

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.

	Pro forma combined 1998 RMB'000	Pro forma combined 1997 RMB'000	Variance %
Turnover	28,527,747	19,122,348	49.19
Operating expenses	(20,383,454)	(12,435,546)	63.91
Operating profit	8,144,293	6,686,802	21.80
Other income	333,669	57,452	480.78
Non-operating expenses	(50,005)	(27,544)	81.55
Interest expense	(160,883)	(177,441)	(9.33)
Profit before exceptional item	8,267,074	6,539,269	26.42

EBITDA (in RMB millions)	13,634	10,133	34.55
Capital expenditures (in RMB millions)	16,397	10,234	60.23

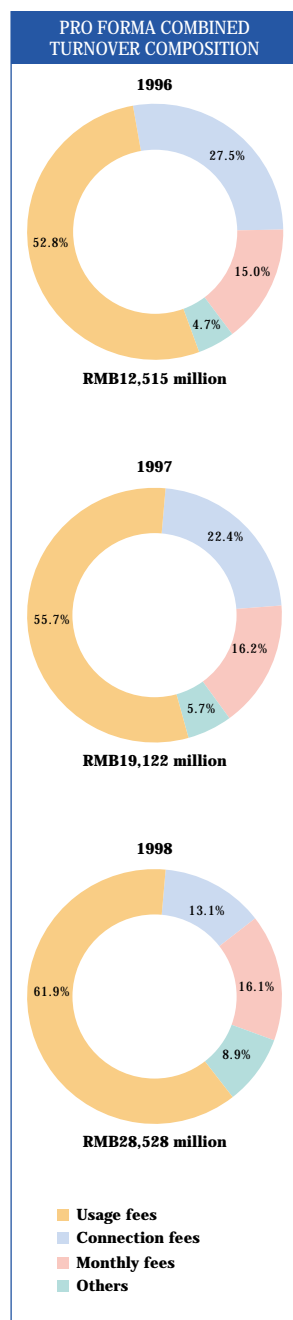
MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

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.

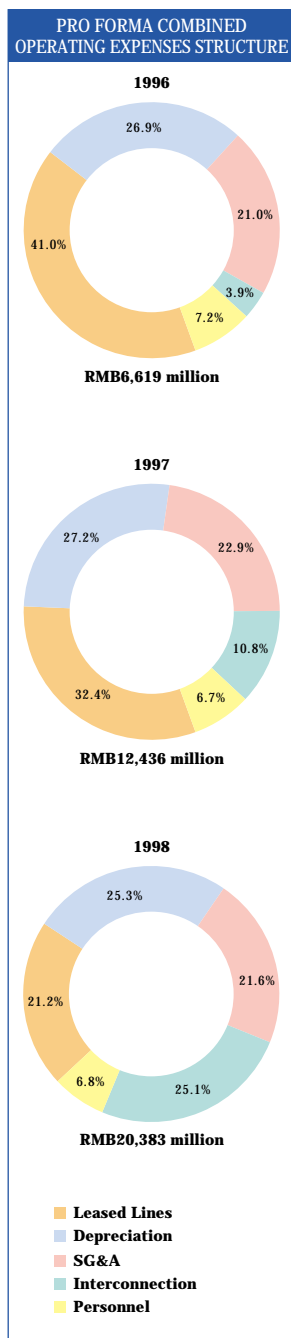
Leased line expenses increased by 7.51 per cent from RMB4,030 million in 1997 to RMB4,332 million in 1998. Leased line expenses represented 21.25 per cent of operating expenses in 1998, compared to 32.40 per cent in 1997 and 40.96 per cent in 1996. Comparing the increase in leased line expenses in 1998 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.