

INTERIM
REPORT



中国电信
CHINA TELECOM

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

Interim Report
1998

Chairman's Statement

In the first six months of 1998, besides keeping our cellular telecommunications business continuously growing in Guangdong and Zhejiang provinces, China Telecom (Hong Kong) Limited successfully expanded its operations to cover a new province by acquiring Jiangsu Mobile Communication Company Limited ("Jiangsu Mobile").

On 28 April 1998, the Company announced a proposed acquisition of Jiangsu Mobile at a cash consideration of HK\$22.475 billion. This was unanimously approved at the Extraordinary General Meeting of shareholders held on 3 June 1998. Thereafter, Jiangsu Mobile joined China Telecom (Hong Kong) Limited to become a new member of the Group.

As at 30 June 1998, the Group had an aggregate cellular subscriber base of 5.452 million, representing a growth of 27.2% over the proforma combined (*) subscriber base of 4.285 million at the end of 1997. The increase of 1.167 million new subscribers in the first half of the year indicated that the cellular operation of the Group has continued to grow well. Of the aggregate, Guangdong Mobile Communication Company Limited ("Guangdong Mobile") had a cellular subscriber base of 3.034 million, of which new subscribers comprised 532,000, representing an increase of 21.3% over the subscriber base at the end of 1997. Zhejiang Mobile Communication Company Limited ("Zhejiang Mobile") had a subscriber base of 1.223 million, of which new subscribers comprised 320,000, representing an increase of 35.4% over the subscriber base at the end of 1997. Jiangsu Mobile had a subscriber base of 1.195 million, of which new subscribers comprised 315,000, representing an increase of 35.8% over the subscriber base at the end of 1997.

In the first six months of this year, the Group not only achieved impressive increase in cellular subscriber base, but also maintained a high level of actual cellular subscriber usage. In the first six months of 1998, the Group's proforma combined cellular subscriber usage reached a total of 11.51 billion minutes, of which Guangdong Mobile accounted for 6.73 billion minutes; Zhejiang

Mobile accounted for 2.69 billion minutes and Jiangsu Mobile accounted for 2.09 billion minutes. In the first half of 1998, the Group's proforma combined cellular subscriber usage achieved 65.4% of the Group's proforma combined cellular subscriber usage in 1997, which was 17.6 billion minutes. In the first six months of this year, the Group had a proforma combined monthly average usage per subscriber of 394 minutes, representing a decrease from last year's proforma combined average of 433 minutes.

The Company is pleased with the financial performance of the Group in the first six months of 1998. For the six months ended 30 June 1998, the Group's proforma combined turnover reached Rmb13.55 billion, proforma combined net profit after tax reached Rmb3.96 billion and proforma combined earnings per share reached Rmb34 cents.

In addition to expanding cellular subscriber base and increasing cellular subscriber usage, the Group is also endeavouring to improve service quality and provide new value-added services. This year, the Group's digital mobile "Global Access Network" international roaming service was extended to 10 new countries and regions including Russia, Czech, Slovakia, Latvia, Slovenia, Romania, Azerbaijan, Portugal, South Africa and Gibraltar, making roaming coverage available in 32 countries and regions in total. To better cater to our customers' growing needs, the Group has also put new mobile network numbers with the prefixes 135,136 and 137 into use and introduced voice mail value added service.

The Year 2000 Problem has always been a major concern to the management of the Group. As it may affect all time and date-related functions in the Group's telecommunications and computer networks, the Group has already devised a strategy and practical measures to solve the problems. Such strategy and practical measures are now being implemented by the Year 2000 Task Forces of the Group.

Looking into the future, we are confident of the Group's promising prospects. The financial turmoil in Asia has to a certain extent affected China's

(*) Assuming that the existing Group structure had been in place throughout the relevant periods.

economic development. However, China has not changed its basic national policy of focusing on economic development, aggressive pursuit of reform and expanding the opening up. The continuous economic development will demand and urge for rapid development of the telecommunications industry. At present, the cellular penetration rate in China is still low and the demand is strong. This provides us with a huge market and high potential for rapid growth. The Group will continue its efforts to achieve better economic return by deploying advanced management information systems, improving operating efficiency, expediting the development of the huge market in China, and providing high quality telecommunications services to subscribers. Following the successful acquisition of Jiangsu Mobile, the Group will continue to actively explore opportunities for strategic investments in China's telecommunications industry to further expand its businesses on a solid foundation.

Finally, on behalf of the Board of Directors of the Company, I would like to thank our shareholders for their support and confidence. In addition, we would like to take this opportunity to express our sincere thanks to all executives and employees of the Group for their hard work, dedication and contributions to the Group.

Shi Cuiming

Chairman

31 August 1998

Unaudited Group Results

For the six months ended 30 June 1998

The unaudited consolidated results and unaudited proforma combined results of the Group for the six months ended 30 June 1998 are presented as follows:

		Unaudited	
		For the six months ended 30 June 1998 consolidated	For the six months ended 30 June 1998 proforma combined
	Note	Note (1) Rmb'000	Note (1) Rmb'000
Turnover	2		
Usage fees	3	6,838,997	8,159,475
Monthly fees		1,841,264	2,084,570
Connection fees		1,732,618	2,132,559
Others	3	954,261	1,172,890
		<u>11,367,140</u>	<u>13,549,494</u>
Operating expenses			
Leased lines		1,683,252	2,098,307
Interconnection		2,130,654	2,489,311
Depreciation		1,884,730	2,442,146
Personnel		603,669	654,982
Selling, general and administrative and others		<u>1,476,785</u>	<u>1,784,900</u>
		<u>7,779,090</u>	<u>9,469,646</u>
Operating profit		3,588,050	4,079,848
Other income		118,779	116,514
Non-operating income		114,490	117,075
Interest expense		<u>(73,197)</u>	<u>(74,329)</u>
Profit before exceptional item		3,748,122	4,239,108
Exceptional item	4	<u>1,082,712</u>	<u>1,082,712</u>
Profit before tax and minority interests		4,830,834	5,321,820
Income tax	5	<u>(1,357,887)</u>	<u>(1,359,140)</u>
Profit before minority interests		3,472,947	3,962,680
Minority interests		<u>(728)</u>	<u>(728)</u>
Net profit		<u>3,472,219</u>	<u>3,961,952</u>

Earnings per share	6	Rmb 29 cents	
Proforma earnings per share	6	Rmb 34 cents	
EBITDA (Rmb million)	7	5,592	6,639

Notes:

(1) Basis of presentation

The consolidated results of the Group for the six months ended 30 June 1998 include the results of the Company and its subsidiaries in Guangdong and Zhejiang provinces for the six months ended 30 June 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 results of the Group for the six months ended 30 June 1998 only include the results of Jiangsu Mobile for the period from 4 June 1998 to 30 June 1998.

The proforma combined results of the Group for the six months ended 30 June 1998, which are provided for information purpose only, include the results of the subsidiaries for the period from 1 January 1998 to 30 June 1998 on a combined basis as if the current Group structure had been in existence throughout the six months ended 30 June 1998.

Since the Company was incorporated on 3 September 1997, no comparative figures for the corresponding period in 1997 are available.

(2) Turnover

Turnover primarily represents usage fees, monthly fees and connection fees for the use of the Group's cellular telephone networks, net of the People's Republic of China ("PRC") business tax and government surcharges. Business tax and government surcharges are charged at approximately 3.3% of the corresponding revenue.

(3) Usage fees and others

Other operating revenue primarily represents telephone number selection fees, value-added services fees and interconnection income in respect of calls made by other networks' subscribers using the Group's cellular networks.

The Group's usage fees and others for the six months ended 30 June 1998 included Rmb2,773,121,000 interconnection income. The proforma combined amount for the six months ended 30 June 1998 was Rmb3,340,413,000.

(4) Exceptional item

Exceptional item represents interest income of the Company.

(5) Income tax

	Unaudited	
	For the six months ended 30 June 1998 consolidated	For the six months ended 30 June 1998 proforma combined
	Note (1) Rmb'000	Note (1) Rmb'000
Provision for Hong Kong profits tax for the period	3,421	3,421
Provision for PRC income tax on the estimated taxable profits for the period	1,357,497	1,357,497
Deferred tax	<u>(3,031)</u>	<u>(1,778)</u>
	<u>1,357,887</u>	<u>1,359,140</u>

The provision for Hong Kong profits tax is calculated at 16% of the estimated assessable profits for the six months ended 30 June 1998. Pursuant to the income tax rules and regulations of the PRC, the profit of the Group's subsidiaries (except for connection fees and certain surcharges of Jiangsu Mobile) in the PRC are subject to the statutory income tax rate of 33% for the six months ended 30 June 1998. According to a notice from the PRC Ministry of Finance, connection fees and certain surcharges of Jiangsu Mobile are not subject to income tax rate of 33% before it is registered as a wholly foreign-owned enterprise.

(6) Earnings per share

The calculation of earnings per share for the six months ended 30 June 1998 is based on the consolidated net profit of Rmb3,472,219,000 and the weighted average number of 11,780,788,000 shares in issue during the six months ended 30 June 1998.

The calculation of proforma earnings per share for the six months ended 30 June 1998 is based on the proforma combined net profit for the period of Rmb3,961,952,000 and the proforma weighted average number of 11,780,788,000 shares in issue during the period.

(7) EBITDA

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

Transfer To And From Reserves

There were no transfers to or from reserves of the Group during the six months ended 30 June 1998.

Interim Dividend

The Board of Directors of the Company does not recommend the payment of an interim dividend for the six months ended 30 June 1998.

Year 2000 Problem

The Year 2000 Problem has always been a major concern to the management of the Group. This problem will affect time and date related functions in the computer system, such as execution of computer commands, storage of data and compilation of real-time information. If the problem is not resolved, it will affect the normal operations of the Group's telecommunications and computer systems.

We believe that if we can modify or upgrade the time identification sections in the telecommunications network and computer systems and ensure that our telecommunications network works smoothly, and our information management network is protected from the problem, at and beyond Year 2000, then we can say that we are Year 2000 compliant.

The Company's solution to the Year 2000 Problem emphasises that the functions performed by telecommunications and computer networks which are based on time and date should run properly before and after Year 2000. The practical measure is to use a 4 digits decimal system to indicate year. If such a change proves to be difficult, the Group will adopt a transitional method: using digits 80-99 to indicate Years 1980-1999 and 00-30 to indicate Years 2000-2030. It will be made sure that systems using the transitional method and systems using other methods can exchange information correctly. It is also required that Year 2000 be identified as a leap year. Any new equipment to be purchased has to meet the above requirements. Any equipment that does not meet such requirements has to be removed from the network before the end of June 1999.

The Group has set up Year 2000 Task Forces in charge of addressing the Year 2000 Problem. The Company finished assessment of all equipment between April and June 1998. From June to August 1998, negotiations and contract-signing with respective equipment suppliers have been carried out. The implementation of system rectification project started in August 1998 and shall be completed by the end of June 1999. The observation phase will start in July 1999, during which a series of function tests will be carried out on the equipment and operation will be under close scrutiny to ensure that any problem that may occur will be dealt with timely.

Through discussions and negotiations, the Company will sign contracts with the suppliers of its telecommunications and computer equipment. The suppliers will be responsible for upgrading or modifying the necessary components of the equipment. The Group's telecommunications equipment are provided by Motorola, Ericsson and Nokia, and these suppliers have already undertaken that they are capable of and responsible for solving the Year 2000 Problem relating to the Group's telecommunications network. IBM and SUN are the suppliers of the Group's computer equipment. They have also undertaken to solve the Year 2000 Problem relating to the Group's computer equipment. The Group will closely monitor the completion of the rectification and upgrading project to ensure that the Group's telecommunications network and computer system can operate properly by Year 2000.

The Company will issue a separate announcement before 31 December 1998 to disclose information concerning the costs and expenses involved in solving the Year 2000 Problem. As at 30 June 1998, no commitments had been authorised by the Board of Directors of the Company or contracted for in respect of the Year 2000 Problem modification costs.

Directors' Interests In Shares

As at 30 June 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 granted pursuant to the terms of the share option scheme adopted by the Company as follows:

Directors	No. of share options
Shi Cuiming	2,900,000
Chen Zhaobin	2,600,000
Li Ping	2,400,000
Ding Donghua	2,100,000
Lu Errui	1,000,000
Zhu Jianhua	1,000,000

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

Apart from the foregoing, none of the directors had any personal, family, corporate or other interests in the securities of the Company or any of its associated corporations as defined in the Securities (Disclosure of Interests) Ordinance.

Other than the share option scheme adopted by the Company, at no time during the six months ended 30 June 1998 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 30 June 1998 amounting to 10% or more of the ordinary shares in issue:

	Ordinary shares held	Percentage of total issued shares
(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: The register of substantial shareholders indicates that the interest disclosed by CTHK (BVI) includes the 9,010,000,000 shares disclosed by MII, Telpo, DGT and CTHK (Group).

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

Purchase, Sale Or Redemption Of The Company's Listed Securities

During the six months period ended 30 June 1998, neither the Company nor any of its subsidiaries has purchased, sold or redeemed any of the Company's listed securities.

Compliance With The Code Of Best Practice

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

By Order of the Board

Chen Zhaobin Yung Shun Loy Jacky
Joint Company Secretaries

Hong Kong, 31 August 1998

Supplementary Information For North American Shareholders

The above unaudited financial information have been 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 between HK GAAP and US GAAP that affect the Group's results for the six months ended 30 June 1998 are substantially the same as those disclosed in the Company's 1997 annual report. Effect on the Group's unaudited consolidated net profit and unaudited proforma combined net profit of the significant differences between HK GAAP and US GAAP for the six months ended 30 June 1998 are set out below. The US GAAP adjustments shown below have been prepared by management and have not been subject to independent audit.

	Unaudited			
	For the six months ended 30 June 1998 consolidated		For the six months ended 30 June 1998 proforma combined	
	US\$'000	Rmb'000	US\$'000	Rmb'000
Net profit under HK GAAP	419,360	3,472,219	478,508	3,961,952
US GAAP adjustments	<u>46,900</u>	<u>388,323</u>	<u>62,399</u>	<u>516,651</u>
Approximate net profit under US GAAP	<u>466,260</u>	<u>3,860,542</u>	<u>540,907</u>	<u>4,478,603</u>
Approximate basic net profit and basic proforma combined net profit per share in accordance with US GAAP	<u>0.04</u>	<u>0.33</u>	<u>0.05</u>	<u>0.38</u>
Approximate basic net profit and basic proforma combined net profit per ADS in accordance with US GAAP*	<u>0.79</u>	<u>6.55</u>	<u>0.92</u>	<u>7.60</u>
Approximate diluted net profit and diluted proforma combined net profit per share in accordance with US GAAP	<u>0.04</u>	<u>0.33</u>	<u>0.05</u>	<u>0.38</u>
Approximate diluted net profit and diluted proforma combined net profit per ADS in accordance with US GAAP*	<u>0.79</u>	<u>6.55</u>	<u>0.92</u>	<u>7.60</u>

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

Solely for the convenience of the reader, amounts in Renminbi have been translated into United States dollars at the rate of US\$1.00 = Rmb8.2798 quoted by the People's Bank of China on 30 June 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 rate on 30 June 1998 or on any other date.

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