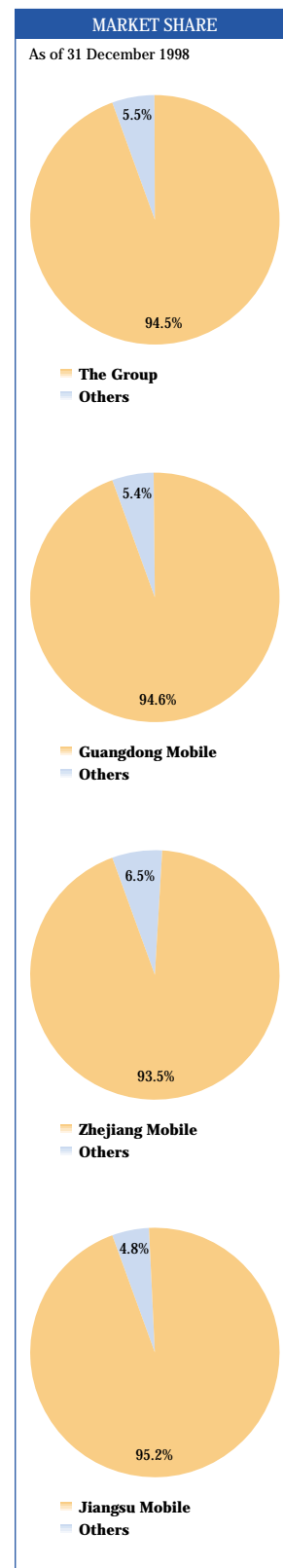
As of 31 December 1998, the Group's aggregate subscriber base reached 6.531 million in Guangdong, Zhejiang and Jiangsu provinces, representing an increase of 2.246 million subscribers and a growth rate of 52.42 per cent over the pro forma combined\* aggregate subscriber base of 4.285 million at the end of 1997.

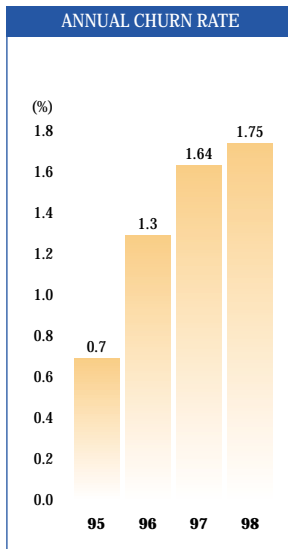


As of 31 December 1998, of the Group's total subscribers, Guangdong Mobile accounted for 3.623 million subscribers, representing an increase of 1.121 million subscribers and a growth rate of 44.80 per cent; Zhejiang Mobile accounted for 1.507 million subscribers, representing an increase of 604,000 subscribers and a growth rate of 66.89 per cent; and Jiangsu Mobile accounted for 1.401 million subscribers, representing an increase of 521,000 subscribers and a growth rate of 59.20 per cent, from the end of 1997.

During the three years ended 31 December 1998, the Group's pro forma combined aggregate subscriber base grew at a compound annual growth rate of 63.77 per cent. However, the cellular penetration rate in the Group's three provinces of operation was only 3.7 per cent at the end of 1998, which suggests significant potential for further growth. The Group believes that the anticipated strong demand for cellular telecommunications services will be one of the major drivers of future subscriber growth.

\* The Group's current structure was established in June 1998 following the completion of the acquisition of Jiangsu Mobile. For ease of comparison, unless otherwise specified, the pro forma combined results of operations described herein assume that the current Group structure existed during all periods discussed.



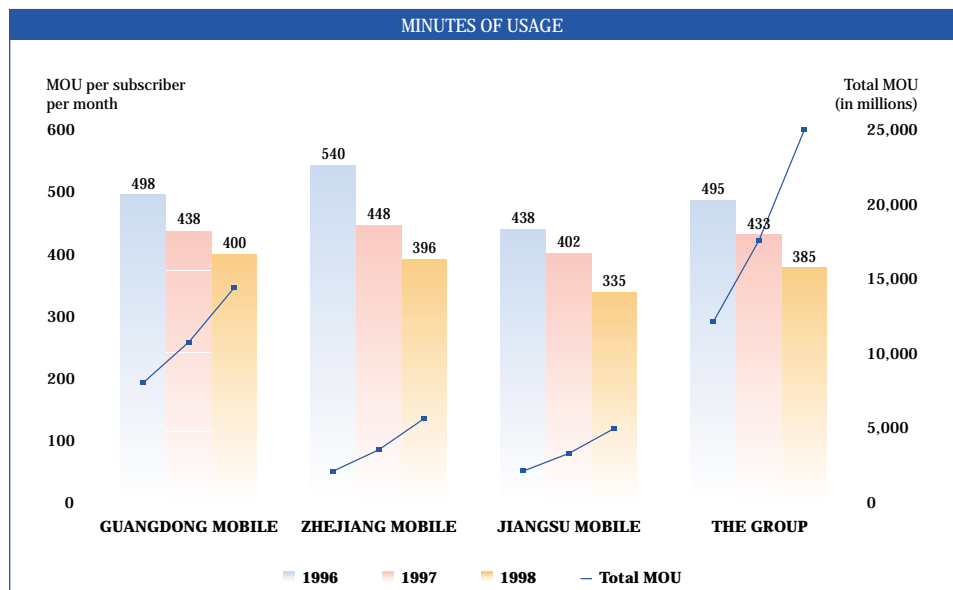


In 1998, the Group adopted aggressive sales and marketing strategies and improved its distribution channels. The Group had a distribution network of 3,489 sales outlets by the end of 1998. The Group's churn rate was only 1.75 per cent in 1998, reflecting greater customer loyalty. Connection fees have been reduced, and the Group has made efforts to offer telecommunications services targeted at customer needs and enhance marketing and after-sales customer services.

The Group maintained its leading market position in its provinces of operation in 1998. According to the Group's estimates, the Group enjoyed market shares of approximately 94.6 per cent, 93.5 per cent and 95.2 per cent, in Guangdong, Zhejiang and Jiangsu provinces, respectively, at the end of 1998. The Group's subscribers represented 94.5 per cent of total cellular subscribers in the three provinces and 26.1 per cent of the mainland China cellular telecommunications market as a whole at the end of 1998.

**Usage Volume**

The Group's pro forma combined aggregate subscriber usage volume in 1998 reached 25.0 billion minutes, representing an increase of 42.05 per cent from the pro forma combined aggregate subscriber usage volume of 17.6 billion minutes in 1997, with subscribers in Guangdong, Zhejiang and Jiangsu provinces accounting for 14.69 billion, 5.73 billion and 4.58 billion minutes of usage, respectively.



The pro forma combined average minutes of usage volume per subscriber per month (“MOU”) decreased from 433 minutes in 1997 to 385 minutes in 1998. The average MOU in Guangdong, Zhejiang and Jiangsu provinces was 400 minutes, 396 minutes and 335 minutes, respectively, in 1998.

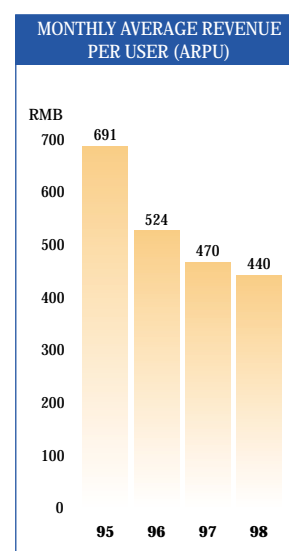
The Group’s management believes that the decline in MOU, resulting primarily from the rapid expansion of its subscriber base and the inclusion of more lower usage subscribers, is normal and typical of the experiences of its peer group cellular telecommunications companies operating in other countries. Moreover, the Group’s total subscriber usage volume increased as a result of the expansion of the Group’s subscriber base.

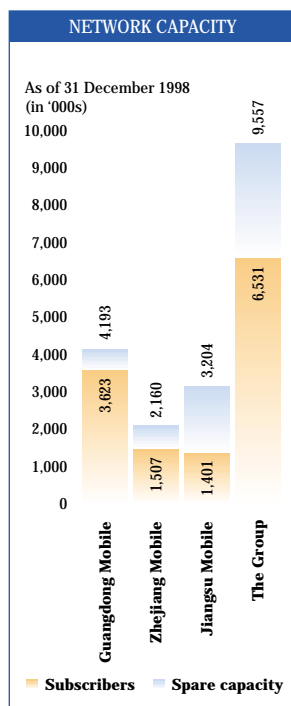
### Products, Pricing and Customer Care

The Group’s basic product is cellular telephone services, including local, domestic and international long distance services, as well as domestic and international roaming services. In addition, the Group offers value added services, including caller ID display, call forwarding, call waiting and voicemail, short message services, prepaid SIM cards and mobile data. During 1998, the Group’s “Global Access Network” digital cellular service was extended to offer roaming services in 16 additional countries and regions, including Russia, the Czech Republic, Slovakia, Lithuania, Slovenia, Romania, Azerbaijan, Portugal, South Africa, Gibraltar, Kyrgyzstan, Cyprus, Qatar, Luxembourg, Thailand and Norway. Roaming is now available in a total of 38 countries and regions.

The Group’s tariffs for cellular telecommunications services were disclosed in the prospectus for the Company’s initial public offering and all subsequent material changes have been disclosed by public announcements in newspapers.

In 1998, the Group offered tailored service packages, such as “1+1” and “Provincial Access”, and adopted flexible tariff plans distinguishing between day and night and peak and non-peak hours, based upon customer requirements as well as the functions and features of the Group’s network resources. The Group also established customer care centres to improve the quality of information available to customers and after-sales services. In addition, the Group took steps to improve its billing and collection systems to shorten payment collection cycles and improve billing services.





### Network, Technology and Capital Expenditures

In 1998, the Group expanded and optimized its digital GSM network and further refined its analog TACS network based on coverage requirements and market demands. At 31 December 1998, the standard capacity of the Group's network reached 9.557 million subscribers, with the Group's GSM network at 7.376 million and the TACS network at 2.181 million subscribers, and a digital to analog ratio of 77.18 per cent to 22.82 per cent. In 1998, the Group's network, with 478,000 radio channels and 10,199 base stations, covered all cities, counties and more than 95 per cent of the major highways within the Group's service areas. The average network utilization rate was 68 per cent.

The Group continues to expand and optimize its network, to match the capacity of its network and throughput with usage volume and maintain its leadership position in network function, quality and coverage. In addition, the Group is closely following commercial applications of "third generation" cellular telecommunications technology in relation to the possible transition of its network from "second generation" technology to "third generation" technology in the future.

In 1998, the Group incurred pro forma combined aggregate capital expenditures of RMB16.397 billion, of which Guangdong Mobile, Zhejiang Mobile and Jiangsu Mobile accounted for RMB6.405 billion, RMB4.814 billion and RMB5.168 billion, respectively.

Actual capital expenditures and network construction in 1998 exceeded the estimates made at the time of the Company's initial public offering as a result of an acceleration in the deployment of the Group's network infrastructure due to the swifter than expected growth of the Group's cellular subscriber base in recent years.

### Year 2000 Issue

The Year 2000 issue has always been of particular concern to the management of the Group. The Group disclosed certain important features relating to its Year 2000 compliance programme in its 1998 interim report.

On 31 December 1998, the Group announced a budget of approximately US\$30 million (equivalent to approximately HK\$232 million) to address Year 2000 compliance. Approximately 20 per cent of this amount was recognized as an expense in the year ended 31 December 1998. By 31 December 1998, contracts executed by the Group relating to the Year 2000 compliance programme had a total value of US\$17.965 million.

The Group's Year 2000 Task Force is leading and coordinating compliance efforts under and in accordance with the Year 2000 compliance programme. The Group estimates that approximately 75 per cent of the scheduled work has been completed to date, and that the modification and upgrading of relevant equipment and software will be completed and Non-Year 2000 compliant equipment will be removed by the end of June 1999. Testing and verification of equipment is expected to commence in July 1999 in order to allow sufficient time to monitor the equipment's operating performance, detect and resolve any potential problems, and ensure the smooth transition of the Group's network into the year 2000.

### **Community Service**

In 1998, the Group donated RMB7.7 million to public welfare activities in Hong Kong and towards the reconstruction and recovery of areas affected by the Yangtze River floods in mainland China, and provided cellular telephones and related services free of charge during the natural disaster.

### **LOOKING AHEAD**

Looking to the future, we are confident about the Group's prospects for further strong growth. As we move towards the new millennium, we believe that the information industry will become one of the key industries in the information-based global economy, with the telecommunications industry as its core.

We believe that the reorganization currently taking place within the mainland China telecommunications industry will create an environment conducive to orderly, transparent, healthy and fair competition among cellular telecommunications providers, which will further enhance the Group's opportunities for growth and development.

According to the draft plan for the restructuring of the telecommunications industry, China Telecom will be reorganized based on business lines, and it is anticipated that the Group may come under the control of the China mobile telecommunications company to be established.

In line with mainland China's rapid economic growth during the last three years, its cellular telecommunications market grew at an average compound annual rate of 84 per cent over the same period. However, the overall cellular penetration rate in mainland China is only about 2 per cent and is low compared to other international markets, which suggests that the mainland China cellular telecommunications market has significant potential for further growth.

We believe that, with its robust financial profile, advanced network infrastructure, leading market position and sound management practices, the Group enjoys considerable competitive advantages within China's expansive telecommunications sector.

The Group has adopted a customer-orientated management philosophy centered on providing high quality telecommunications services tailored to subscriber needs, with the primary goal of maximizing shareholder value. The Group will endeavor to apply management and operating standards in line with international best practice in the telecommunications industry and run the Group's business in a professional manner.

Efforts are ongoing to more fully integrate the three operating subsidiaries into the Group to enhance existing synergies and maximize shareholder value. The Group's internal information technology ("IT") infrastructure will be further improved to support core business processes and enhance workflow. Moreover, in keeping with the philosophy of "change management", we will respond to changes and challenges by continually reassessing and reshaping our organizational imperatives, introducing motivational and incentive mechanisms as appropriate, to bring out the fullest talents and abilities of our human resources.

We appreciate that the talents of our employees are an invaluable asset. We aim to establish a diversified corporate culture by building on this most important asset, fostering respect for ability and talent, promoting specialization and internationalization and encouraging individual initiative.

The Group continues to focus on expanding and optimizing its integrated network, which utilizes GSM 900 MHz and compatible DCS 1800 MHz digital technologies. Concurrently, the Group will continue to devote close attention to commercial applications of "third generation" mobile telecommunications technology.

In keeping with our resolve to build a world-class telecommunications company, we will continue to enhance our competitive edge and competency by emphasizing organic growth through the adoption of aggressive marketing and sales strategies, and to promote external growth by exploring opportunities to acquire high-quality cellular and other telecommunications businesses in China.

The information set out in this financial review presents the unaudited pro forma combined ("pro forma combined") results of the Group with effect from 1 January 1997 as if the current group structure had been in place throughout the two years ended 31 December 1997 and 1998.

	<b>Pro forma combined 1998 RMB'000</b>	Pro forma combined 1997 RMB'000	Variance %
Turnover	<b>28,527,747</b>	19,122,348	49.19
Operating expenses	<b>(20,383,454)</b>	(12,435,546)	63.91
Operating profit	<b>8,144,293</b>	6,686,802	21.80
Other income	<b>333,669</b>	57,452	480.78
Non-operating expenses	<b>(50,005)</b>	(27,544)	81.55
Interest expense	<b>(160,883)</b>	(177,441)	(9.33)
Profit before exceptional item	<b><u>8,267,074</u></b>	<u>6,539,269</u>	26.42
<hr/>			
EBITDA (in RMB millions)	<b>13,634</b>	10,133	34.55
Capital expenditures (in RMB millions)	<b>16,397</b>	10,234	60.23

## MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

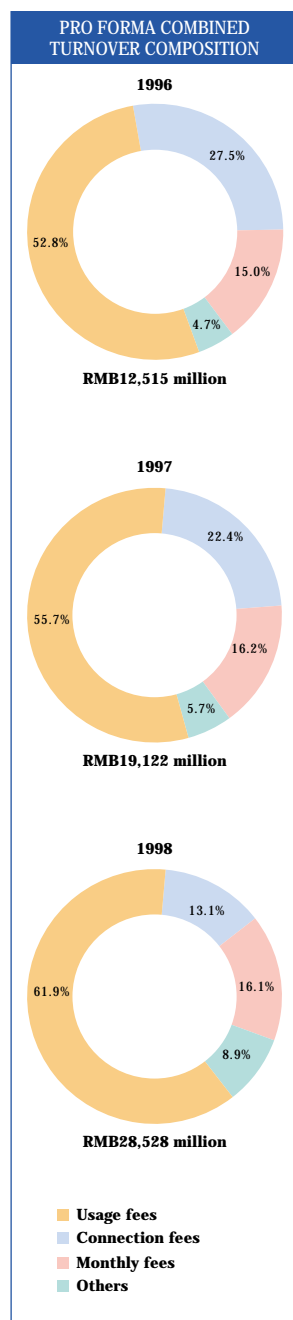
The current structure of the Group was established after the completion of the corporate restructuring in September 1997 and the acquisition of Jiangsu Mobile in June 1998. As part of the restructuring, the Group entered into certain operating arrangements which were implemented subsequently. The Group also entered into similar arrangements in connection with the acquisition of Jiangsu Mobile in 1998. The satisfactory financial results of the Group for 1998 reflected the impact of such arrangements. Turnover and profit before exceptional item for 1998 recorded significant increases over the previous year.

### Turnover (Operating Revenue)

**Pro forma combined turnover** for 1998 was RMB28,528 million. This represented an increase of 49.19 per cent from RMB19,122 million in 1997. This increase was primarily due to the rapid growth of the Group's subscriber base, leading to corresponding increases in usage fees and monthly fees. The Group's pro forma combined number of subscribers increased by 2.246 million, or 52.42 per cent, from 4.285 million at the end of 1997 to 6.531 million at the end of 1998.

**Usage fees** increased by 65.78 per cent from RMB10,656 million in 1997 to RMB17,666 million in 1998. This was mainly due to the considerable growth in the aggregate usage volume of the Group's subscribers in 1998. It should be noted that, as a result of the implementation of interconnection arrangements subsequent to the restructuring, usage fees in 1998 included the full amount of revenues from international long distance calls (IDD), domestic long distance calls (DDD), and off home-location





roaming services (“roaming out”) totalling RMB6,451 million. Part of these revenues were required to be settled with other network operators in accordance with the relevant agreements.

**Monthly fees** increased by 47.95 per cent from RMB3,103 million in 1997 to RMB4,591 million in 1998. The increase was mainly due to solid growth in the number of the Group’s subscribers. Monthly fees replaced connection fees as the second largest component of the Group’s turnover in 1998.

**Connection fees** for 1998 were RMB3,723 million, a decrease of 13.01 per cent from RMB4,280 million in 1997. The average connection fee for each new subscriber of the Group decreased by 30.59 per cent from RMB2,388 in 1997 to RMB1,658 in 1998. As connection fees only represented 13.05 per cent of turnover in 1998, the impact of the overall reduction of standard connection fees charged to subscribers on the Group’s total turnover has gradually lessened. On the other hand, the Group considers that the reduction of the standard connection fees charged to subscribers may promote the growth of the Group’s subscriber base and increase usage volume, and reduce the Group’s reliance on up-front connection fees to drive turnover growth. The Group expects that this will result in a more reliable, solid and rational turnover structure that will, in the long run, bring benefits to the Group.

**Other operating income** increased by 135.18 per cent from RMB1,083 million in 1997 to RMB2,548 million in 1998. This income mainly included revenues from interconnection settlement, fees charged to subscribers of other network operators for visitor-location roaming services (“roaming in”) within the Group’s service areas, and fees charged to the Group’s subscribers for value added services. The growth in other operating income reflected the favourable growth of the above items in 1998, which, the Group believes, will have a positive effect on the long term growth of the Group’s turnover.

Analysis of the Group’s turnover over the past three years reveals that the Group’s turnover composition is currently undergoing adjustment. Usage fees, which constitute the largest component of turnover, increased as a percentage of turnover from 52.84 per cent in 1996, to 55.73 per cent in 1997, and 61.93 per cent in 1998. In contrast, connection fees, which constituted the second largest component of turnover before 1998, decreased as a percentage of turnover from 27.48 per cent in 1996, to 22.38 per cent in 1997, and 13.05 per cent in 1998. Monthly fees increased as a percentage of turnover to 16.09 per cent, and became the second largest component of turnover in 1998. The Group expects that income related to its subscriber base and subscriber usage volume, which is of a recurrent nature, represents an important source of revenue and will constitute an increasingly larger component of turnover. The Group believes this adjustment represents a more effective turnover structure and anticipates that it will lead to more reliable and solid turnover growth in the long run.

### Operating Expenses

The Group’s operating expenses increased by 63.91 per cent from RMB12,436 million in 1997 to RMB20,383 million in 1998. This was due to increases in leased line expenses, interconnection expenses, depreciation expense, personnel expenses as well as selling, general and administrative and other expenses.

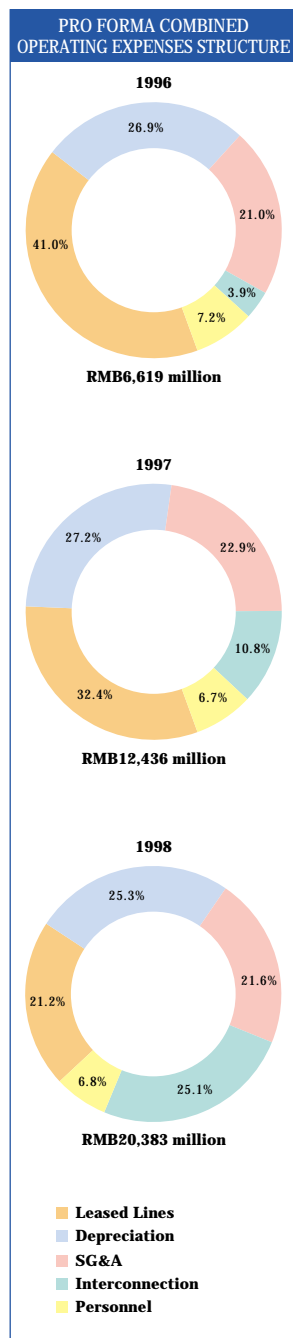
**Leased line expenses** increased by 7.51 per cent from RMB4,030 million in 1997 to RMB4,332 million in 1998. Leased line expenses represented 21.25 per cent of operating expenses in 1998, compared to 32.40 per cent in 1997 and 40.96 per cent in 1996. Comparing the increase in leased line expenses in 1998 against the Group's increased network capacity and number of subscribers, it should be noted that the efficiency of utilization of the Group's leased lines improved. In addition, upon the implementation of the new leased line agreements after the restructuring and listing of the Group in 1997, standard tariffs for leased lines payable by Guangdong Mobile were reduced. This slowed the increase in the Group's leased line expenses payable in 1998. However, leased line expenses continued to be a significant component of the Group's total operating expenses in 1998, accounting for 21.25 per cent. The Group continues to optimize its network, adjust the number of leased lines and routings promptly in accordance with subscriber usage volume and traffic flow, and utilize advanced multiplex technology to increase the efficiency of its leased lines.

**Interconnection expenses** (including expenses for roaming out settlement) increased by 282.09 per cent from RMB1,338 million in 1997 to RMB5,111 million in 1998. This was mainly due to newly imposed charges payable on settlement for inter-network traffic in accordance with the relevant agreements implemented after the restructuring for the initial public offering ("IPO") and the acquisition of Jiangsu Mobile, and the general increase in the volume of roaming out and inter-network traffic. Included in usage fees and other operating income in the Group's turnover for the year 1998 was an amount of RMB8,442 million representing the full amount of revenues from DDD, IDD and roaming usage fees, including revenues from intra-network traffic not requiring interconnection settlement. Interconnection expenses represented 25.07 per cent of total operating expenses in 1998.

**Depreciation expense** amounted to RMB5,156 million in 1998, representing a 52.16 per cent increase from RMB3,388 million in 1997. The significant increase in depreciation expense was principally due to the increase in the Group's fixed assets. In addition, the increase in value of assets arising from the revaluation of the assets of Guangdong Mobile, Zhejiang Mobile and Jiangsu Mobile during the restructuring and the acquisition of Jiangsu Mobile also contributed to the increase in depreciation expense. Depreciation expense represented 25.29 per cent of total operating expenses in 1998.

**Personnel expenses** increased by 66.54 per cent from RMB833 million in 1997 to RMB1,387 million in 1998. This was mainly due to the hiring of additional employees to provide services for a larger subscriber base, to improve the quality of service and maintain competitive salary packages to retain outstanding employees. As a percentage of operating expenses, personnel expenses slightly increased from 6.70 per cent in 1997 to 6.81 per cent in 1998. In the future, the Group will further increase its efforts to enhance operating efficiency and control labour costs.

**Selling, general and administrative and other expenses** ("SG&A") for 1998 were RMB4,397 million, 54.46 per cent higher than the RMB2,847 million reported in 1997. The increase in SG&A was mainly due to a provision for diminution in value of part of the TACS-B network communication equipment by Zhejiang Mobile, and an increase in selling and promotion expenses, as well as network maintenance expenses. As a percentage of total operating expenses, SG&A expenses decreased by 1.32 percentage points from 22.89 per cent in 1997, to 21.57 per cent in 1998.



The Group has consistently focused on taking effective steps to control doubtful debt risks and fraud. The Group has also tightened controls intended to promote timely payment by subscribers. The Group adopts prudent principles for managing accounts receivable and makes provision for doubtful accounts based on its assessment of the recoverability of accounts receivable on maturity. In particular, the Group makes full provision for doubtful accounts in respect of accounts receivable aged more than three months. In 1998, our efforts improved the control of doubtful debts. Although provision for doubtful accounts increased by 16.54 per cent from RMB527 million in 1997 to RMB614 million in 1998, provision for doubtful accounts in 1998 represented only 2.15 per cent of turnover in 1998, compared to 2.75 per cent in 1997. As a percentage of turnover, excluding connection fees, provision for doubtful accounts decreased from 3.55 per cent in 1997 to 2.47 per cent in 1998. The Group believes that this level is low compared with other major cellular mobile telephone operators in the world.

It should be explained that, before the restructuring in 1997, the Group was not required to settle with the former Ministry of Posts and Telecommunications system for arrangements such as interconnection. With the implementation of a series of relevant service agreements after the restructuring, it was stipulated that the Group would conduct full operating settlement with the former Ministry of Posts and Telecommunications system in accordance with fair and reasonable commercial principles. As a result, the Group's operating expenses in 1998 were not fully comparable with those in 1997. However, an analysis of the changes in the composition of operating expenses shows that there were no material changes in the percentages of total operating expenses represented by specific expenses in 1998, except that SG&A as a percentage of total operating expenses for the full year of 1998 was 2.72 percentage points higher than for the first half year of 1998. This was primarily due to a provision for diminution in value of part of the TACS-B network communication equipment by Zhejiang Mobile and an increase in selling and promotional expenses. The Group will continue to focus on reducing operating expenses and optimizing its cost structure.

#### Other Income, Non-operating Expenses and Interest Expense

**Other income** (net of expenses) of the Group increased by 480.78 per cent from RMB57 million in 1997 to RMB334 million in 1998. This was mainly due to the significant increase in the number of GSM subscribers in 1998 resulting in increased income from sales of SIM cards. Concurrently, the Group's cost for SIM cards declined.

**Non-operating expenses** mainly include net gains or losses on disposal of fixed assets and donations. The Group's non-operating expenses increased by 81.55 per cent from RMB28 million in 1997 to RMB50 million in 1998.

**Interest expense** of the Group fell by 9.33 per cent from RMB177 million in 1997 to RMB161 million in 1998. This was primarily due to the repayment of a portion of borrowings in 1998 and the fact that the proceeds from the Group's IPO in 1997 funded a significant portion of the Group's capital requirement. This reduced the need for borrowing and concurrently reduced interest expense in 1998.

### **Profit Before Exceptional Item**

Profit before exceptional item of the Group increased by 26.42 per cent from RMB6,539 million in 1997 to RMB8,267 million in 1998. This was mainly due to the growth of the Group's subscriber base and the considerable increase in usage volume.

### **EBITDA**

**EBITDA** represents earnings before interest income, interest expense, non-operating income (expenses), 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.

The EBITDA of the Group increased by 34.55 per cent from RMB10,133 million in 1997 to RMB13,634 million in 1998. This was primarily due to the increase in turnover resulting from the strong growth in the number of subscribers.

### **Profitability of Jiangsu Mobile**

The Group forecast when it acquired Jiangsu Mobile in 1998 that, based on the assumptions made at that time and provided that there were no unforeseeable circumstances, net profit and EBITDA of Jiangsu Mobile for 1998 were unlikely to be less than RMB1,250 million and RMB3,309 million, respectively. Actual operating profit of Jiangsu Mobile for 1998 was RMB1,244 million, which was slightly lower than forecast, whereas EBITDA was RMB2,636 million, which was 20.34 per cent lower than forecast. These differences were mainly attributable to the fact that neither the number of subscribers nor turnover of Jiangsu Mobile in 1998 met our targets. In an effort to control costs, local government departments and large enterprises tightened their control over the usage of mobile telephone services by their employees in 1998. Since a large portion of the subscribers of Jiangsu Mobile came from government departments, large enterprises, and town and village enterprises, this development significantly affected subscriber growth and turnover, particularly in the second half of the year. Notwithstanding Jiangsu Mobile's increased efforts to control costs during the second half of the year, network operation and maintenance costs were closely tied to the size and scale of the network, which was designed and constructed according to the anticipated growth rate of number of subscribers, and could not be adjusted quickly in accordance with the actual business performance. However, Jiangsu Province is an economically developed province and the penetration rate of mobile telephones there was only 2 per cent at the end of 1998. The Group believes that there is still plenty of room for business development. With the advancement of economic reform in Jiangsu Province and expansion of the subscriber base, the composition of subscribers of Jiangsu Mobile is becoming more rational. The Group therefore has confidence in the performance of Jiangsu Mobile in the years to come and expects it to contribute to the steady growth of the Group's business.

### Liquidity and Capital Resources

As at 31 December 1998, net current assets of the Group were RMB7,083 million, or RMB5,305 million lower than the pro forma combined net current assets of RMB12,388 million in 1997. This decline was largely due to the application of funds for the expansion and improvement of the Group's network and repayment of a portion of long-term borrowings during 1998.

The Group's short-term and long-term borrowings as at 31 December 1998 were RMB5,337 million and RMB991 million, respectively. The ratio of debt to capitalization (the sum of total debts and owners' equity) of the Group at the end of 1998 was 12.13 per cent, which was slightly higher than the pro forma combined ratio of 12.05 per cent at the end of 1997. The ratio of total liabilities to total assets was 28.97 per cent, which was 6.54 percentage points higher than the pro forma combined ratio of 22.43 per cent at the end of 1997. The Group believes these ratios are still low compared with other fast-growing cellular mobile communications operators in the world. The Group's borrowings were primarily denominated in Renminbi and US dollars.

The Group's cash and bank balances at the end of 1998, amounting to RMB18,792 million, were denominated in Renminbi, Hong Kong dollars and US dollars.

The Group's pro forma combined capital expenditures increased by 60.23 per cent from RMB10,234 million in 1997 to approximately RMB16,397 million in 1998. The increase was principally attributable to the Group's investments to expand and improve its network.

### Financial Policies

The Group's primary financial objectives are to manage financial resources efficiently and maximize the return on owners' equity by adopting prudent principles of financial management, including by:

- \* reviewing capital structure regularly and maintaining appropriate leverage and liquidity;
- \* implementing risk management in relation to interest rates and foreign exchange;
- \* strengthening management of working capital to enhance funds turnover, and reducing cost of capital;
- \* pursuing alternative sources of financing to ensure the availability of capital at reasonable cost to meet the Group's requirements after fully utilizing internal resources; and,
- \* controlling investment direction strictly, optimizing the Group's project investment portfolio and actively exploring strategic acquisition opportunities in mainland China's telecommunications industry.

The directors have pleasure in submitting their annual report together with the audited accounts for the year ended 31 December 1998.

### **Principal activities**

The principal activities of the Group are the provision of cellular telephone and related services in Guangdong, Zhejiang and Jiangsu provinces of the People's Republic of China. The principal activity of the Company is investment holding.

The turnover of the Group during the financial year consists solely of 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 1998.

Purchases from the largest supplier for the year represented 35 per cent of the Group's total purchases of network equipment. The five largest suppliers accounted for an aggregate of 70 per cent of the Group's network equipment purchases in 1998. 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 year did the directors, their associates or any shareholder of the Company (which to the knowledge of the directors owns more than 5 per cent of the Company's share capital) have any interest in these major suppliers.

### **Subsidiaries and associated companies**

Particulars of the Company's subsidiaries and the Group's associated companies at 31 December 1998 are set out in Note 14 and Note 15 respectively to the accounts.

### **Accounts**

The profit of the Group for the year ended 31 December 1998 and the state of the Company's and the Group's financial affairs as at that date are set out in the accounts on pages 34 to 64.

The directors consider that the Group is experiencing a period of rapid growth and the retention of capital for future investment, improvement and expansion of the telecommunications network and acquisition of quality telecommunications assets could provide a better return to shareholders. Therefore, the directors do not recommend the payment of a dividend for the year ended 31 December 1998 (1997: RMB Nil).

### **Charitable donations**

Donations made by the Group during the year amounted to RMB7,701,660 (1997: RMB230,265).

**Fixed assets**

Movements in fixed assets of the Group and the Company during the year are set out in Note 12 to the accounts.

**Share capital and share option scheme**

Details of the share capital and share option scheme of the Company are set out in Note 20 and Note 21 respectively to the accounts.

The Group raised approximately RMB33,570,231,000 net of related expenses from the listing of its shares in 1997. Such proceeds have been applied in part as follows during the year ended 31 December 1998:

- (i) as to approximately RMB24,120,714,000 for the acquisition of China Telecom Jiangsu Mobile (BVI) Limited and Jiangsu Mobile; and
- (ii) as to approximately RMB3,752,214,000 to mainly fund the expansion of the Group's cellular networks in Guangdong, Zhejiang and Jiangsu provinces.

The balance of the proceeds of RMB5,697,303,000 will be applied as planned to fund the expansion of the Group's cellular networks in Guangdong, Zhejiang and Jiangsu provinces, the implementation of a new management information system and billing, clearance and collection systems and strategic investments in the P.R. China telecommunications industry, and for general corporate purposes.

**Reserves**

Movements in the reserves of the Group and the Company during the year are set out in Note 22 to the accounts.

**Directors**

The directors during the financial year and up to the date of this report were:

**Executive directors:**

Wang Xiaochu ( <i>Chairman</i> )	(appointed on 30 March 1999)
Shi Cuiming ( <i>Chairman</i> )	(resigned on 30 March 1999)
Chen Zhaobin	(resigned on 30 March 1999)
Li Ping	
Ding Donghua	
Lu Errui	
Zhu Jianhua	
He Ning	(appointed on 31 August 1998)

**Directors (Cont'd)****Non-executive directors:**

Cui Xun

Hu Wangshan

Zhang Bingyin (appointed on 31 August 1998)

**Independent non-executive directors:**

Professor Arthur Li Kwok Cheung

Antony Leung Kam Chung

In accordance with Article 97 of the Company's Articles of Association, Mr. Hu Wangshan, Mr. Lu Errui and Mr. Zhu Jianhua will retire by rotation and, being eligible, offer themselves for re-election. In accordance with Article 101 of the Company's Articles of Association, Mr. Wang Xiaochu, Mr. Zhang Bingyin and Mr. He Ning 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 year or at any time during the year.

**Directors' interests in shares**

As at 31 December 1998, 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.

In addition, the directors personally hold options to purchase ordinary shares of the Company as disclosed under the paragraph "Directors' rights to acquire shares" below. These share options are granted pursuant to the terms of the share option scheme adopted by the Company.

Apart from the foregoing, as at 31 December 1998, 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 Hong Kong 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.

On 9 March 1998, options were granted to the following directors under the share option scheme:

<b>Directors</b>	<b>Number of share options</b>
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. No share options were exercised by the directors under the share option scheme during the year.

Mr. Shi Cuiming and Mr. Chen Zhaobin exercised all their share options on 20 April 1999 at a price of HK\$11.1 per share. The market value per share on exercise of the share options was HK\$15.15.

Apart from the foregoing, at no time during the year 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.

### 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 1998 amounting to 10 per cent or more of the ordinary shares in issue:

	Ordinary shares held		Percentage of total issued shares
	Held directly	Held indirectly	
(i) The Ministry of Information Industry ("MII")	—	9,010,000,000	76.48%
(ii) Telpo Communications (Group) Limited ("Telpo")	—	9,010,000,000	76.48%
(iii) The Directorate General of 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:* Because of the fact that the MII, Telpo, DGT and CTHK (Group) directly or indirectly own one-third or more of the voting rights in the shareholders' meetings of CTHK (BVI), in accordance with the Securities (Disclosure of Interests) Ordinance, the interests of CTHK(BVI) are deemed to be, and have therefore been included in, the interests of MII, Telpo, DGT and CTHK (Group).

Apart from the foregoing, 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 23(a) 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 favourable 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 year, 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 1998 are set out in Note 18 to the accounts.

**Financial summary**

A summary of the pro forma combined results of the Group for each of the four years ended 31 December 1994, 1995, 1996 and 1997, the results of the Group for the year ended 31 December 1998, the audited statements of the Group’s assets and liabilities as at 31 December 1997 and 1998, 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 71 and 72.

**Financial summary (Cont'd)**

The Group's proforma combined results for each of the four years ended 31 December 1994, 1995, 1996 and 1997 have been prepared on a combined basis as if Guangdong Mobile and Zhejiang Mobile were subsidiaries of the Company since 1 January 1994 or since the respective dates of incorporation where these are shorter periods. The Group's results for the year ended 31 December 1998 include the results of the Company, Guangdong Mobile and Zhejiang Mobile for the year ended 31 December 1998 and the post-acquisition results of Jiangsu Mobile for the period from 4 June 1998 to 31 December 1998.

The Group's proforma combined statements of assets and liabilities as at 31 December 1995 and 1996 are combinations of the statements of assets and liabilities of Guangdong Mobile and Zhejiang Mobile as at 31 December 1995 and 1996 respectively.

**Compliance with the Code of Best Practice**

The Company has complied throughout the year with the Code of Best Practice as set out by The Stock Exchange of Hong Kong Limited 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**

On 19 November 1998 our auditors changed the name under which they practise to KPMG and, accordingly, have signed their report in their new name. A resolution for the reappointment of KPMG as auditors of the Company is to be proposed at the forthcoming annual general meeting.

By order of the Board

**Wang Xiaochu**

*Chairman*

Hong Kong, 28 April 1999

**Notice is hereby given** that the Annual General Meeting of China Telecom (Hong Kong) Limited will be held on 16 June 1999 at 11:00 a.m. in the Conference Room, 8th Floor, Renaissance 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 year ended 31 December 1998 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 the making and granting of 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 shares in lieu of the whole or part of a dividend 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 date of any revocation or variation of the mandate given under this Resolution by ordinary resolution of the shareholders of the Company at a 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  
**Li Ping      Yung Shun Loy Jacky**  
*Joint Company Secretaries*

**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 benefit 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 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 1998 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 to the shareholders of  
China Telecom (Hong Kong) Limited**  
*(Incorporated in Hong Kong with limited liability)*

We have audited the accounts on pages 34 to 64 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 1998 and of the Group's profit and cash flows for the year then ended and have been properly prepared in accordance with the Companies Ordinance.

**KPMG**  
Certified Public Accountants

Hong Kong, 28 April 1999



	Note	1998 RMB'000	Period from 3 September 1997 (date of incorporation) to 31 December 1997 RMB'000
<b>Turnover</b>	3	<u><b>26,345,393</b></u>	<u>4,696,333</u>
<b>Profit before exceptional item</b>		<b>7,777,101</b>	1,342,642
<b>Exceptional item</b>	4	<u><b>1,609,419</b></u>	<u>599,915</u>
<b>Profit before tax and minority interests</b>	5	<b>9,386,520</b>	1,942,557
<b>Income tax</b>	8(a)	<u><b>(2,485,950)</b></u>	<u>(427,836)</u>
<b>Profit before minority interests</b>		<b>6,900,570</b>	1,514,721
<b>Minority interests</b>		<u><b>(728)</b></u>	<u>(998)</u>
<b>Profit attributable to shareholders</b>	9	<b>6,899,842</b>	1,513,723
<b>Appropriations</b>			
<b>Transfer to general reserve</b>		—	(72,463)
<b>Transfer to PRC statutory reserves</b>	22	<u><b>(2,091,944)</b></u>	<u>(110,946)</u>
<b>Retained profit for the year/period</b>		<u><b>4,807,898</b></u>	<u>1,330,314</u>
<b>Earnings per share</b>			
<b>Basic</b>	11(a)	<u><b>RMB59 cents</b></u>	<u>RMB17 cents</u>
<b>Diluted</b>	11(b)	<u><b>RMB59 cents</b></u>	

at 31 December 1998  
(Expressed in Renminbi)

	Note	1998 RMB'000	1997 RMB'000
<b>Fixed assets</b>	12	<u>33,986,326</u>	<u>18,634,237</u>
<b>Construction in progress</b>	13	<u>7,339,152</u>	<u>3,557,665</u>
<b>Interest in associated companies</b>	15	<u>30,430</u>	<u>30,430</u>
<b>Amounts due from related parties</b>	16	<u>—</u>	<u>72,546</u>
<b>Deferred tax assets</b>	17	<u>151,610</u>	<u>24,140</u>
<b>Current assets</b>			
Inventories		101,296	77,138
Amounts due from related parties	16	287,264	—
Accounts receivable		2,481,704	1,591,919
Other receivables		326,067	786,449
Prepaid expenses and other current assets		1,045,826	104,923
Deposits with banks		8,849,322	33,912,852
Cash and bank balances		9,943,040	6,157,805
		<u>23,034,519</u>	<u>42,631,086</u>
<b>Less: Current liabilities</b>			
Bank and other loans	18(a)	5,337,368	2,147,558
Amounts due to intermediate holding company		1,025	31,613
Amounts due to related parties		596,155	221,786
Accounts payable		5,962,692	1,769,134
Accrued expenses and other payables		2,755,151	1,720,432
Taxation	8(b)	1,298,988	272,440
		<u>15,951,379</u>	<u>6,162,963</u>
<b>Net current assets</b>		<u>7,083,140</u>	<u>36,468,123</u>
<b>Bank and other loans</b>	18(b)	<u>(991,170)</u>	<u>(2,870,326)</u>
<b>Deferred revenue</b>	19	<u>(1,756,726)</u>	<u>(1,352,863)</u>
		<u>45,842,762</u>	<u>54,563,952</u>

	Note	1998 RMB'000	1997 RMB'000
Representing:			
<b>Share capital</b>	20	<b>1,261,419</b>	1,261,419
<b>Reserves</b>	22	<b><u>44,566,332</u></b>	<u>53,288,250</u>
<b>Shareholders' equity</b>		<b>45,827,751</b>	54,549,669
<b>Minority interests</b>		<b><u>15,011</u></b>	<u>14,283</u>
		<b><u>45,842,762</u></b>	<u>54,563,952</u>

Approved by the board of directors on 28 April 1999.

**Wang Xiaochu**  
*Director*

**Ding Donghua**  
*Director*

**Balance Sheet**  
at 31 December 1998  
(Expressed in Renminbi)

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	Note	1998 RMB'000	1997 RMB'000
<b>Fixed assets</b>	12	----- <u>4,947</u>	----- <u>2,049</u>
<b>Construction in progress</b>	13	----- <u>6,406</u>	----- <u>—</u>
<b>Interest in subsidiaries</b>	14	----- <u>46,206,693</u>	----- <u>18,333,765</u>
<b>Current assets</b>			
Other receivables		39,123	243,289
Prepaid expenses and other current assets		26,384	—
Deposits with banks		7,488,459	33,912,852
Cash and bank balances		<u>7,383</u>	<u>6,650</u>
		----- <u>7,561,349</u>	----- <u>34,162,791</u>
<b>Less: Current liabilities</b>			
Amounts due to intermediate holding company		1,025	31,613
Accrued expenses and other payables		25,066	71,749
Taxation	8(b)	<u>801</u>	<u>8,161</u>
		----- <u>26,892</u>	----- <u>111,523</u>
<b>Net current assets</b>		----- <u>7,534,457</u>	----- <u>34,051,268</u>
		<u>53,752,503</u>	<u>52,387,082</u>
Representing:			
<b>Share capital</b>	20	1,261,419	1,261,419
<b>Reserves</b>	22	<u>52,491,084</u>	<u>51,125,663</u>
<b>Shareholders' equity</b>		<u>53,752,503</u>	<u>52,387,082</u>

Approved by the board of directors on 28 April 1999.

**Wang Xiaochu**  
*Director*

**Ding Donghua**  
*Director*

	Note	1998 RMB'000	1997 RMB'000
<b>Net cash inflows from operating activities</b>	(a)	<u>13,566,801</u>	<u>8,825,543</u>
<b>Returns on investments and servicing of finance</b>			
Interest received		1,814,895	413,958
Interest paid		(352,178)	(268,424)
Distributions		—	(221,812)
<b>Net cash inflow/(outflow) from returns on investments and servicing of finance</b>		<u>1,462,717</u>	<u>(76,278)</u>
<b>Taxation</b>			
Hong Kong profits tax paid		(10,780)	—
PRC income tax paid		(1,574,701)	(546,216)
<b>Tax paid</b>		<u>(1,585,481)</u>	<u>(546,216)</u>
<b>Investing activities</b>			
Payment for acquisition of subsidiaries (net of cash and cash equivalents acquired)	(d) and (e)	(24,114,617)	—
Capital expenditures		(11,040,277)	(5,806,798)
Investment in associated companies		—	(30,430)
Proceeds from disposal of fixed assets		36,224	12,591
Decrease in amounts due from related parties		72,546	497,551
Increase in deposits with banks		(1,310,863)	—
<b>Net cash outflow from investing activities</b>		<u>(36,356,987)</u>	<u>(5,327,086)</u>
<b>Net cash (outflow)/inflow before financing activities</b>		<u>(22,912,950)</u>	<u>2,875,963</u>
<b>Financing activities</b>			
Proceeds from issue of shares, net of expenses		—	33,570,231
Proceeds from bank and other loans	(f)	3,752,500	710,139
Repayments of bank and other loans	(f)	(3,206,922)	(523,853)
(Decrease)/increase in amounts due to related parties	(f)	(221,786)	216,237
Proceeds from capital contribution		—	245,700
<b>Net cash inflow from financing activities</b>		<u>323,792</u>	<u>34,218,454</u>
<b>(Decrease)/increase in cash and cash equivalents</b>	(b)	<u>(22,589,158)</u>	<u>37,094,417</u>
<b>Cash and cash equivalents at beginning of year</b>		<u>40,070,657</u>	<u>2,976,240</u>
<b>Cash and cash equivalents at end of year</b>	(c)	<u>17,481,499</u>	<u>40,070,657</u>

**Notes to the Consolidated Cash Flow Statement****(a) Reconciliation of profit before tax and minority interests to net cash inflows from operating activities**

	1998 RMB'000	1997 RMB'000
Profit before tax and minority interests	9,386,520	5,953,325
Depreciation of fixed assets	4,598,151	2,680,538
Provision for diminution in value of fixed assets	281,560	—
Provision for doubtful accounts	558,090	449,124
Loss on disposal of fixed assets	59,320	12,668
Exceptional item	(1,609,419)	(656,607)
Interest expense	159,751	175,335
Unrealised exchange loss/(gain), net	931	(1,497)
Decrease in inventories	48,788	157,309
Increase in amounts due from related parties	(54,685)	—
Increase in accounts receivable	(1,080,191)	(953,693)
Decrease/(increase) in other receivables	392,047	(29,161)
Increase in prepaid expenses and other current assets	(931,668)	(85,992)
(Decrease)/increase in amounts due to intermediate holding company	(30,588)	31,613
Increase in amounts due to related parties	579,486	—
Decrease in accounts payable	(117,130)	(7,175)
Increase/(decrease) in accrued expenses and other payables	921,975	(54,500)
Increase in deferred revenue	403,863	1,154,256
	<u>13,566,801</u>	<u>8,825,543</u>
Net cash inflows from operating activities	<u>13,566,801</u>	<u>8,825,543</u>

**(b) Increase in cash and cash equivalents**

Increase in cash and cash equivalents of RMB37,094,417,000 for the year ended 31 December 1997 includes RMB34,656,469,000 which relates to the increase in cash and cash equivalents for the period from 3 September 1997 to 31 December 1997.

**(c) Analysis of the balances of cash and cash equivalents**

	1998 RMB'000	1997 RMB'000
Deposits with banks maturing within three months	7,538,459	33,912,852
Cash and bank balances	9,943,040	6,157,805
	<u>17,481,499</u>	<u>40,070,657</u>

## Notes to the Consolidated Cash Flow Statement (Cont'd)

### (d) Acquisition of subsidiaries

	RMB'000
<b>Net assets acquired:</b>	
Fixed assets	7,443,235
Construction in progress	1,488,261
Deferred tax assets	1,391
Inventories	72,946
Amounts due from related parties	232,579
Accounts receivable	367,684
Other receivables	137,141
Prepaid expenses and other current assets	9,235
Cash and bank balances	6,097
Bank and other loans	(683,500)
Amounts due to related parties	(3,994)
Accounts payable	(333,466)
Accrued expenses and other payables	(158,010)
Long-term bank and other loans	<u>(80,645)</u>
	8,498,954
Goodwill arising on acquisition	<u>15,621,760</u>
	<u><u>24,120,714</u></u>
Satisfied by: Cash paid	<u><u>24,120,714</u></u>

The subsidiaries acquired during the year ended 31 December 1998 contributed RMB1,339,562,000 to the Group's net operating cash flows, paid RMB44,492,000 in respect of the net returns on investments and servicing of finance, utilised RMB2,533,394,000 for investing activities and contributed RMB2,207,796,000 for financing activities.

### (e) Analysis of net outflow of cash and cash equivalents in respect of the acquisition of subsidiaries

	RMB'000
Cash consideration	24,120,714
Cash and bank balances acquired	<u>(6,097)</u>
Net outflow of cash and cash equivalents in respect of the acquisition of subsidiaries	<u><u>24,114,617</u></u>

**Notes to the Consolidated Cash Flow Statement (Cont'd)****(f) Analysis of changes in financing during the year**

	<b>Bank and other loans RMB'000</b>	<b>Amounts due to related parties RMB'000</b>
Balance at 1 January 1998	5,017,884	221,786
Acquired on acquisition of subsidiaries	<u>764,145</u>	<u>3,994</u>
	5,782,029	225,780
<b>Changes in financing:</b>		
Cash flows from financing	3,752,500	(221,786)
Repayments of loans	<u>(3,206,922)</u>	<u>—</u>
	6,327,607	3,994
<b>Operating activities:</b>		
Payables for additions of construction in progress	—	12,675
Increase in amounts due to related parties included under operating activities	—	579,486
Effect of changes in foreign exchange rates	<u>931</u>	<u>—</u>
Balance at 31 December 1998	<u><u>6,328,538</u></u>	<u><u>596,155</u></u>

**(g) Significant non-cash transactions**

The Group incurred payables of RMB3,977,222,000 and RMB12,675,000 from equipment suppliers and related parties respectively for additions of construction in progress during the year ended 31 December 1998.

In addition, the Group incurred payables of RMB1,529,934,000 from equipment suppliers and a loan of RMB1,382,395,000 from its ultimate holding company for additions of construction in progress during the year ended 31 December 1997.



## 1. BASIS OF PRESENTATION OF ACCOUNTS

The consolidated profit and loss account of the Group for the year ended 31 December 1998 includes the results of the Company and its subsidiaries in Guangdong province (i.e. Guangdong Mobile Communication Company Limited ("Guangdong Mobile")) and in Zhejiang province (i.e. Zhejiang Mobile Communication Company Limited ("Zhejiang Mobile")) for the year ended 31 December 1998. Pursuant to the ordinary resolution passed by the Company's shareholders on 3 June 1998, the Company acquired the entire issued share capital of China Telecom Jiangsu Mobile (BVI) Limited ("Jiangsu Mobile BVI") from China Telecom Hong Kong (BVI) Limited. The only asset of Jiangsu Mobile BVI is its interest in the entire equity of Jiangsu Mobile Communication Company Limited ("Jiangsu Mobile"). As such, the consolidated profit and loss account of the Group for the year ended 31 December 1998 also includes the results of Jiangsu Mobile for the period from 4 June 1998 to 31 December 1998.

The consolidated profit and loss account for the period ended 31 December 1997 includes the results of the Company for the period from 3 September 1997 to 31 December 1997 and the post-acquisition results of Guangdong Mobile and Zhejiang Mobile for the period from 27 September 1997 to 31 December 1997. The consolidated cash flow statement for the period ended 31 December 1997 is prepared based on the consolidated balance sheet at 31 December 1997 and the proforma combined balance sheet (i.e. the combination of the balance sheets of Guangdong Mobile and Zhejiang Mobile) at 31 December 1996. A separate note is included in the notes to the consolidated cash flow statement which shows the increase in the amount of cash and cash equivalents for the period from 3 September 1997 to 31 December 1997.

## 2. PRINCIPAL ACCOUNTING POLICIES

These accounts have been prepared in accordance with Statements of Standard Accounting Practice issued by the Hong Kong Society of Accountants, accounting principles generally accepted in Hong Kong and the disclosure requirements of the Hong Kong Companies Ordinance. A summary of the significant accounting policies adopted by the Group is set out below.

### (a) Basis of consolidation

- (i) The consolidated accounts include the accounts of the Company and all of its subsidiaries made up to 31 December 1998. The results of subsidiaries acquired during the year are included in the consolidated profit and loss account from the date of their acquisition. All material intercompany transactions and balances are eliminated on consolidation.
- (ii) Goodwill arising on the acquisition of subsidiaries, being the excess of the cost over the fair value of the Group's share of the separable net assets acquired, is eliminated against reserves immediately on acquisition. The excess of the Group's share of the fair value of the separable net assets of subsidiaries acquired over the cost of investments in these companies is credited to capital reserve.

### (b) Interest in subsidiaries

Interest in subsidiaries in the Company's balance sheet is stated at cost less any provisions for permanent diminution in value, if necessary, as determined by the directors.

### (c) Associated companies

An associated company is a company, not being a subsidiary, in which the Group's interest is for the long term and the Group is in a position to exercise significant influence over the company in which the investment is made.

**2. PRINCIPAL ACCOUNTING POLICIES (Cont'd)****(c) Associated companies (Cont'd)**

The Group's share of the post-acquisition results of its associated companies for the year is not considered material and therefore is not included in the consolidated profit and loss account. In the consolidated balance sheet, interest in associated companies is stated at cost less any provisions for permanent diminution in value, if necessary, as determined by the directors.

**(d) Fixed assets and depreciation**

- (i) Fixed assets are stated at cost/revalued amount less accumulated depreciation. The circumstances and basis under which the revalued amount is arrived at are set out in details in Note 12 to the accounts.
- (ii) The cost of fixed assets comprises the purchase price and any directly attributable costs of bringing the asset to its working condition and location for its intended use. Expenditures incurred after the fixed asset has been put into operation, such as repairs and maintenance and overhaul costs, are normally charged to the profit and loss account in the period in which it is incurred. In situations where it can be clearly demonstrated that the expenditure has resulted in an increase in the future economic benefits expected to be obtained from the use of the fixed asset, the expenditure is capitalised as an additional cost of the fixed asset.
- (iii) Gains or losses arising from the retirement or disposal of fixed assets are determined as the difference between the net disposal proceeds and the carrying amount of the asset and are recognised as income or expense in the profit and loss account on the date of retirement or disposal.
- (iv) The carrying amount of fixed assets carried at depreciated cost is reviewed periodically in order to assess whether the recoverable amount has declined below the carrying amount. When such a decline has occurred, the carrying amount is reduced to the recoverable amount. The amount of the reduction is recognised as an expense in the profit and loss account. In determining the recoverable amount, expected future cash flows generated by the fixed assets are discounted to their present values.

A subsequent increase in the recoverable amount of an asset carried at depreciated cost is written back to the profit and loss account when the circumstances and events that led to the write-down or write-off cease to exist. The amount written back is reduced by the amount that would have been recognised as depreciation had the write-down or write-off not occurred.

- (v) Depreciation is calculated to write off the cost, or revalued amount where appropriate, of fixed assets on a straight-line basis over their estimated useful lives, to residual values, as follows:

	<b>Depreciable life</b>	<b>Residual value</b>
Land use rights	Over the period of grant	—
Buildings	8 – 35 years	3%
Telecommunications transceivers, switching centres and other network equipment	7 years	3%
Office equipment, furniture and fixtures and others	4 – 18 years	3%

**2. PRINCIPAL ACCOUNTING POLICIES (Cont'd)****(e) Construction in progress**

Construction in progress is stated at cost. Cost comprises direct costs of construction as well as interest expense and exchange differences capitalised during the periods of construction and installation. Capitalisation of these costs ceases and the construction in progress is transferred to fixed assets when substantially all the activities necessary to prepare the assets for their intended use are completed. No depreciation is provided in respect of construction in progress until it is completed and ready for its intended use.

**(f) Inventories**

Inventories, which consist primarily of handsets, SIM cards and accessories, are stated at the lower of cost and net realisable value. Cost represents purchase cost of goods calculated using the weighted average cost method. Net realisable value is determined by reference to the sales proceeds of items sold in the ordinary course of business after the balance sheet date or to management's estimates based on prevailing market conditions.

When inventories are sold, the carrying amount of those inventories is recognised as a deduction of other income due to its insignificance. The amount of any write-down of inventories to net realisable value and all losses of inventories are recognised as an expense in the period the write-down or loss occurs. The amount of any reversal of any write-down of inventories, arising from an increase in net realisable value, is recognised as a reduction in the amount of inventories recognised as an expense in the period in which the reversal occurs.

**(g) Deferred revenue**

Deferred revenue from assignment of rights to income from subscribers with distributors of telecommunications services is stated in the balance sheet at the amount of consideration received according to the relevant assignment contracts less income recognised in the profit and loss account up to the balance sheet date.

Income is deferred and recognised on a straight-line basis over the relevant assignment period. For assignment contracts which the distributors surrender for early cancellation, the balance of the Group's deferred revenue in respect of those contracts is recognised as non-operating income in the profit and loss account when the assignment contracts are cancelled.

**(h) Borrowing costs**

Borrowing costs are expensed in the profit and loss account in the period in which they are incurred, except to the extent that such costs are capitalised as being directly attributable to the acquisition or construction of an asset which necessarily takes a substantial period of time to get ready for its intended use.

**2. PRINCIPAL ACCOUNTING POLICIES (Cont'd)****(i) Revenue recognition**

Revenue is recognised when it is probable that the economic benefits will accrue to the Group and when the revenue can be measured reliably on the following bases:

- (i) usage fees are recognised as revenue when the service is rendered;
- (ii) monthly fees are recognised as revenue in the month during which the service is rendered;
- (iii) connection fees are recognised as revenue when received;
- (iv) deferred revenue from assignment of rights to income from subscribers is recognised on a straight-line basis over the duration of the assignment period;
- (v) interest income is recognised on a time proportion basis on the principal outstanding and at the rate applicable; and
- (vi) sales of handsets and SIM cards are recognised on delivery of goods to the buyer. Such revenue, net of cost of goods sold, is included in other income due to its insignificance.

**(j) Allowance for doubtful accounts**

An allowance for doubtful accounts is provided based upon evaluation of the recoverability of the receivables at the balance sheet date.

**(k) Translation of foreign currencies**

Foreign currency transactions during the year are translated into Renminbi at the exchange rates ruling at the transaction dates. Monetary assets and liabilities denominated in foreign currencies are translated into Renminbi at the exchange rates ruling at the balance sheet date. Exchange differences attributable to the translation of borrowings denominated in foreign currencies and used for financing the construction of fixed assets, are included in the cost of the related construction in progress. Exchange differences capitalised to construction in progress are immaterial for the periods presented. Other exchange gains and losses are recognised in the profit and loss account.

**(l) Deferred taxation**

Deferred taxation is provided in respect of the tax effect arising from all significant timing differences which are expected with reasonable probability to crystallise in the foreseeable future and is calculated under the liability method. Future deferred tax benefits are not recognised unless their realisation is assured beyond reasonable doubt.

**2. PRINCIPAL ACCOUNTING POLICIES (Cont'd)****(m) Retirement benefits**

The employees of the subsidiaries participate in a defined benefit retirement plan managed by the MII whereby the subsidiaries are required to contribute to the scheme at a fixed rate of 19.1 per cent of the employees' salary costs. The subsidiaries have no obligation for the payment of retirement and other post-retirement benefits of staff other than the contributions described above.

**(n) Operating leases**

Operating lease payments are charged to the profit and loss account on a straight-line basis over the periods of the respective leases.

**(o) Related parties**

For the purposes of these accounts, parties are considered to be related to the Group if the Group has the ability, directly or indirectly, to control the party or exercise significant influence over the party in making financial and operating decisions, or vice versa, or where the Group and the party are subject to common control or common significant influence. Related parties may be individuals or other entities.

**3. TURNOVER**

Turnover primarily represents usage fees, monthly fees and connection fees for the use of the Group's cellular telephone networks, net of PRC business tax and government surcharges and central irrigation construction levy. Business tax and government surcharges are charged at approximately 3.3 per cent of the corresponding revenue and central irrigation construction levy was charged at approximately 3 per cent of certain connection and surcharge revenue. Turnover is analysed as follows:

	<b>1998</b>	Period from 3 September 1997 (date of incorporation) to 31 December 1997
	<b>RMB'000</b>	RMB'000
Usage fees	<b>16,345,713</b>	2,760,412
Monthly fees	<b>4,347,218</b>	771,414
Connection fees	<b>3,323,191</b>	851,057
Others	<b>2,329,271</b>	313,450
	<b><u>26,345,393</u></b>	<u>4,696,333</u>

Others mainly represent telephone number selection fees, charges for value added services, interconnection revenue and roaming in fees. Roaming in fees are received from the MII and other operators in respect of calls made by non-subscribers using the Group's cellular telecommunications networks.

**4. EXCEPTIONAL ITEM**

Exceptional item represents interest income earned by the Group, of which RMB1,425,635,000 (1997: RMB570,606,000) relates to the interest income earned by the Company from the proceeds received on the issue of new shares in 1997.

**5. PROFIT BEFORE TAX AND MINORITY INTERESTS**

Profit before tax and minority interests is arrived at

	<b>1998</b>	Period from
	<b>RMB'000</b>	3 September 1997
		(date of
		incorporation) to
		31 December 1997
		RMB'000
<b>after crediting:</b>		
Amortisation of deferred revenue from assignment of rights to income from subscribers	<b>284,733</b>	49,710
Penalty income on overdue accounts	<b>64,594</b>	23,738
Exchange gain, net	<b>19,283</b>	—
<b>and after charging:</b>		
Interest on bank advances and other borrowings repayable within five years	<b>125,272</b>	11,834
Interest on other loans	<b>181,640</b>	81,715
Less: Amount capitalised as construction in progress ( <i>Note</i> )	<b>(147,161)</b>	(55,176)
Interest expense	<b>159,751</b>	38,373
Depreciation	<b>4,598,151</b>	854,268
Operating lease charges in respect of		
— properties	<b>260,926</b>	60,735
— leased lines	<b>3,917,362</b>	791,512
— others	<b>40,375</b>	6,061
Exchange loss, net	—	57,877
Loss on disposal of fixed assets	<b>59,320</b>	12,476
Provision for diminution in value of fixed assets	<b>281,560</b>	—
Contribution to retirement scheme	<b>209,391</b>	26,916
Provision for doubtful accounts	<b>558,090</b>	139,662
Provision for obsolete inventories	<b>8,346</b>	3,086
Auditors' remuneration		
— current year / period	<b>14,748</b>	10,703
— prior period	<b>1,069</b>	—

*Note:* The borrowing costs have been capitalised at a rate of 5.81 per cent to 9.50 per cent (1997: 7.50 per cent to 11.03 per cent) per annum for construction in progress.

**6. DIRECTORS' REMUNERATION**

Directors' remuneration disclosed pursuant to section 161 of the Companies Ordinance is as follows:

	<b>1998</b>	Period from 3 September 1997 (date of incorporation) to 31 December 1997
	<b>RMB'000</b>	RMB'000
Fees	<b>2,371</b>	642
Salaries, allowances and benefits in kind	<b>9,501</b>	2,829
Retirement benefits	<b>106</b>	33
Bonuses	<b>78</b>	30
	<u><b>12,056</b></u>	<u>3,534</u>

Included in the directors' remuneration were fees of RMB385,000 (1997: RMB129,000) paid to the independent non-executive directors during the year/period.

In addition to the above emoluments, certain directors were granted share options under the Company's share option scheme. The details of these benefits in kind are disclosed under the paragraph "Directors' rights to acquire shares" in the report of the directors.

The number of directors whose remuneration from the Group falls within the following bands is set out below:

	<b>1998</b>	Period from 3 September 1997 (date of incorporation) to 31 December 1997
<b>HK\$ equivalent</b>		
Nil to 1,000,000	<b>8</b>	10
2,000,001 to 2,500,000	<b>4</b>	—

**7. FIVE HIGHEST PAID INDIVIDUALS**

Of the five highest paid individuals in this year, four (1997: four) are directors of the Company and their remuneration has been included in Note 6 above. The remuneration of the remaining highest paid individual is as follows:

	<b>1998</b>	Period from 3 September 1997 (date of incorporation) to 31 December 1997
	<b>RMB'000</b>	RMB'000
Salaries, allowances and benefits in kind	<u><u>1,118</u></u>	<u><u>231</u></u>

During the year/period, no emoluments were paid by the Group to the five highest paid individuals, including directors, as an inducement to join or upon joining the Group or as compensation for loss of office.

**8. INCOME TAX****(a) Income tax in the consolidated profit and loss account represents:**

	<b>1998</b>	Period from 3 September 1997 (date of incorporation) to 31 December 1997
	<b>RMB'000</b>	RMB'000
Provision for Hong Kong profits tax for the year/period	<b>3,564</b>	8,161
Over-provision in respect of Hong Kong profits tax for prior period	<u>(144)</u>	<u>—</u>
	<b>3,420</b>	8,161
Provision for PRC income tax on the estimated taxable profits for the year/period	<b>2,608,609</b>	421,684
Deferred tax assets ( <i>Note 17(a)</i> )	<u>(126,079)</u>	<u>(2,009)</u>
	<u><u>2,485,950</u></u>	<u><u>427,836</u></u>

- (i) The provision for Hong Kong profits tax is calculated at 16 per cent (1997: 16.5 per cent) of the estimated assessable profits for the year.
- (ii) Pursuant to the income tax rules and regulations of the PRC, the Group's subsidiaries in the PRC are subject to the statutory income tax rate of 33 per cent for the year ended 31 December 1998. According to notices from the PRC Ministry of Finance, connection fees and certain surcharges, which were previously not subject to income tax, are subject to income tax rate of 33 per cent with effect from 23 October 1997 for Guangdong Mobile and Zhejiang Mobile and 26 August 1998 for Jiangsu Mobile.



**8. INCOME TAX (Cont'd)****(b) Taxation in the balance sheet represents:**

	<b>The Group</b>		<b>The Company</b>	
	<b>1998</b>	<b>1997</b>	<b>1998</b>	<b>1997</b>
	<b>RMB'000</b>	<b>RMB'000</b>	<b>RMB'000</b>	<b>RMB'000</b>
Provision for Hong Kong profits tax for the year/period	<b>3,564</b>	8,161	<b>3,564</b>	8,161
Provision for PRC income tax for the year	<b>2,608,609</b>	984,867	—	—
Balance of PRC income tax payable/ (recoverable) relating to prior year	<b>43,609</b>	(174,372)	—	—
Hong Kong provisional profits tax paid	<b>(2,763)</b>	—	<b>(2,763)</b>	—
PRC income tax paid	<b>(1,354,031)</b>	(546,216)	—	—
	<b><u>1,298,988</u></b>	<u>272,440</u>	<b><u>801</u></b>	<u>8,161</u>

**9. PROFIT ATTRIBUTABLE TO SHAREHOLDERS**

Profit attributable to shareholders includes a profit of RMB1,365,421,000 (1997: RMB483,086,000) which has been dealt with in the accounts of the Company.

**10. DIVIDENDS**

The board of directors of the Company does not recommend the payment of any dividends for the year ended 31 December 1998 (1997: RMB Nil).

**11. EARNINGS PER SHARE****(a) Basic earnings per share**

The calculation of basic earnings per share for the year/period is based on the profit attributable to shareholders of RMB6,899,842,000 (1997: RMB1,513,723,000) and the weighted average number of 11,780,788,000 shares (1997: 8,802,944,500 shares) in issue during the year/period.

**(b) Diluted earnings per share**

The calculation of diluted earnings per share for the year is based on the profit attributable to shareholders of RMB6,899,842,000 and the weighted average number of 11,782,520,775 shares after adjusting for the effects of all dilutive potential ordinary shares. All dilutive potential ordinary shares arise from the share options granted to the directors under the share option scheme which, if converted to ordinary shares, would decrease profit attributable to shareholders per share. There were no dilutive potential ordinary shares in existence during 1997.

**11. EARNINGS PER SHARE (Cont'd)****(c) Reconciliations**

	<b>1998</b>	1997
	<b>Number of shares</b>	Number of shares
Weighted average number of ordinary shares used in calculating basic earnings per share	<b>11,780,788,000</b>	<u>8,802,944,500</u>
Deemed issue of ordinary shares for no consideration	<u>1,732,775</u>	
Weighted average number of ordinary shares used in calculating diluted earnings per share	<u><b>11,782,520,775</b></u>	

**12. FIXED ASSETS**

	<b>Land use rights and buildings</b>	<b>Telecommuni- cations transceivers, switching centres and other network equipment</b>	<b>Office equipment, furniture and fixtures and others</b>	<b>Total</b>
	RMB'000	RMB'000	RMB'000	RMB'000
<b>(a) The Group</b>				
<b>Cost:</b>				
At 1 January 1998	775,889	19,083,349	583,860	20,443,098
Acquired on acquisition of subsidiaries	37,020	7,950,022	13,609	8,000,651
Additions	446,618	224,223	154,741	825,582
Transferred from construction in progress	537,998	11,427,123	93,406	12,058,527
Disposals	(36,329)	(83,568)	(1,622)	(121,519)
Provision for diminution in value of fixed assets	—	(281,560)	—	(281,560)
At 31 December 1998	<u>1,761,196</u>	<u>38,319,589</u>	<u>843,994</u>	<u>40,924,779</u>
<b>Accumulated depreciation:</b>				
At 1 January 1998	13,481	1,738,353	57,027	1,808,861
Acquired on acquisition of subsidiaries	429	552,196	4,791	557,416
Charge for the year	54,953	4,427,467	115,731	4,598,151
Written back on disposals	(702)	(24,457)	(816)	(25,975)
At 31 December 1998	<u>68,161</u>	<u>6,693,559</u>	<u>176,733</u>	<u>6,938,453</u>
<b>Net book value:</b>				
At 31 December 1998	<u>1,693,035</u>	<u>31,626,030</u>	<u>667,261</u>	<u>33,986,326</u>
At 31 December 1997	<u>762,408</u>	<u>17,344,996</u>	<u>526,833</u>	<u>18,634,237</u>

**12. FIXED ASSETS (Cont'd)****Office equipment, furniture  
and fixtures and others**  
RMB'000**(b) The Company****Cost:**

At 1 January 1998	2,350
Additions	<u>3,743</u>
At 31 December 1998	-----6,093

**Accumulated depreciation:**

At 1 January 1998	301
Charge for the year	<u>845</u>
At 31 December 1998	-----1,146

**Net book value:**

At 31 December 1998	<u><u>4,947</u></u>
At 31 December 1997	<u><u>2,049</u></u>

**(c) The analysis of net book value of land use rights is as follows:**

	<b>The Group</b>	
	<b>1998</b>	1997
	<b>RMB'000</b>	RMB'000
Long leases	<b>248,294</b>	85,691
Medium-term leases	<b><u>1,098,960</u></b>	<u>77,950</u>
	<b><u><u>1,347,254</u></u></b>	<u><u>163,641</u></u>

All of the Group's buildings are located outside Hong Kong.

As part of the Group restructuring in 1997, the cellular telephone businesses of Guangdong Mobile and Zhejiang Mobile together with the relevant assets and liabilities were transferred to the Company. Pursuant to the ordinary resolution passed by the Company's shareholders on 3 June 1998, the Company acquired the cellular telephone business of Jiangsu Mobile together with its relevant assets and liabilities.

**12. FIXED ASSETS (Cont'd)**

As required by the relevant PRC rules and regulations, a valuation of the assets and liabilities of Guangdong Mobile and Zhejiang Mobile to be injected into the Group was carried out at 31 May 1997 and a valuation of the assets and liabilities of Jiangsu Mobile to be acquired by the Group was carried out at 31 December 1997. These valuations were approved by the State-owned Assets Administration Bureau on 5 September 1997 and 7 April 1998 respectively and the injected/acquired assets and liabilities were reflected in the accounts on this basis. These valuations were each regarded as one-off exercises which established the deemed cost of the fixed assets acquired by the Group.

The effect of the above valuations on the fixed assets of Guangdong Mobile, Zhejiang Mobile and Jiangsu Mobile is to increase the depreciation charges reflected in the consolidated profit and loss account for the year ended 31 December 1998 by approximately RMB925,693,000.

**13. CONSTRUCTION IN PROGRESS**

Construction in progress comprises expenditure incurred on the network expansion projects, construction of office buildings and construction of staff quarters not yet completed at 31 December 1998.

**14. INTEREST IN SUBSIDIARIES**

	1998 RMB'000	1997 RMB'000
Unlisted equity investments, at cost	42,454,479	18,333,765
Amounts due from subsidiaries	<u>3,752,214</u>	<u>—</u>
	<u><b>46,206,693</b></u>	<u><b>18,333,765</b></u>

Details of the subsidiaries are as follows:

Name of company	Place of incorporation and operation	Particulars of issued and paid up capital	Attributable interest held by the Group		Principal activities
			Held by the Company	Held by subsidiary	
Guangdong Mobile	PRC	RMB5,594,840,700	100%	—	Cellular telephone operator
Zhejiang Mobile	PRC	RMB2,117,790,000	99.63%	—	Cellular telephone operator
Jiangsu Mobile BVI	BVI	1 share at HK\$1	100%	—	Investment holding company
Jiangsu Mobile	PRC	RMB2,800,000,000	—	100%	Cellular telephone operator

**15. INTEREST IN ASSOCIATED COMPANIES**

	<b>The Group</b>	
	<b>1998</b>	1997
	<b>RMB'000</b>	RMB'000
Unlisted shares, at cost	<b>21,430</b>	21,430
Capital contributions, at cost	<b>9,000</b>	9,000
	<b><u>30,430</u></b>	<u>30,430</u>

Details of the associated companies are as follows:

<b>Name of company</b>	<b>Place of incorporation</b>	<b>Attributable interest held by the Group</b>	<b>Principal activities</b>
China Motion United Telecom Limited	Hong Kong	30%	Provision of telecommunication services
Shenzhen China Motion Telecom United Limited	PRC	30%	Provision of telecommunication services

**16. AMOUNTS DUE FROM RELATED PARTIES**

Amounts due from related parties are unsecured, non-interest bearing, repayable on demand and arose in the ordinary course of business.

**17. DEFERRED TAXATION**

(a) **Movements on deferred taxation comprise:**

	<b>The Group</b>	
	<b>1998</b>	1997
	<b>RMB'000</b>	RMB'000
Balance at 1 January	<b>24,140</b>	—
Acquired on acquisition of subsidiaries	<b>1,391</b>	22,131
Transfer from the profit and loss account ( <i>Note 8(a)</i> )	<b>126,079</b>	2,009
Balance at 31 December	<b><u>151,610</u></b>	<u>24,140</u>

**17. DEFERRED TAXATION (Cont'd)****(b) Deferred tax assets of the Group provided for are as follows:**

	<b>The Group</b>	
	<b>1998</b>	1997
	<b>RMB'000</b>	RMB'000
Provision for obsolete inventories	<b>26,276</b>	24,140
Provision for diminution in value of fixed assets	<b>43,415</b>	—
Amortisation of deferred revenue	<b>81,919</b>	—
	<u><b>151,610</b></u>	<u>24,140</u>

**(c) Deferred tax asset of the Group not provided for is as follows:**

	<b>The Group</b>	
	<b>1998</b>	1997
	<b>RMB'000</b>	RMB'000
Provision for doubtful accounts	<u><b>283,293</b></u>	<u>228,082</u>

**18. BANK AND OTHER LOANS****(a) Short-term**

	<b>The Group</b>	
	<b>1998</b>	1997
	<b>RMB'000</b>	RMB'000
Bank loans	<b>4,112,500</b>	600,000
Loans from related parties	—	227,000
	<b>4,112,500</b>	827,000
Current portion of long-term bank and other loans ( <i>Note 18(b)</i> )	<u><b>1,224,868</b></u>	<u>1,320,558</u>
	<u><b>5,337,368</b></u>	<u>2,147,558</u>

All of the above short-term loans are unsecured.

**18. BANK AND OTHER LOANS (Cont'd)****(b) Long-term**

	<b>The Group</b>	
	<b>1998</b>	1997
	<b>RMB'000</b>	RMB'000
Bank loans	<b>344,580</b>	413,990
Loans from related parties	<b>800,000</b>	800,000
Loan from ultimate holding company	—	1,382,395
Other loans	<b>1,071,458</b>	1,594,499
	<b>2,216,038</b>	4,190,884
Less: Current portion ( <i>Note 18(a)</i> )	<b>(1,224,868)</b>	(1,320,558)
	<b>991,170</b>	2,870,326

All of the above long-term loans are unsecured. Loans from related parties represent long-term loans from Zhejiang Posts and Telecommunications Administrations ("Zhejiang PTA"), bearing interest at 10.98 per cent per annum with maturities in 1999. Other loans bear interest at various rates between 6.4 per cent to 7.5 per cent per annum with maturities in 1999 to 2004.

**(c) The Group's long-term bank and other loans were repayable as follows:**

At 31 December 1998:

	<b>The Group</b>		
	<b>Bank loans</b>	<b>Other loans</b>	<b>Total</b>
	RMB'000	RMB'000	RMB'000
On demand or within one year	137,498	1,087,370	1,224,868
After one year but within two years	103,541	181,304	284,845
After two years but within five years	103,541	520,101	623,642
After five years	—	82,683	82,683
	207,082	784,088	991,170
	344,580	1,871,458	2,216,038

**18. BANK AND OTHER LOANS (Cont'd)****(c) The Group's long-term bank and other loans were repayable as follows (Cont'd):**

At 31 December 1997:

	<b>The Group</b>		<b>Total</b>
	<b>Bank loans</b>	<b>Other loans</b>	
	RMB'000	RMB'000	RMB'000
On demand or within one year	103,498	1,217,060	1,320,558
After one year but within two years	103,498	1,248,236	1,351,734
After two years but within five years	206,994	997,005	1,203,999
After five years	—	314,593	314,593
	<u>310,492</u>	<u>2,559,834</u>	<u>2,870,326</u>
	<u>413,990</u>	<u>3,776,894</u>	<u>4,190,884</u>

**19. DEFERRED REVENUE**

Deferred revenue from assignment of rights to income from subscribers represents the unamortised portion of proceeds received by Guangdong Mobile from certain distributors of telecommunications services pursuant to agreements under which Guangdong Mobile sold certain mobile phone numbers to these distributors at RMB9,167 each, in return for assigning to such distributors the rights to certain revenue such as usage fees, monthly fees, connection fees, telephone number selection fees and 50 per cent value-added services fees from those subscribers over a period of seven years. The distributors have no recourse to the Group under the relevant agreements and the Group maintains no credit risk from such subscribers during the seven-year period. The proceeds received by Guangdong Mobile have been accounted for as deferred revenue and are amortised over a period of seven years. After the expiration of the relevant agreements, the rights to income from these subscribers will revert to the Group.

	<b>The Group</b>	
	<b>1998</b>	1997
	RMB'000	RMB'000
Balance at 1 January	<b>1,352,863</b>	—
Acquired on acquisition of subsidiaries	—	1,174,573
Additions	<b>688,596</b>	228,000
Recognised in profit and loss account	<b>(284,733)</b>	(49,710)
Balance at 31 December	<u><b>1,756,726</b></u>	<u>1,352,863</u>



**20. SHARE CAPITAL**

	<b>1998</b>	<b>1997</b>
	<b>HK\$'000</b>	<b>HK\$'000</b>
<b>Authorised:</b>		
16,000,000,000 ordinary shares of HK\$0.1 each	<u><b>1,600,000</b></u>	<u>1,600,000</u>
	<b>1998</b>	1997
	<b>HK\$'000</b>	<b>HK\$'000</b>
<b>Issued and fully paid:</b>		
11,780,788,000 ordinary shares of HK\$0.1 each	<u><b>1,178,079</b></u>	<u>1,178,079</u>
RMB'000 equivalent	<u><b>1,261,419</b></u>	<u>1,261,419</u>

**21. SHARE OPTION SCHEME**

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 under the share option scheme 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.

On 9 March 1998, share options for a total of 12,000,000 shares at an exercise price of HK\$11.1 per share (which can be exercised during the period from 9 March 1998 to 8 March 2006) were granted under the share option scheme to certain directors of the Company.

At 31 December 1998, the outstanding options were:

<b>Date options granted</b>	<b>Period during which options exercisable</b>	<b>Exercise price</b>	<b>Number of options outstanding at the year end</b>
9 March 1998	9 March 1998 to 8 March 2006	HK\$11.1	12,000,000

**21. SHARE OPTION SCHEME (Cont'd)**

On 20 April 1999, 5,500,000 share options were exercised to subscribe for 5,500,000 ordinary shares in the Company at a consideration of HK\$61,050,000, of which HK\$550,000 was credited to share capital and the balance of HK\$60,500,000 was credited to the share premium account. These ordinary shares were issued by the Company on 23 April 1999.

**22. RESERVES**

	<b>Share premium</b>	<b>Capital reserve/ (goodwill)</b>	<b>General reserve</b>	<b>PRC statutory reserves</b>	<b>Retained profits</b>	<b>Total</b>
	RMB'000	RMB'000	RMB'000	RMB'000	RMB'000	RMB'000
<b>The Group</b>						
At 1 January 1998	50,642,577	1,131,950	72,463	110,946	1,330,314	53,288,250
Goodwill arising on acquisition of subsidiaries	—	(15,621,760)	—	—	—	(15,621,760)
Net profit for the year	—	—	—	—	6,899,842	6,899,842
Transfer to PRC statutory reserves, net of minority interests' share	—	—	—	2,091,944	(2,091,944)	—
At 31 December 1998	<u>50,642,577</u>	<u>(14,489,810)</u>	<u>72,463</u>	<u>2,202,890</u>	<u>6,138,212</u>	<u>44,566,332</u>
<b>The Company</b>						
At 1 January 1998	50,642,577	—	72,463	—	410,623	51,125,663
Net profit for the year (Note 9)	—	—	—	—	1,365,421	1,365,421
At 31 December 1998	<u>50,642,577</u>	<u>—</u>	<u>72,463</u>	<u>—</u>	<u>1,776,044</u>	<u>52,491,084</u>

At 31 December 1998, the amount of distributable reserves of the Company amounted to RMB1,848,507,000 (1997: RMB483,086,000).

**PRC statutory reserves**

In accordance with the Articles of Association and Regulations on Posts and Telecommunications Enterprises, for the period ended 31 December 1997, Guangdong Mobile and Zhejiang Mobile are required to transfer a certain percentage of the profit after taxation to the statutory surplus reserve and statutory public welfare reserve as determined by accounting principles generally accepted in the PRC ("PRC GAAP"). As Guangdong Mobile and Jiangsu Mobile were wholly-owned foreign enterprises at 31 December 1998 and Zhejiang Mobile was a sino-foreign joint venture company at 31 December 1998, they are not required to make the above transfers for the year ended 31 December 1998. At 31 December 1998, the balances of statutory surplus reserve and statutory public welfare reserve were RMB73,964,000 (1997: RMB73,964,000) and RMB36,982,000 (1997: RMB36,982,000) respectively.

**22. RESERVES (Cont'd)****PRC statutory reserves (Cont'd)**

Statutory surplus reserve can be used to make good previous years' losses, provided that the balance after such offset is not less than 25 per cent of the registered capital. Statutory public welfare reserve can only be utilised on capital items for the collective benefits of the employees such as the construction of staff quarters and other staff welfare facilities. This reserve is non-distributable other than in liquidation.

In accordance with the Regulations on Enterprises with Foreign Investment, Guangdong Mobile, Zhejiang Mobile and Jiangsu Mobile are required to transfer a certain percentage of profit after taxation, as determined under PRC GAAP, to the general reserve fund and the enterprise expansion fund. In case of Guangdong Mobile and Jiangsu Mobile, since they are wholly-owned foreign enterprises, at least 10 per cent of their profit after taxation determined under the PRC GAAP should be transferred to the general reserve fund until the balance of the general reserve fund is equal to 50 per cent of the registered capital. During the year, appropriations were made to the general reserve fund and the enterprise expansion fund by Guangdong Mobile, Zhejiang Mobile and Jiangsu Mobile at 10 per cent and 30 per cent respectively of the profit after taxation determined under PRC GAAP. At 31 December 1998, the balances of the general reserve fund and the enterprise expansion fund were RMB522,986,000 (1997: RMB Nil) and RMB1,568,958,000 (1997: RMB Nil) respectively.

The general reserve fund can be used to make good losses and to increase the capital of the subsidiaries while the enterprise expansion fund can be used to increase the capital of the subsidiaries.

**23. CONNECTED AND RELATED PARTY TRANSACTIONS**

- (a) The Group's operations are subject to extensive regulation by the PRC government. The MII, pursuant to the authority delegated to it by the PRC State Council, directly or indirectly regulates licensing, competition, interconnection, technology and equipment standards, and other aspects of the PRC telecommunications industry. The MII, together with other PRC government entities, also regulates tariff policy, foreign investment and spectrum allocation and spectrum usage fees. Specifically, the Group's tariffs are subject to the regulation by various Government authorities, including the State Planning Commission ("SPC"), the MII, the PTAs and the relevant Provincial Price Bureaus ("PPBs"). The connection fees charged by the Group are based on a guidance price range set jointly by the MII and SPC, with each actual fee determined by the relevant PTA in consultation with the relevant PPB. In general, the Group's base usage charges and domestic roaming usage charges are set by the MII and SPC. International roaming charges are set by the MII pursuant to agreements between the DGT and other cellular operators. The principal connected and related party transactions, which were entered into with the MII and other entities under the control of MII, are as follows:

	Note	1998 RMB'000
Interconnection revenue	(i)	752,054
Interconnection charges	(ii)	3,924,748
Leased line charges	(iii)	3,917,362
Roaming revenue	(iv)	1,053,042
Roaming expenses	(v)	827,591
Spectrum fees	(vi)	12,431
Operating lease charges	(vii)	226,670
Sales commission	(viii)	263,859
Debt collection service fees	(viii)	133,270
Billing service fees	(viii)	1,723
Interest paid/payable	(ix)	83,253

**23. CONNECTED AND RELATED PARTY TRANSACTIONS (Cont'd)***Notes:*

- (i) Interconnection revenue represents the amounts received or receivable from the Guangdong PTA, the Zhejiang PTA and the Jiangsu PTA in respect of calls made between the Total Access Communication Systems ("TACS")/Global System for Mobile Communications ("GSM") networks and the Public Switched Telephone Network ("PSTN") in Guangdong, Zhejiang and Jiangsu respectively.
- (ii) Interconnection charges represent the amounts paid or payable to the Guangdong PTA, the Zhejiang PTA and the Jiangsu PTA in respect of calls made between the TACS/GSM networks and the PSTN in Guangdong, Zhejiang and Jiangsu respectively.
- (iii) Leased line charges represent expenses paid or payable to the Guangdong PTA/Posts and Telecommunications Bureaus ("PTBs"), the Zhejiang PTA/PTBs and the Jiangsu PTA/PTBs for the use of leased lines between the base transceiver stations, base station controllers, base stations, fixed line network connectors, long distance network connectors and main switches.
- (iv) A cellular telephone user using roaming services is charged at the respective roaming usage rate for roaming in calls, in addition to applicable long distance charges. Roaming revenue represents domestic and international roaming in usage charges from non-subscribers received or receivable from the relevant PTAs and international cellular telephone operators through MII.
- (v) A cellular telephone user using roaming services is charged at the respective roaming usage rate for roaming out calls, in addition to applicable long distance charges. Roaming expenses represent the amount of domestic and international roaming out charges received or receivable from subscribers which is to be remitted to the relevant PTAs and international cellular telephone operators for their share of the roaming revenue through MII.
- (vi) Spectrum fees represent the spectrum usage fees paid or payable to DGT for the usage of the frequency bands allocated to Guangdong Mobile, Zhejiang Mobile and Jiangsu Mobile.
- (vii) Operating lease charges represent the rental paid or payable to the Guangdong PTA/PTBs, the Zhejiang PTA/PTBs, the Jiangsu PTA/PTBs and Telpo for operating leases in respect of land and buildings and others.
- (viii) With effect from 20 October 1997 for Guangdong PTA and Zhejiang PTA, and 1 January 1998 for Jiangsu PTA, the Group entered into certain services agreements in respect of marketing services with authorised dealers, debt collection services and billing services.

Sales commission represents the amounts paid or payable to the Guangdong PTA/PTBs, the Zhejiang PTA/PTBs and the Jiangsu PTA/PTBs for their marketing of the cellular services in Guangdong, Zhejiang and Jiangsu respectively.

Debt collection service fees represent the amounts paid or payable to the Guangdong PTA/PTBs, the Zhejiang PTA/PTBs and the Jiangsu PTA/PTBs for their provision of debt collection services to Guangdong Mobile, Zhejiang Mobile and Jiangsu Mobile respectively.

Billing service fees represent the amounts paid or payable to the Zhejiang PTA/PTBs for their provision of the billing services to Zhejiang Mobile.

- (ix) Interest paid/payable represents the interest incurred on loans borrowed from Zhejiang PTA and Telpo.

**23. CONNECTED AND RELATED PARTY TRANSACTIONS (Cont'd)**

Advantage has been taken of the transitional provisions set out in paragraph 28 of Statement of Standard Accounting Practice 20 "Related Party Disclosures" issued by the Hong Kong Society of Accountants which provides exemption from the need to present comparative information for prior periods when this Statement is first adopted and such information is not available.

- (b) Pursuant to the ordinary resolution passed by the Company's shareholders on 3 June 1998, the Company acquired the entire issued share capital of Jiangsu Mobile BVI from China Telecom Hong Kong (BVI) Limited, the immediate holding company of the Company, by a total cash consideration of HK\$22,475,000,000. The only asset of Jiangsu Mobile BVI is its interest in the entire equity of Jiangsu Mobile.

**24. COMMITMENTS****(a) Capital commitments**

Capital commitments outstanding at 31 December 1998 not provided for in the accounts were as follows:

	The Group		The Company	
	1998 RMB'000	1997 RMB'000	1998 RMB'000	1997 RMB'000
Commitments in respect of land and buildings				
— authorised and contracted for	<b>77,340</b>	298,226	—	—
— authorised but not contracted for	<b>919,046</b>	865,987	—	—
	<b>996,386</b>	1,164,213	—	—
Commitments in respect of telecommunications equipment				
— authorised and contracted for	<b>3,088,654</b>	6,788,040	<b>1,240,240</b>	2,893,128
— authorised but not contracted for	<b>14,598,708</b>	9,919,129	—	—
	<b>17,687,362</b>	16,707,169	<b>1,240,240</b>	2,893,128
Total commitments				
— authorised and contracted for	<b>3,165,994</b>	7,086,266	<b>1,240,240</b>	2,893,128
— authorised but not contracted for	<b>15,517,754</b>	10,785,116	—	—
	<b>18,683,748</b>	17,871,382	<b>1,240,240</b>	2,893,128

**24. COMMITMENTS (Cont'd)****(b) Operating lease commitments**

At 31 December 1998, the Group and the Company had commitments under operating leases to make payments in the next year as follows:

At 31 December 1998:

	The Group			Total RMB'000	The Company
	Land and buildings RMB'000	Leased lines RMB'000	Others RMB'000		Land and buildings RMB'000
<b>Leases expiring:</b>					
Within one year	4,385	—	—	4,385	1,858
After one year but within five years	30,711	1,047,873	—	1,078,584	2,781
After five years	192,502	3,088,246	39,094	3,319,842	—
	<u>227,598</u>	<u>4,136,119</u>	<u>39,094</u>	<u>4,402,811</u>	<u>4,639</u>

At 31 December 1997:

	The Group			Total RMB'000	The Company
	Land and buildings RMB'000	Leased lines RMB'000	Others RMB'000		Land and buildings RMB'000
<b>Leases expiring:</b>					
Within one year	5,392	—	—	5,392	—
After one year but within five years	30,172	830,318	—	860,490	4,730
After five years	107,282	1,592,195	17,116	1,716,593	—
	<u>142,846</u>	<u>2,422,513</u>	<u>17,116</u>	<u>2,582,475</u>	<u>4,730</u>

**25. POST BALANCE SHEET EVENTS**

Subsequent to the balance sheet date, in connection with the exercise of share options, the Company issued 5,500,000 ordinary shares of HK\$0.1 each at HK\$11.1 per share.

**26. COMPARATIVE FIGURES**

Certain comparative figures in the accounts have been reclassified to conform with the current year's presentation.

**27. ULTIMATE HOLDING COMPANY**

The directors consider the ultimate holding company at 31 December 1998 to be Telpo Communications (Group) Limited, incorporated in Hong Kong.

The Group's accounts are prepared in accordance with the generally accepted accounting principles applicable in Hong Kong ("HK GAAP"), which differ in certain significant respects from those applicable in the United States ("US GAAP"). The significant differences relate principally to the following items and the adjustments considered necessary to present net profit and shareholders' equity in accordance with US GAAP are shown in the tables set out below.

**(a) Effect of combination of entities under common control**

Under HK GAAP, the Group adopted the acquisition method to account for the purchase of Jiangsu Mobile. Under the acquisition method, the acquired results are included in the results of operations from the date of their acquisition. Goodwill arising on the acquisition, being the excess of the cost over the fair value of the Group's share of the separable net assets acquired, is eliminated against reserves immediately on acquisition.

As a result of both the Group and Jiangsu Mobile being under common control prior to the acquisition, such acquisition under US GAAP is considered a "combination of entities under common control". Under US GAAP, combinations of entities under common control are accounted for under the "as if pooling-of-interests" method, whereby assets and liabilities are accounted for at historical cost and the accounts of previously separate companies for periods prior to the combination generally are restated on a combined basis. The cash consideration paid by the Group in excess of the historical carrying amounts of the net assets acquired has been treated as an equity transaction in the year of acquisition for US GAAP purposes.

**(b) Capitalisation of interest**

Under HK GAAP, the Group capitalises interest costs to the extent that the related borrowings are directly attributable to the acquisition or construction of an asset which necessarily takes a substantial period of time to get ready for its intended use.

Under US GAAP, interest costs capitalised are determined based on specific borrowings related to the acquisition or construction of an asset, if an entity's financing plans associate a specific new borrowing with a qualifying asset. If average accumulated expenditures for the asset exceed the amounts of specific new borrowings associated with an asset, additional interest costs capitalised are based on the weighted average interest rate applicable to other borrowings of the entity.

**(c) Revaluation of fixed assets**

For certain periods prior to 31 May 1997, the fixed assets of the subsidiaries were revalued in compliance with PRC rules and regulations, resulting in an increase in shareholders' equity.

Additionally, in connection with the Group restructuring in 1997, the fixed assets of Guangdong Mobile and Zhejiang Mobile were revalued as of 31 May 1997. Upon the acquisition of Jiangsu Mobile in 1998, the fixed assets of Jiangsu Mobile were revalued as of 31 December 1997. These fixed asset revaluations result in an increase in shareholders' equity with respect to the increase in carrying amount of certain fixed assets above their historical cost bases.

Under US GAAP, fixed assets are stated at their historical cost, less accumulated depreciation. However, as a result of the tax deductibility of the revaluation reserve, a deferred tax asset related to the reversal of the revaluation reserve is created under US GAAP with a corresponding increase in shareholders' equity.



**(d) Employee housing scheme**

The Group provides staff quarters under its employee housing schemes at below market prices. Under HK GAAP, employee housing scheme costs borne by the corresponding PTA and not charged to the subsidiaries are not recognised by the subsidiaries.

Under US GAAP, employee housing scheme costs borne by the corresponding PTA and not charged to the subsidiaries are reflected as an expense in the profit and loss account and a corresponding capital contribution. Additionally, under US GAAP, the costs to be borne by the subsidiaries are accrued over the term of the program.

**(e) Deferred taxation**

Under HK GAAP, the Group provides for deferred tax liabilities only to the extent that there is a reasonable probability that such deferred tax liabilities will become payable in the foreseeable future. Deferred tax assets are not recognised unless their realisation is assured beyond reasonable doubt.

Under US GAAP, provisions are made for all deferred taxes as they arise, except a valuation allowance is provided against deferred tax assets when realisation of such amounts does not meet the criterion of "more likely than not".

**(f) Share option scheme**

The Group grants share options to directors and employees. Under HK GAAP, the proceeds received are recognised as an increase to capital upon the exercise of the share options.

Under US GAAP, the Group determines compensation expenses based upon the excess, if any, of the quoted market price of the shares over the exercise price of the options on the date of grant and amortises this amount over the vesting period of the option concerned.

Effect on net profit of significant differences between HK GAAP and US GAAP is as follows:

	<b>1998</b> US\$'000	<b>1998</b> RMB'000	1997 RMB'000	1996 RMB'000
		(except per share data)		
<b>Net profit under HK GAAP</b>	<b>833,445</b>	<b>6,899,842</b>	4,955,381	4,509,158
<b>Adjustments:</b>				
Effect of combination of entities under common control	<b>59,156</b>	<b>489,733</b>	1,244,812	944,609
Capitalised interest	<b>6,947</b>	<b>57,514</b>	58,688	133,938
Revaluation of fixed assets	<b>151,006</b>	<b>1,250,141</b>	411,587	31,711
Employee housing scheme	<b>3,384</b>	<b>28,018</b>	(147,411)	(111,471)
Deferred taxation	<b>2,079</b>	<b>17,209</b>	(43,000)	(186,368)
Share option scheme	<b>(3,869)</b>	<b>(32,034)</b>	—	—
Deferred tax effects of US GAAP adjustments	<b>(52,125)</b>	<b>(431,526)</b>	(155,191)	(54,664)
<b>Net profit under US GAAP</b>	<b><u>1,000,023</u></b>	<b><u>8,278,897</u></b>	<u>6,324,866</u>	<u>5,266,913</u>
Basic and diluted net profit per share in accordance with US GAAP	<b><u>0.09</u></b>	<b><u>0.70</u></b>	<u>0.65</u>	<u>0.58</u>
Basic and diluted net profit per ADS in accordance with US GAAP*	<b><u>1.70</u></b>	<b><u>14.05</u></b>	<u>13.27</u>	<u>11.69</u>

\* Based on a ratio of 20 ordinary shares to one ADS.

Effect on shareholders' equity of significant differences between HK GAAP and US GAAP is as follows:

	<b>1998</b>	<b>1998</b>	1997
	<b>US\$'000</b>	<b>RMB'000</b>	RMB'000
<b>Shareholders' equity under HK GAAP</b>	<b>5,535,622</b>	<b>45,827,751</b>	54,549,669
<b>Adjustments:</b>			
Effect of combination of entities under common control	—	—	8,009,221
Capitalised interest	<b>35,458</b>	<b>293,551</b>	236,037
Revaluation of fixed assets			
— Cost	<b>(748,275)</b>	<b>(6,194,744)</b>	(6,194,744)
— Accumulated depreciation and other	<b>208,376</b>	<b>1,725,086</b>	474,945
Deferred tax adjustments on revaluations	<b>183,965</b>	<b>1,522,995</b>	1,887,528
Employee housing scheme	<b>(43,491)</b>	<b>(360,049)</b>	(388,067)
Deemed capital contribution for employee housing scheme	<b>30,131</b>	<b>249,448</b>	247,511
Recognition of deferred taxes	<b>34,220</b>	<b>283,293</b>	266,084
Deferred tax effects of US GAAP adjustments	<b>(17,500)</b>	<b>(144,881)</b>	(77,893)
<b>Shareholders' equity under US GAAP</b>	<b><u>5,218,506</u></b>	<b><u>43,202,450</u></b>	<u>59,010,291</u>

Solely for the convenience of the reader, the 31 December 1998 accounts have been translated into United States dollars at the rate of US\$1.00 = RMB8.2787 quoted by the People's Bank of China on 31 December 1998. No representation is made that the Renminbi amounts could have been, or could be, converted into United States dollars at that rate or at any other certain rate on 31 December 1998, or any other certain date.

**Consolidated Statements of Income prepared under US GAAP**

	1998 US\$'000	1998 RMB'000	1997 RMB'000	1996 RMB'000
		(except per share data)		
<b>Turnover</b>				
Usage fees	2,133,933	17,666,191	10,656,277	6,612,800
Monthly fees	554,498	4,590,524	3,102,763	1,873,238
Connection fees	449,724	3,723,132	4,279,946	3,438,923
Others	307,766	2,547,900	1,083,362	589,878
	<u>3,445,921</u>	<u>28,527,747</u>	<u>19,122,348</u>	<u>12,514,839</u>
<b>Operating expenses</b>				
Leased lines	523,321	4,332,417	4,029,737	2,711,172
Interconnection	617,367	5,110,996	1,337,651	255,651
Depreciation	489,316	4,050,904	2,976,757	1,750,526
Personnel	168,063	1,391,339	980,432	584,788
Selling, general and administrative and others	519,295	4,299,086	2,846,793	1,396,977
	<u>2,317,362</u>	<u>19,184,742</u>	<u>12,171,370</u>	<u>6,699,114</u>
<b>Operating profit</b>	1,128,559	9,343,005	6,950,978	5,815,725
<b>Other income</b>	40,304	333,669	57,452	60,971
<b>Non-operating income</b>	194,214	1,607,840	629,063	95,790
<b>Interest expense</b>	(12,486)	(103,369)	(118,753)	(33,323)
<b>Profit before tax and minority interests</b>	1,350,591	11,181,145	7,518,740	5,939,163
<b>Income tax</b>	(350,480)	(2,901,520)	(1,186,949)	(668,192)
<b>Profit before minority interests</b>	1,000,111	8,279,625	6,331,791	5,270,971
<b>Minority interests</b>	(88)	(728)	(6,925)	(4,058)
<b>Net profit</b>	<u>1,000,023</u>	<u>8,278,897</u>	<u>6,324,866</u>	<u>5,266,913</u>
Basic and diluted net profit per share	<u>0.09</u>	<u>0.70</u>	<u>0.65</u>	<u>0.58</u>
Basic and diluted net profit per ADS*	<u>1.70</u>	<u>14.05</u>	<u>13.27</u>	<u>11.69</u>

\* Based on a ratio of 20 ordinary shares to one ADS.

**Consolidated Balance Sheets prepared under US GAAP**

	1998 US\$'000	1998 RMB'000	1997 RMB'000
<b>Assets</b>			
Current assets			
Cash and cash equivalents	2,111,623	17,481,499	40,085,307
Deposits with banks	158,342	1,310,863	—
Accounts receivable	299,770	2,481,704	1,948,508
Other receivables	39,386	326,067	858,961
Inventories	12,236	101,296	140,226
Prepaid expenses and other current assets	126,327	1,045,826	109,284
Amounts due from related parties	34,699	287,264	109,551
	<hr/>	<hr/>	<hr/>
Total current assets	2,782,383	23,034,519	43,251,837
Fixed assets			
Construction in progress	921,968	7,632,703	4,033,357
Interest in associated companies	3,676	30,430	30,430
Amounts due from related parties	—	—	72,546
Deferred tax assets	218,998	1,813,017	2,102,503
	<hr/>	<hr/>	<hr/>
<b>Total assets</b>	<b><u>7,492,400</u></b>	<b><u>62,027,337</u></b>	<b><u>70,284,192</u></b>
<b>Liabilities and shareholders' equity</b>			
Current liabilities			
Accounts payable	720,245	5,962,692	2,085,770
Bank and other loans	644,711	5,337,368	2,246,058
Taxes payable	156,907	1,298,988	272,440
Amounts due to related parties	72,135	597,180	301,702
Accrued expenses and other payables	346,159	2,865,752	1,977,416
	<hr/>	<hr/>	<hr/>
Total current liabilities	1,940,157	16,061,980	6,883,386
Bank and other loans	119,726	991,170	3,023,369
Deferred revenue	212,198	1,756,726	1,352,863
	<hr/>	<hr/>	<hr/>
<b>Total liabilities</b>	<b>2,272,081</b>	<b>18,809,876</b>	<b>11,259,618</b>
Minority interests	1,813	15,011	14,283
<b>Shareholders' equity</b>	<b><u>5,218,506</u></b>	<b><u>43,202,450</u></b>	<b><u>59,010,291</u></b>
	<hr/>	<hr/>	<hr/>
<b>Total liabilities and shareholders' equity</b>	<b><u>7,492,400</u></b>	<b><u>62,027,337</u></b>	<b><u>70,284,192</u></b>

*Note:* The above "Consolidated Balance Sheets" and "Consolidated Statements of Income" as at 31 December 1997 and 1998 and for each of the three years ended 31 December 1996, 1997 and 1998 include the results of the Company and its subsidiaries, Guangdong Mobile, Zhejiang Mobile, Jiangsu Mobile BVI and Jiangsu Mobile, prepared under US GAAP as if the current Group structure had been in place throughout the relevant periods.

## Results

	1998 RMB'000	Proforma combined 1997 RMB'000	Proforma combined 1996 RMB'000	Proforma combined 1995 RMB'000	Proforma combined 1994 RMB'000
<b>Turnover</b>					
Usage fees	16,345,713	8,718,056	5,527,875	3,243,101	1,655,259
Monthly fees	4,347,218	2,692,166	1,658,188	939,478	598,574
Connection fees	3,323,191	3,173,529	2,673,425	2,981,214	2,014,612
Others	2,329,271	904,028	507,753	434,332	321,903
	<u>26,345,393</u>	<u>15,487,779</u>	<u>10,367,241</u>	<u>7,598,125</u>	<u>4,590,348</u>
<b>Operating expenses</b>					
Leased lines	3,917,362	3,134,260	2,213,563	1,243,662	657,493
Interconnection	4,752,339	1,214,229	196,361	26,267	9,749
Depreciation	4,598,151	2,680,538	1,424,306	788,956	355,233
Personnel	1,336,010	755,523	416,459	213,942	137,483
Selling, general and administrative and others	4,089,036	2,289,042	1,154,115	583,358	454,795
	<u>18,692,898</u>	<u>10,073,592</u>	<u>5,404,804</u>	<u>2,856,185</u>	<u>1,614,753</u>
<b>Operating profit</b>	<b>7,652,495</b>	5,414,187	4,962,437	4,741,940	2,975,595
<b>Other income</b>	<b>335,934</b>	84,954	48,976	176,114	41,751
<b>Non-operating (expenses)/ income</b>	<b>(51,577)</b>	(27,088)	96,490	125,259	67,510
<b>Interest expense</b>	<b>(159,751)</b>	(175,335)	(167,144)	(88,966)	(63,740)
<b>Profit before exceptional item</b>	<b>7,777,101</b>	5,296,718	4,940,759	4,954,347	3,021,116
<b>Exceptional item</b>	<b>1,609,419</b>	656,607	—	—	—
<b>Profit before tax and minority interests</b>	<b>9,386,520</b>	5,953,325	4,940,759	4,954,347	3,021,116
<b>Income tax</b>	<b>(2,485,950)</b>	(991,019)	(427,543)	(285,701)	(201,506)
<b>Profit before minority interests</b>	<b>6,900,570</b>	4,962,306	4,513,216	4,668,646	2,819,610
<b>Minority interests</b>	<b>(728)</b>	(6,925)	(4,058)	—	—
<b>Profit attributable to shareholders</b>	<b>6,899,842</b>	4,955,381	4,509,158	4,668,646	2,819,610

**Assets and liabilities**

	<b>1998</b>	1997	Proforma combined 1996	Proforma combined 1995
	<b>RMB'000</b>	RMB'000	RMB'000	RMB'000
Fixed assets	<b>33,986,326</b>	18,634,237	11,536,029	7,345,751
Construction in progress	<b>7,339,152</b>	3,557,665	1,001,499	820,899
Interest in associated companies	<b>30,430</b>	30,430	—	—
Amounts due from related parties	—	72,546	570,097	790,450
Deferred tax assets	<b>151,610</b>	24,140	22,131	108
Net current assets	<b>7,083,140</b>	36,468,123	1,493,752	2,087,450
<b>Total assets less current liabilities</b>	<b>48,590,658</b>	58,787,141	14,623,508	11,044,658
Long-term bank and other loans	<b>(991,170)</b>	(2,870,326)	(1,946,444)	(2,003,970)
Deferred revenue	<b>(1,756,726)</b>	(1,352,863)	(198,607)	—
	<b>45,842,762</b>	54,563,952	12,478,457	9,040,688

*Note:* The above tables summarise the Group's proforma combined results for each of the four years ended 31 December 1994, 1995, 1996 and 1997, the results of the Group for the year ended 31 December 1998, the audited statements of the Group's assets and liabilities as at 31 December 1997 and 1998, together with the proforma combined statements of the Group's assets and liabilities as at 31 December 1995 and 1996.

The Group's proforma combined results for each of the four years ended 31 December 1994, 1995, 1996 and 1997 have been prepared on a combined basis as if Guangdong Mobile and Zhejiang Mobile were subsidiaries of the Company since 1 January 1994 or since the respective dates of incorporation where these are shorter periods. The Group's results for the year ended 31 December 1998 include the results of the Company, Guangdong Mobile and Zhejiang Mobile for the year ended 31 December 1998 and the post-acquisition results of Jiangsu Mobile for the period from 4 June 1998 to 31 December 1998.

The Group's proforma combined statements of assets and liabilities as at 31 December 1995 and 1996 are combinations of the statements of assets and liabilities of Guangdong Mobile and Zhejiang Mobile as at 31 December 1995 and 1996 respectively.

- 1 November 1949 The Ministry of Posts and Telecommunications is established under the People's Central Government of the People's Republic of China.
- February 1987 The first cellular mobile telephone system is introduced in China. The Guangdong Posts and Telecommunications Administration signed the contract for the first phase of the Pearl Delta Mobile Telecommunications Project, the total investment being US\$8.9 million.
- 18 November 1987 The Guangzhou Exchange, China's first cellular telecommunications exchange, opened with a subscriber base of 150. It had 3 base stations and 40 channels.
- September 1988 Guangdong Mobile Communication Corporation was established.
- October 1989 The Pearl Delta Mobile network introduced automated roaming service.
- December 1992 Automatic cellular roaming service is inaugurated between Guangdong Province, Hong Kong and Macau.
- 1 December 1993 Telpo Communications Development Limited, later renamed Telpo Communications (Group) Limited, a company wholly owned by the Ministry of Posts and Telecommunications, was established in Hong Kong.
- 9 February 1994 The State Council of the People's Republic of China approved the Ministry of Posts and Telecommunications' Three Directions proposal to change the status of the Directorate General of Telecommunications to an independently audited enterprise managing telecommunications networks and services throughout China.
- 27 April 1995 The Directorate General of Telecommunications was registered as a legal enterprise and was renamed Directorate General of Telecommunications of China Posts and Telecommunications — China Telecom for short.
- June 1995 National analog mobile telecommunications networks A and B were interconnected to provide automatic roaming.
- 1 January 1996 The GSM network commenced pilot operations, providing automatic roaming service to 15 provinces and cities in China including Guangdong Province, Zhejiang Province and Jiangsu Province.
- 10 January 1996 Interconnection of national analog mobile networks A and B commenced pilot operations.
- February 1996 Zhejiang GSM Mobile Communication Company Limited was established. The name was later changed to Zhejiang Mobile Communication Company Limited.
- 18 July 1996 China Telecom launched international GSM roaming service and roaming services to Hong Kong and Macau. Automatic roaming service was established with Hongkong Telecom CSL.



- 21 March 1997 China Telecom (Hong Kong) Limited was established in Hong Kong. It was later renamed China Telecom (Hong Kong) Group Limited.
- 6 June 1997 China Telecom (Hong Kong) Group Limited acquired a 5.5 per cent interest in Hongkong Telecom.
- 17 July 1997 The cellular subscriber base of the China Telecom (DGT) system exceeded 10 million subscribers and was ranked the third largest cellular subscriber base in the world.
- 3 September 1997 China Telecom (Hong Kong) Limited was incorporated in Hong Kong.
- 16 September 1997 The Securities Committee of the State Council of the P.R. China gave its approval for China Telecom (Hong Kong) Limited to issue shares and seek listings in Hong Kong and overseas.
- 22 and 23 October 1997 The ordinary shares of China Telecom (Hong Kong) Limited were listed on the New York Stock Exchange and The Stock Exchange of Hong Kong Limited.
- 9 April 1998 China Telecom (Hong Kong) Group Limited completed the acquisition of an approximately 7.6 per cent interest in the share capital of Hongkong Telecom, increasing its total shareholding in that company to approximately 13 per cent.
- China Telecom (Hong Kong) Group Limited completed the acquisition of an approximately 1.6 per cent interest in Globalstar L.P.
- 3 June 1998 At an extraordinary general meeting of shareholders, the shareholders of China Telecom (Hong Kong) Limited unanimously approved the acquisition of Jiangsu Mobile Communication Company Limited, which was thereafter completed.
- 26 June 1998 The China Telecom (Hong Kong) Limited Shenzhen Representative Office was established in Shenzhen, P.R. China.
- 18 August 1998 The cellular subscriber base of the China Telecom (DGT) system throughout China exceeded 20 million.

This glossary contains certain definitions and other terms as they relate to the Company and the Group and as they are used in the annual report. These definitions may, or may not, correspond to standard industry definitions.

analog	Communications by transmission of continuously varying representations of the input signal, as compared with binary coding of words in digital transmission.
base station; base transceiver station	Transmitter and receiver which serves as a bridge between all mobile users in a cell and connects mobile calls to the mobile switching centre.
cellular system	A telephone system based on a grid of cells deployed at a specified frequency.
channel	Communication path for transmitting voice or non-voice signals.
churn rate	Subscriber disconnection rate for a given period, determined by dividing the sum of voluntary and involuntary disconnections during the period by the number of subscribers at the end of the same period.
DCS 1800	Digital Cellular System for 1800 MHz, a European digital cellular standard based on GSM technology that operates in the 1800 MHz frequency band (also referred to as PCN).
digital	A method of storing, processing and transmitting information through the use of distinct electronic or optical pulses that represent the binary digits 0 and 1. Digital transmission and switching technologies employ a sequence of discrete, distinct pulses to represent information, as opposed to the continuously variable analog signal.
GSM	Global System for Mobile Communications, a pan-European mobile telephone system operating in the 900 MHz frequency band based on digital transmission and cellular network architecture with roaming. GSM is the standard accepted in most of Europe, the Middle East, Africa, Australia and Asia (with the exception of, among others, Japan and South Korea).
interconnect	Any variety of hardware arrangements that permits the connection of telecommunications equipment to a communications common carrier network such as a public switched telephone network.
MHz	Megahertz, a unit of measure of frequency; 1 MHz is equal to one million cycles per second.
mobile switching centre	A central switching point to which each call is connected, which controls the routing of calls. A mobile switching centre allows cellular telephone users to move freely from cell to cell while continuing their calls.
network infrastructure	Fixed infrastructure equipment consisting of base transceiver stations, base station controllers, antennas, switches, management information systems and other equipment that receives, transmits and processes signals from and to subscriber equipment and/or between wireless systems and the public switched telephone network.

penetration rate	Total market subscribers divided by the population of the service area, which means number of subscribers per 100 of population.
PSTN	Public Switched Telephone Network, which comprises the network infrastructure necessary for providing basic telephone services.
roaming	A service offered by mobile communications network operators which allows a subscriber to use his or her handset while in the service area of another carrier. Roaming requires an agreement between operators of different individual markets to permit customers of either operator to access the other's system.
SIM card	Subscriber Identity Module card, an electronic card that is inserted into a handset and identifies the subscriber to the network. The SIM card contains the personal identification number of the subscriber and identifies the network to which the subscriber belongs.
switch	A mechanical, electrical or electronic device which opens or closes a circuit, completes or breaks an electrical path, or selects paths or circuits used to route traffic between the mobile system and the PSTN.
TACS	Total Access Communication System, a European standard for analog mobile telephone transmissions in the 800 and 900 MHz frequency bands.