Solid financial profile

Financial Review

The Group maintained double-digit growth in both revenue and net profit in 2002, with revenue reaching RMB143.8 billion. Benefiting from management enhancements and increasing economies of scale, EBITDA margin reached 59.4 per cent. The Group further optimized its capital structure, continued to maintain strong free cash flow and achieved satisfactory financial performance.

For ease of comparison, unless otherwise specified, the financial information relating to the profit and loss accounts for 2002 and 2001 set out in this Financial Review represents the Group's unaudited pro-forma combined ("Pro-forma Combined") results and has been prepared on the assumption that the existing corporate structure of the Group with 21 operating subsidiaries was in place since 1 January 2001. Financial information relating to the balance sheet and the cashflow statement set out in this Financial Review is extracted from the audited financial statements. Business information as extracted represents Pro-forma Combined data.

	2002 Pro-forma Combined (RMB Millions)	2001 Pro-forma Combined (RMB Millions)	Change %
Operating revenue (Turnover)			
Usage fees	**104,373**	92,478	13
Monthly fees	**19,032**	18,237	4
Connection fees	**–**	754	N/A
New business revenue	**8,735**	3,589	143
Other operating revenue	**11,644**	11,354	3
	143,784	126,412	14
Operating expenses			
Leased lines	**5,961**	6,398	(7)
Interconnection	**14,840**	16,341	(9)
Depreciation	**30,470**	23,505	30
Personnel	**7,501**	6,852	9
Other operating expenses	**31,875**	25,377	26
	90,647	78,473	16
Profit from operations	**53,137**	47,939	11
Other net income	**1,739**	1,715	1
Profit attributable to shareholders	**34,116**	28,423	20
EBITDA	**85,346**	73,159	17

Management's Discussion and Analysis of Financial Condition and Results of Operations

Summary of Financial Results for 2002

While the global telecommunications industry remained sluggish in 2002, the Chinese economy continued its rapid growth and demand for telecommunications continued to be strong. With its noteworthy economies of scale and established position as the market leader in Mainland China, the Group focused on developing its core mobile telecommunications business, engaged in rational competition and investments, and actively integrated the newly acquired assets, and the Group's results in 2002 reflected continued remarkable growth. Operating revenue, EBITDA and EBITDA margin of the Group for 2002 were RMB 143,784 million (all monetary amounts below are expressed in RMB, unless otherwise specified), 85,346 million and 59.4 per cent., respectively, representing increases of 14 per cent., 17 per cent. and 1.5 percentage points over the 2001 figures, respectively. Profit attributable to shareholders was 34,116 million, representing an increase of 20 per cent. from last year, while audited actual consolidated earnings per share was 1.71, representing an actual increase of 13 per cent. from last year. The Group's overall financial performance was satisfactory.

Benefiting from the Group's increased revenue and effective cost control measures, the Group continued to maintain strong cash flow in 2002. The Group's free cash flow (net cash inflow from operating activities after deduction of capital expenditure, and before the net cash outflow of 28,733 million regarding the acquisition of Anhui Mobile and the other seven mobile telecommunications companies during the year) and net cash inflow from operating activities for 2002 reached 28,422 million and 69,422 million, respectively. Through the adoption of a well-structured financing package, whereby the interests of all shareholders were taken into account, the Group completed the acquisition of Anhui Mobile and the other seven mobile telecommunications companies, optimized its capital structure and lowered its cost of capital. Meanwhile, the Group's total debt to equity ratio and interest coverage multiple remained sound. Moody's recently upgraded the Company's international credit rating outlook from "stable" to "positive", reflecting further market acknowledgement of the prudent approach consistently adopted by the Group.

In 2002, the Group successfully completed the acquisition of new assets. As a result of the rapid growth and the enormous market potential of the local economies where these newly acquired assets are located, as well as the Group's intensive post-acquisition integration and management reforms, the eight newly-acquired subsidiaries reported markedly improved results. These subsidiaries have all exceeded their profit forecast targets and have achieved significant improvements in management efficiency, thus contributing to the enhancement of the Group's economies of scale and growth prospects, while concurrently contributing substantially to the Group's earnings per share.

Operating Revenue (Turnover)

Despite ever-intensifying market competition, the Group successfully maintained double-digit growth in operating revenue through the adoption of rational competitive strategies in 2002. New businesses, principally the Short Message Service, have achieved remarkable growth. Their contribution to the Group's overall revenue growth is becoming increasingly apparent.

Benefiting primarily from the expansion in subscriber base and the continued growth in usage volume, operating revenue for 2002 reached 143,784 million, representing an increase of 14 per cent. over 2001. In 2002, the Group faced increasing competition. Aggressive marketing and sales tactics, such as severe price reductions and handset subsidies, were more broadly adopted by the Group's competitors to cultivate CDMA customers and promote the development of "Xiaolingtong" services. Nevertheless, the Group adhered to its existing strategies, leveraged its competitive edge and special features, focused on providing premium mobile telecommunications services to its subscribers and operating a unified GSM network, promoted corporate brands for different customers, and offered differentiated sales and business promotions targeting different market segments, which enabled the Group to maintain its position as the market leader and sustain healthy and stable revenue growth.

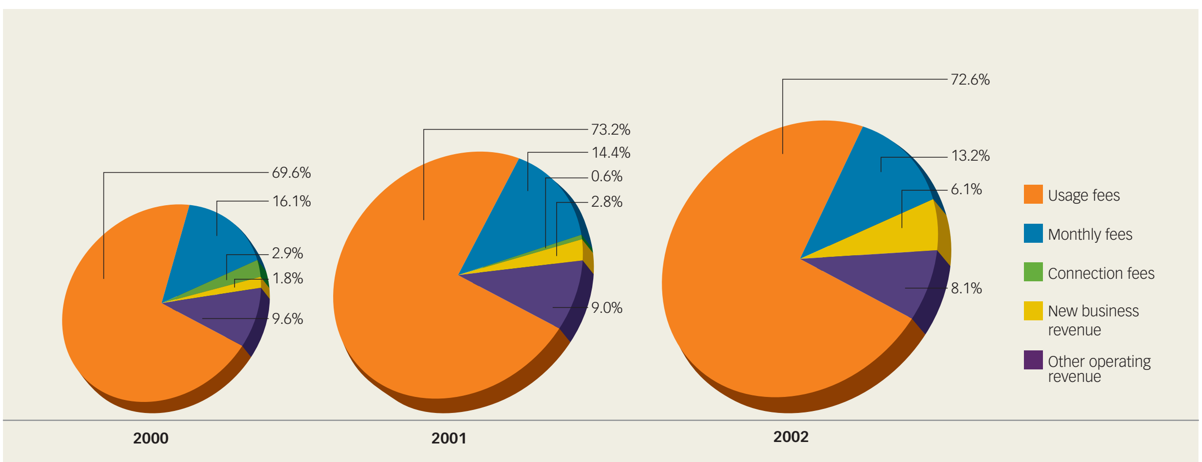
During 2002, the Group strengthened the promotion and development of new businesses, principally Short Message Service. Revenue from new businesses continued its very strong growth trend, reaching 8,735 million in 2002, representing an increase of 143 per cent. over 2001. This accounted for 6.1 per cent. of operating revenue, representing an increase of 3.3 percentage points over the same period in 2001. In particular, for five subsidiaries, revenue from new businesses reached as much as 8 per cent. of their operating revenue. Revenue from new businesses has become a strong contributor to the growth of the Group's operating revenue.

Operating Expenses

As market competition intensified, the Group's operating expenses increased from last year. However, with the benefit of the Group's sound cost control measures, economies of scale and synergies, the asset utilization rate has improved, the average operating expenses per user per month and average operating expenses per minute of usage continued to decline, and the Group's cost structure was further improved.

Operating expenses for 2002 were 90,647 million, representing an increase of 16 per cent. over last year. Average operating expenses per user per month for 2002 were 72, representing a decline of 18 per cent. from 2001, and average operating expenses per minute of usage were 0.35, representing a decline of 7 per cent. from 2001.

Composition of Operating Revenue

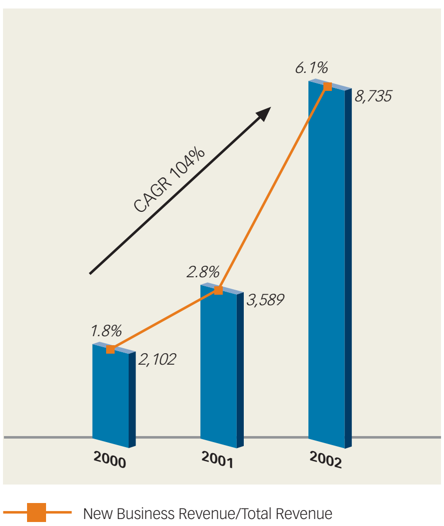


Leased line expenses for 2002 were 5,961 million, representing a decline of 7 per cent. from last year. These expenses as a percentage of operating revenue also decreased from 5.1 per cent. in 2001 to 4.1 per cent. in 2002. As the Group continued to make significant improvements to its network structure and terminated leases of transmission lines which were no longer necessary, the Group recorded a reduction in leased line expenses, notwithstanding the double-digit growth in usage fee revenue and total minutes of usage. The Group has also been constructing its own transmission lines to service certain high traffic areas. As these transmission lines gradually came into operation, leased line expenses were reduced.

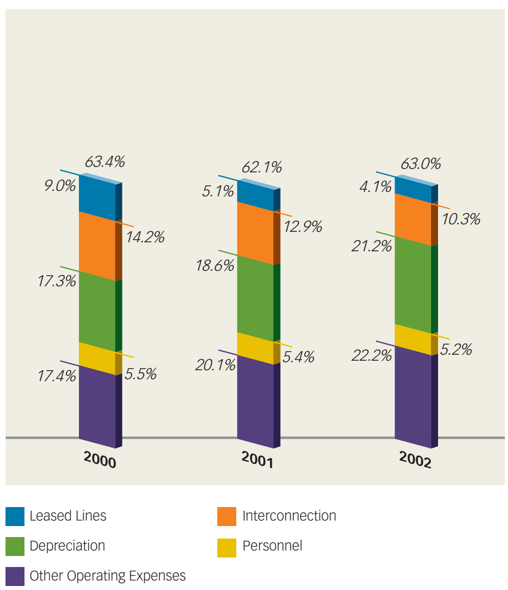
Usage volume increased by 25 per cent. over that of 2001, while interconnection expenses were 14,840 million for 2002, representing a decrease of 9 per cent. from 2001. Interconnection expenses accounted for 10.3 per cent. of total operating revenue in 2002, representing a decrease of 2.6 percentage points from 2001. The large decline in interconnection expenses was largely attributable, first, to the growing proportion of the Group's intra-network traffic as a result of the expansion of the Group's networks and subscriber base, and second, to the Group's efforts to optimize its network structure and carefully reorganize and re-route traffic volume.

Depreciation expenses increased by 30 per cent. from 2001, accounting for 21.2 per cent. of total operating revenue, which was a key factor contributing to the increase in expenses. Faced with intensified competition, the Group focused on long-term development and expanded network capacity according to forecasts in usage volume growth. With a view to enhancing the competitive advantages of its premium networks, after conducting economic valuation and cost-benefit analyses, the Group constructed certain transmission lines to service high traffic areas and urban areas. More investments were also made in new businesses and support systems to reinforce the Group's leading position and competitive edge in business and services. As a result, depreciation expenses increased at a relatively higher rate. However, substantial savings were achieved in the Group's leased line and interconnection expenses. Efficiencies in operations and management have also

New Business Revenue
(RMB Millions)



Proportion of Operating Expenses in Total Operating Revenue



improved noticeably. The Group currently has significant early-mover advantages in the scale of its networks and management platform, as well as noticeable competitive advantages in its production, service and management capabilities, providing a solid foundation for the Group to adapt to intensified market competition.

With regard to personnel expenses, the Group had a total of 59,633 employees as at 31 December 2002. The Group redoubled its human resources reforms, intensified performance-based evaluations and further enhanced its incentive structure, with a view to retaining and attracting talent. Personnel expenses were 7,501 million in 2002, representing an increase of 9 per cent. over 2001. As a percentage of operating revenue, personnel expenses decreased by 0.2 percentage points from that of 2001 to 5.2 per cent. of 2002. Revenue generated per employee increased from 2.18 million in 2001 to 2.41 million in 2002. The Group's human resources reforms are intended to provide the highest possible level of motivation to our employees, at a reasonable cost, and to consolidate and build upon existing strengths.

Other operating expenses (comprised principally of sales and marketing expenses, bad debts, and administrative and other expenses) increased by 26 per cent. over 2001, accounting for 22.2 per cent. of total operating revenue, and was a key factor contributing to the relatively rapid increase in overall expenses. Despite the intensified competition from CDMA and "Xiaolingtong", the Group resolutely and consistently pursued its sales and marketing strategies and carried out differentiated promotional campaigns and sales services in light of the results obtained through market segmentation studies. Through appropriate increases in related expenditures, the Group remained close to its customers, maintained customer loyalty and raised the level of customer satisfaction; while at the same time the Group maintained its competitiveness and market share in new markets, thereby increasing its competitive advantages and economies of scale. In 2002, the aggregate sales and marketing expenses totaled 13,805 million. These marketing strategies yielded encouraging results for the Group in 2002, driving double-digit growth in operating revenue and a net increase of 27.11 million in new subscribers, with a relatively low churn rate. Average other operating expenses per user per month continued its decline to 25 in 2002, representing a decrease of 11 per cent. from the previous year. In 2002, the Group continued to scrutinize customers' credit and exercise strict control over outstanding accounts, thereby effectively managing bad debt expenses. The bad debt ratio in 2002 was 1.4 per cent., representing a slight decrease from the previous year, and stabilized at a relatively low level. As competition intensifies, sales and marketing expenses are expected to further increase in the future. However, the Group will continue its stringent cost control strategies and its focus on cost effectiveness, while proactively cultivating new customers and providing quality services, in order to obtain the best possible return on expenditures.

EBITDA and Profit Attributable to Shareholders

The Group has consistently endeavored to maintain long-term, sustainable and favourable profit growth. EBITDA margin reached 59.4 per cent.

Through significant efforts to realise subscriber and revenue growth and manage ARPU and expenses at reasonable levels, the Group has continued to realize satisfactory profitability and EBITDA. EBITDA for 2002 was 85,346 million, representing an increase of 17 per cent. over 2001. EBITDA margin was 59.4 per cent., representing an increase of 1.5 percentage points over that of 57.9 per cent. in 2001, and was maintained at a relatively high level in comparison with the Group's international peers. The Group's profit attributable to shareholders in 2002 was 34,116 million, representing an increase of 20 per cent. over 2001. These reflect the Group's effective enhancements to its management of operating expenses, even during times of solid growth in its operating revenue, the realization of the benefits of economies of scale and synergies, as well as the result of continued improvements in the Group's operational efficiency. The Group will continue to focus on developing its core business of mobile telecommunications and will adopt appropriate strategies to manage EBITDA and profit levels, with a view to achieving sustainable and favourable long-term development.

Strong Cash Flow and Sound Capital Structure

Sound business growth, proactive cost control measures and the effective management of capital expenditures led to strong free cash flow. Robust cash generating capability and a sound capital structure supported the Group in capturing business development opportunities, while providing a cash return to shareholders.

The Group's debt to capitalization ratio (capitalization represents the sum of total debts and shareholders' equity) at the end of 2002 was approximately 26.2 per cent., representing an increase of 5.4 percentage points from last year. This reflects the Group's success in maintaining its financial position at a sound level, while optimizing its capital structure, and provided a solid foundation for the continuation of the Group's organic and external development. At the end of 2002, the Group's total cash and bank balances were 43,644 million, of which 90.8 per cent., 7.1 per cent. and 2.1 per cent. were denominated in RMB, US dollars and Hong Kong dollars, respectively.

To further reduce the cost of capital, the Group continued to reinforce its centralized treasury function, making appropriate allocations of the Group's overall capital, thereby enhancing the Group's ability to deploy internal funds with maximum utility. At the end of 2002, the Group's short-term and long-term borrowings totaled 60,980 million, representing an increase of 31,680 million from those at the end of 2001. This increase was mainly due to the adoption of debt financing for payment of a portion of the purchase consideration for the Acquisition and the inclusion of net debts of the eight newly acquired subsidiaries. Of the total borrowings, 56.8 per cent. was in RMB (consisting principally of RMB bonds, bank loans and finance leases) and 43.2 per cent. was in US dollars (consisting principally of US dollar-denominated fixed rate notes and convertible notes and the balance of deferred consideration for the Acquisition). Approximately 59.4 per cent. of the Group's borrowings were made at floating interest rates. The actual average interest rate of borrowings (ratio of interest expenses to the average balance of borrowings, excluding capitalized interest) of the Group in 2002 was maintained at approximately 4 per cent., whereas the actual interest coverage multiple (ratio of profit before interest and tax to interest expenses) was 27 times. This reflects the prudent financial risk management policies consistently adopted by the Group, as well as its solid cash flow and sound repayment capability. In 2002, the Group successfully issued RMB8 billion of corporate bonds. The overwhelming subscription interest reflects that the Group's solid financial capability and strong growth potential are well recognized by the public.

The Group endeavors to maintain strong cash flow generating capability, thereby maximizing its advantages in a scientific manner, ensuring the sustained long-term development of the Group, its ability to undertake investments and acquisition

Financial Review

projects which enhance value, while at the same time providing a cash return to shareholders, with a view to maximizing shareholder value.

Acquisition and Synergies

The Company successfully acquired Anhui Mobile and the other seven mobile telecommunications companies in 2002, and effectively integrated them into the Group, thereby promoting economies of scale and synergies and enhancing growth potential, while broadening markets for the Group's future expansion.

In 2002, the Group completed the Acquisition of Anhui Mobile and the other seven mobile telecommunications companies. Despite the downturn in global capital markets in 2002, the Group completed the Acquisition through carefully structured financing arrangements, which took into account the interests of diverse parties. Upon completion of the Acquisition, the Group reduced its cost of capital and financing risks, and further optimized the Group's capital structure. The eight newly acquired operating subsidiaries achieved remarkable business growth in 2002 and have demonstrated noticeable synergies. The financial performance of these eight subsidiaries continued to improve, surpassing the profit forecast targets as stated in the Company's circular to shareholders dated 27 May 2002 ("Forecasted Targets") and achieving encouraging operating results. By the end of 2002, total subscribers of the eight newly acquired subsidiaries reached 28.68 million, representing an increase of 37 per cent. compared to 2001, the financial year prior to the Acquisition. Operating revenue was 31,504 million, representing a growth of 21 per cent. Net profits reached 6,054 million, representing a growth of 84 per cent. and exceeding the Forecasted Targets by 8 per cent. EBITDA reached 17,191 million, representing an increase of 33 per cent. and exceeding the Forecasted Targets by 7 per cent. The operational efficiency of the newly acquired subsidiaries also experienced significant improvement. The network utilization rate, the labour productivity rate and the EBITDA margin reached 76.8 per cent., 1,495 users per employee and 54.6 per cent., respectively, representing an increase of 12 percentage points, 37 per cent. and 5.2 percentage points, respectively, from the corresponding figures in 2001, the financial year prior to the Acquisition.

The eight newly acquired subsidiaries achieved favourable results and performance, and have made an immediate and positive impact to the Group's earnings per share in 2002. With the inclusion of the new subsidiaries as part of the Group, and given the increasing effect of synergies in management, the Group believes that it can further leverage the benefits of economies of scale to generate favourable returns for shareholders.

The Group will continue to pursue prudent financial policies, strictly control financial risk, improve financial management procedures, maintain debt at a sustainable level, enhance its capital structure, lower the overall cost of capital, broaden revenue sources and reduce expenditures, and reinforce and develop favourable economic efficiency, with a view to generating greater returns for our shareholders.