SECURITIES AND EXCHANGE COMMISSION

Washington, DC 20549

FORM 20-F

● REGISTRATION STATEMENT PURSUANT TO SECTION 12(b) OR 12(g) OF THE SECURITIES EXCHANGE ACT OF 1934

OR

● ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the fiscal year ended December 31, 1997

OR

● TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from __________ to __________

Commission file number 1-14696

China Telecom (Hong Kong) Limited
(Exact Name of Registrant as Specified in Its Charter)

Hong Kong, China
(Jurisdiction of Incorporation or Organization)

16th Floor, Dah Sing Financial Centre
108 Gloucester Road, Wanchai
Hong Kong, China
(852) 2877-3332
(Address and Telephone Number of Principal Executive Offices)

Securities registered or to be registered pursuant to Section 12(b) of the Act:

Title of Each Class	Name of Each Exchange on Which Registered
Ordinary Shares, par value HK$0.10 per share	New York Stock Exchange, Inc.*

* Not for trading, but only in connection with the listing on the New York Stock Exchange, Inc. of American Depositary Shares representing the Ordinary Shares.

Securities registered or to be registered pursuant to Section 12(g) of the Act:

None
(Title of Class)

Securities for which there is a reporting obligation pursuant to Section 15(d) of the Act:

None
(Title of Class)

Indicate the number of outstanding shares of each of the issuer's classes of capital or common stock as of the close of the period covered by the annual report.

As of December 31, 1997, 11,780,788,000 Ordinary Shares, par value HK$0.10 per share, were issued and outstanding.

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes ✓ No ___

Indicate by check mark which financial statement item the registrant has elected to follow. Item 17___ Item 18 ✓

TABLE OF CONTENTS

China Telecom (Hong Kong) Limited

CERTAIN DEFINED TERMS AND CONVENTIONS

All references to the "Company" in this Annual Report on Form 20-F (the "Annual Report") are to China Telecom (Hong Kong) Limited, a company incorporated under the laws of Hong Kong on September 3, 1997. All references to the "Group" herein are to China Telecom (Hong Kong) Limited and its subsidiaries, Guangdong Mobile Communication Company Limited ("Guangdong Mobile") and Zhejiang Mobile Communication Company Limited ("Zhejiang Mobile"), or, in respect of references to any time prior to the incorporation of China Telecom (Hong Kong) Limited, the cellular telecommunications businesses in Guangdong and Zhejiang provinces of China which were assumed by China Telecom (Hong Kong) Limited and its subsidiaries pursuant to a restructuring (the "Restructuring") implemented in September 1997, as described herein under "Item 1. Description of Business — History of the Group and Restructuring".

In this Annual Report, references to "China", the "State" or the "PRC" are to the People's Republic of China. Unless otherwise stated, references to and statements regarding China contained in this Annual Report do not apply to Hong Kong, Macau or Taiwan. References to the "Government" are to the government of the People's Republic of China. References to "Hong Kong" are to the Hong Kong Special Administrative Region of the People's Republic of China. References to the "MII" are to the Ministry of Information Industry of the PRC or, in respect of references to any time prior to the establishment of the Ministry of Information Industry, the former Ministry of Posts and Telecommunications (the "MPT"). Pursuant to certain resolutions regarding the reorganization of certain ministries of the Government passed by the Ninth National People's Congress in March 1998, the administrative functions of the MPT were assumed by the MII, which is under the direct leadership of the State Council of the PRC (the "State Council"). See "Recent Developments".

In this Annual Report, references to "US Dollars", "US$" or "$" are to United States dollars, references to "Renminbi" or "RMB" are to Renminbi, the legal tender currency of the PRC and references to "Hong Kong Dollars" or "HK$" are to Hong Kong dollars. References to "Hong Kong GAAP" and to "US GAAP" are to the generally accepted accounting principles in Hong Kong and the United States, respectively. References to "EBITDA" are to earnings before interest income, interest expense, non-operating income (expense), income taxes, depreciation and amortization. The items of net profit excluded from EBITDA are significant components in understanding and assessing the Group's financial performance and the Group's computation of EBITDA may not be comparable to other similarly titled measures of other companies.

The Group publishes its consolidated financial statements in Renminbi. The audited consolidated financial statements (the "Consolidated Financial Statements") included in this Annual Report have been prepared as if the structure of the Group as at December 31, 1997 had been in existence throughout the relevant period. Solely for the convenience of the reader, this Annual Report contains translations of certain Renminbi and Hong Kong Dollar amounts into US Dollars and vice versa at specified rates. These translations should not be construed as representations that the Renminbi or Hong Kong Dollar amounts actually represent such US Dollar amounts or could be converted into US Dollars at the rates indicated or at all. Unless otherwise stated, the translations of Renminbi and Hong Kong Dollars into US Dollars and vice versa have been made at the rate of RMB 8.3100 to US$1.00 and HK$7.7495 to US$1.00, respectively, the noon buying rates in New York City for cable transfers in Renminbi and Hong Kong Dollars, respectively, as certified for customs purposes by the Federal Reserve Bank of New York (the "Noon Buying Rates") on December 31, 1997. See "Item 8. Selected Financial Data—Exchange Rate Information" for information regarding the Noon Buying Rates from January 1, 1993 through December 31, 1997. On June 15, 1998, the Noon Buying Rates for Renminbi and Hong Kong Dollars were RMB 8.3100 to US$1.00 and HK$7.7442 to US$1.00, respectively. Any discrepancies in any table between totals and sums of amounts listed therein are due to rounding.

The statistics set forth in this Annual Report relating to the PRC are taken or derived from various Government publications which have not been prepared or independently verified by the Company. Such statistics may not be consistent with other statistics compiled within or outside the PRC.

FORWARD-LOOKING STATEMENTS

This Annual Report contains certain forward-looking statements that are, by their nature, subject to significant risks and uncertainties. Such forward-looking statements include, without limitation, statements relating to the Group's business strategy, network expansion plans, including proposed capital investments relating thereto, the planned development of DCS 1800 systems, the expected impact of the Acquisition (as defined herein) on the Group's results of operations, the expected impact of the Year 2000 problem on the Group's operations, and other statements relating to the future business development and economic performance of the Group. The words "anticipate", "believe", "estimate", "expect", "intend" and similar expressions, as they relate to the Group, are intended to identify certain of such forward-looking statements.

Such forward-looking statements reflect the current views of the Group with respect to future events. Actual results may differ materially from information contained in the forward-looking statements as a result of a number of factors, including, without limitation: any changes in regulatory policies of the MII and other relevant Government authorities, which could affect, among other things, the granting of any requisite Government approvals, interconnection and transmission line arrangements, tariff policy, capital investment priorities and spectrum allocation, the effects of competition on the demand for and price of the Group's cellular services, any changes in cellular and related technology, which could affect the viability and competitiveness of cellular networks of the Group, and changes in political, economic, legal and social conditions in China including the Chinese government's specific policies with respect to economic growth, inflation, foreign exchange, and the availability of credit. In addition, the Group's future network expansion and other capital expenditure and development plans are dependent on numerous factors, including the availability of adequate financing on acceptable terms, the adequacy of currently available spectrum or the availability of additional spectrum, the availability of the requisite number of sites for locating network equipment on reasonable commercial terms, the availability of transmission lines and equipment when required, and the availability of qualified management and technical personnel.

RECENT DEVELOPMENTS

At the first session of the Ninth National People's Congress in March 1998, a motion was passed to implement the restructuring of Government bodies. The MII was established to assume all the Government functions of the former MPT. The Group believes that this institutional reform, which created a demarcation between Government and enterprise functions, will help to establish a fairer and a more orderly competitive environment, and that it will not only be beneficial to the overall development of the telecommunications industry in China, but will also contribute towards improving the management, operations and service quality of the Group. The MII has become the Company's ultimate controlling shareholder, and the Group has received reassurance that the MII will assume all undertakings given by the former MPT at the time of the Company's initial public offering. See "Item 1. Description of Business", "Item 4. Control of Registrant" and "Item 13. Interest of Management in Certain Transactions".

On April 28, 1998, the Company entered into a conditional acquisition agreement with its controlling shareholder, China Telecom Hong Kong (BVI) Limited, to acquire the entire interest of China Telecom Jiangsu Mobile (BVI) Limited ("Jiangsu Mobile BVI") at a cash consideration of HK$22,475 million (US$2,900 million) (the "Acquisition"). The Acquisition was completed on June 4, 1998. Jiangsu Mobile BVI is a holding company holding the entire interest in Jiangsu Mobile Communication Co. Ltd. ("Jiangsu Mobile"), the dominant provider of cellular telecommunications in Jiangsu province. The Group expects that the Acquisition will have a material impact on the Group's overall results of operations. See "Item 1. Description of Business — Recent Developments" and "Item 9. Management's Discussion and Analysis of Financial Condition and Results of Operations — Acquisition of Jiangsu Mobile".

GLOSSARY

In this Annual Report, unless the context otherwise requires, the following terms have the respective meanings set out below.

analog	Communications by transmission of continuously varying representations of the input signal, as compared to binary coding in digital transmission.
base station controller	Equipment that monitors and controls one or more base stations (message exchange and frequency administration).
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 center.
CDMA	Code Division Multiple Access technology, which is a continuous digital transmission technology that accommodates higher throughput by using various coding sequences to mix and separate voice and data signals for wireless communication.
cell	Coverage area of the whole or part of a base station.
cell site	The entire infrastructure and radio equipment associated with a cellular transmitting and receiving station, including the land, building, tower, antennas, and electrical equipment.
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	Subscriber disconnections for a given period, determined by dividing the sum of voluntary and involuntary deactivations during the period by the average number of subscribers for the same period.
cloning	Communications from unauthorized handsets.
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).
DDD	Domestic Direct Dialing, the capability to directly dial domestic long distance calls from one's own telephone.

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.
dual band handset	A mobile or portable telephone which is capable of operating in two different frequency bands (such as that proposed for GSM-900 and DCS-1800).
frequency	The number of cycles per second, measured in hertz, of a periodic oscillation or wave in radio propagation.
GSM	Global System for Mobile Communications, 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).
GSM-900	A GSM network in the 900 MHz frequency range.
IDD	International Direct Dialing, the capability to directly dial telephones in foreign countries from one's own telephone.
interconnect	Any variety of hardware arrangements that permit 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 center	A central switching point to which each call is connected, which controls the routing of calls. A mobile switching center 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	Number of subscribers per 100 of population.
penetration rate	Total market subscribers divided by population of the service area.

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.
spectrum	The range of electromagnetic frequencies available for use.
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 Systems, a European standard for analog mobile telephone transmissions in the 800 and 900 MHz frequency bands.
transmission line	Dedicated telecommunications transmission line linking one fixed point to another.

PART I

Item 1. Description of Business.

The Group is the dominant provider of cellular telecommunications services in Guangdong and Zhejiang provinces in China. Guangdong and Zhejiang are among China's most economically developed provinces and, as of December 31, 1997, were the two provinces in China with the largest number of cellular subscribers. As of such date, the Group serviced an aggregate subscriber base of approximately 3.4 million, which accounted for an estimated 97.6% of cellular subscribers in these provinces and an estimated 26.0% of all cellular subscribers in China at such date. In 1997, the Group had operating revenue of RMB 15,487.8 million (US$1,863.8 million), EBITDA of RMB 8,179.7 million (US$984.3 million), net profit of RMB 4,955.4 million (US$596.3 million) and cash flows from operating activities of RMB 8,825.5 million (US$1,062.0 million). See "Item 9. Management's Discussion of Financial Condition and Results of Operations".

The Group believes that the cellular telecommunications industry in China is undergoing a period of rapid development and has potential for substantial future growth. The Group's principal objective is to become a world-class telecommunications company by taking advantage of its dominant position in its existing markets to strengthen its competitive advantages, and by adopting international best practice management methods to increase its subscriber base and subscriber usage and to improve profitability. In order to achieve such objectives, the Group's business strategy emphasizes external growth through continuing efforts to explore opportunities for the acquisition of cellular and other telecommunications businesses in China, as well as internal growth through continuing expansion of its network capacity and coverage, enhancement of network quality and service features, increased focus on marketing and distribution, and careful control of operating costs and management of revenue.

History of the Group and Restructuring

Prior to the Restructuring, the Group's TACS and GSM cellular networks in Guangdong were owned by Guangdong Mobile, a state-owned enterprise formed in September 1988. Prior to the Restructuring, the Group's GSM cellular network in Zhejiang was owned by Zhejiang Mobile, a limited liability company formed in February 1996 and 98.55% owned by the Zhejiang Posts and Telecommunications Administration ("PTA"), and the Group's TACS cellular network in Zhejiang was owned by the Zhejiang PTA.

Pursuant to the Restructuring, the Company was incorporated under the laws of Hong Kong on September 3, 1997. The TACS network owned by the Zhejiang PTA was transferred to Zhejiang Mobile, and 99.63% of the equity interest in Zhejiang Mobile was then transferred to the MII, which, in turn, transferred its 100% equity interest in Guangdong Mobile and 99.63% equity interest in Zhejiang Mobile to the Company. Following such transfer, Guangdong Mobile was transformed into a wholly-owned foreign enterprise and Zhejiang Mobile was transformed into a Sino-foreign joint venture. In addition, certain personnel previously employed by the Posts and Telecommunications Bureaus ("PTBs") in Guangdong and Zhejiang were transferred to Guangdong Mobile and Zhejiang Mobile, respectively, and the Group entered into various services agreements and certain other agreements with the Directorate General of Telecommunications (the "DGT"), a State-owned enterprise established by and under the control of the MII, and the relevant PTAs. See "Item 13. Interest of Management in Certain Transactions". The MII, the DGT, the PTAs and the PTBs are collectively referred to herein as the "Posts and Telecommunications System" or the "PT System".

Operations

The Group offers cellular telecommunications services in each of Guangdong and Zhejiang using TACS and GSM technologies. The Group's cellular telephone networks reach all cities and counties in such provinces.

Subscribers and Usage

The Group had a total of approximately 3.4 million cellular subscribers as of December 31, 1997. The Group's subscriber base has grown substantially over the three years ended December 31, 1997. In Guangdong, the number of the Group's subscribers grew from approximately 1.01 million at the end of 1995 to approximately 2.5 million at the end of 1997, representing a compound annual growth rate of approximately 57.5%. As of December 31, 1997, the Group's subscribers in Guangdong accounted for approximately 19.1% of all cellular subscribers in China. In Zhejiang, the Group's subscriber base grew from approximately 248,000 at the end of 1995 to approximately 903,000 by the end of 1997, representing a compound annual growth rate of approximately 90.8%. As of December 31, 1997, the Group's subscribers in Zhejiang accounted for approximately 6.9% of all cellular subscribers in China. The Group believes that its subscriber growth has been attributable to numerous factors, including significant economic growth in Guangdong and Zhejiang, expansion in the coverage of the Group's networks, increases in the number of fixed lines in China, decreased cost of initiating service due to a general decline in handset prices and the Group's connection fees and enhanced roaming capabilities and value added services.

The following table sets forth selected historical information about the Group's cellular subscriber base for the periods indicated:

	As of or for the year ended December 31,		
	1995	**1996**	**1997**
Subscribers (in thousands)			
Guangdong	1,008	1,568	2,502
Zhejiang	248	475	903
Total	1,256	2,043	3,405
Penetration (%)(1)			
Guangdong	1.48	2.27	3.57
Zhejiang	0.57	1.08	2.04
Average churn rate (%)(2)			
Guangdong	0.3	0.8	1.2
Zhejiang	2.2	2.9	2.9

(1) Penetration in a province is determined by dividing the Group's subscribers in such province by the total population of such province.

(2) Rate of subscriber disconnections from cellular telephone service, determined by dividing the sum of voluntary and involuntary deactivations (excluding deactivations due to subscribers switching from the Group's TACS networks to the Group's GSM networks) during the period by the average of the number of subscribers on the first and last days of the period.

Cellular telecommunications services became commercially available in Guangdong and Zhejiang in November 1987 and May 1992, respectively. Initially, the Group's subscriber base consisted primarily of senior managers of state-owned enterprises, high-level government officials and individual entrepreneurs and managers of large private enterprises. The size and composition of the subscriber base and subscribers' usage patterns have evolved over the last few years. As the price of handsets and connection fees has decreased and cellular technology has improved, cellular services have become more popular with the broader middle income market, including technical professionals, mid-level managers of private and state-owned enterprises, and individuals who subscribe to cellular services largely for social rather than business purposes. Such subscribers generally incur lower average monthly usage and are generally more price-sensitive. Accordingly, as is typical in many countries with developing cellular markets, the average usage and revenue per subscriber have declined over the last few years as the Group's cellular telephone penetration has increased. See "— Tariffs". Notwithstanding such declines, the Group has experienced a compound annual growth rate in total subscriber usage minutes of 57.6% from approximately 5,800 million minutes in 1995 to approximately 14,400 million minutes in 1997.

The following table sets forth selected historical information about the Group's cellular subscriber usage for the periods indicated:

	Year ended December 31,		
	1995	**1996**	**1997**
Minutes of usage (in millions)			
Guangdong	4,791	7,698	10,700
Zhejiang	1,008	2,344	3,700
Average minutes of usage per subscriber per month(1)			
Guangdong	535	498	438
Zhejiang	494	540	448
Average revenue per subscriber per month (RMB)(2)			
Guangdong	648	499	454
Zhejiang	880	613	534

(1) Average minutes of usage per subscriber per month is calculated by (i) dividing the total billable minutes of usage during such period by the average number of subscribers during such period (calculated as the average of the period-beginning and period-end number of subscribers) and (ii) dividing the result by the number of months in the relevant period.

(2) Average revenue per subscriber per month is calculated by (i) dividing the operating revenue during such period by the average number of subscribers during such period (calculated as the average of the period-beginning and period-end number of subscribers) and (ii) dividing the result by the number of months in the relevant period.

Tariffs

The tariffs payable by the Group's subscribers are primarily connection fees, monthly fees, monthly service fees for value added services, and usage charges for both incoming and outgoing calls (with respect to both local and roaming services), including, where applicable, an additional component reflecting domestic and international long distance tariffs set by the MII and the State Planning Commission (the “SPC”). Subscribers also pay fees for selection of specific telephone numbers.

On initial subscription, the Group's new subscribers are charged a connection fee for service activation. After initial connection, subscribers are required to pay a fixed monthly fee, currently RMB 100 in Guangdong and RMB 62.50 in Zhejiang. Subscribers are not entitled to any "free minutes" of usage.

Subscribers incur base usage charges on a per minute basis for both incoming and outgoing calls, currently RMB 0.50 per minute for calls made or received by a subscriber within the subscriber's local service area, plus applicable long distance charges. For calls made or received by subscribers who are roaming outside of the province, subscribers incur base usage charges of RMB 0.60 per minute, except for intra-provincial roaming in Guangdong, which is currently charged at RMB 0.50 per minute (plus applicable long distance charges). The Group's base usage charges currently do not vary between peak and non-peak hours and are the same for TACS and GSM services.

The following table summarizes the Group's various charges for cellular services as of December 31, 1997:

	Guangdong	Zhejiang
	(RMB)	**(RMB)**
Connection fee	3,000	2,000-3,000
Monthly fee	100	62.50(1)
Base usage charge (per minute)	0.50(2)	0.50(3)
Domestic roaming charge (per minute)	0.60(4)	0.60
Monthly charges for selected value-added services		
Caller identification	6.00	10.00
Call forwarding	10.00	10.00
Call waiting and holding	—(5)	10.00
Conference call	—(5)	10.00
Call limitation	12.00	10.00

(1) Includes a surcharge of RMB 12.50 per month.
(2) Guangdong Mobile imposes an additional local network service charge of RMB 0.40 per minute for all intra-regional calls in Guangdong, of which Guangdong Mobile retains RMB 0.30 per minute and pays to the Guangdong PTA RMB 0.10 per minute.
(3) Includes a surcharge of RMB 0.10 per minute.
(4) Except for intra-provincial roaming, which is currently charged at RMB 0.50 per minute (plus the applicable long distance charges).
(5) As of December 31, 1997, both call waiting and conference call services were free of charge. Commencing in 1998, RMB 12.00 per month is being charged for conference calls.

The Group's tariffs are subject to regulation by various Government authorities, including the SPC, the MII, the relevant provincial Price Bureaus and the relevant PTAs. The connection fee is based on a guidance price range set jointly by the MII and the SPC and applicable to all cellular operators in the same province with the actual tariff determined by the relevant provincial PTAs in consultation with the relevant Price Bureaus. In general, base usage charges and domestic roaming charges are determined jointly by the MII and the SPC. See "—Regulation — Tariff Setting and Price Controls". In connection with the Company’s initial public offering, the MII has confirmed that the Group's tariffs conform to such specified prices or price range, with deviations approved by the relevant Government authorities. To continue to attract cellular phone users and broaden its customer base, and in line with the MII guidance price, the Group has lowered its connection fees in both Guangdong and Zhejiang provinces in 1998.

Interconnection Revenue and Costs

The Group's networks interconnect with the PT System's PSTN, allowing the Group's subscribers to communicate with fixed line subscribers and subscribers to other cellular networks and to make and receive domestic and international long distance calls. The Group receives from the Guangdong PTA and the Zhejiang PTA fees for incoming calls that involve interconnection with the PSTN. The Group pays to the Guangdong PTA and the Zhejiang PTA fees for outgoing calls that involve interconnection with the PSTN. A majority of all calls on the Group's Guangdong and Zhejiang networks involve interconnection with the PSTN, including certain calls made between cellular subscribers of the Group and other cellular operators.

Prior to the Restructuring, an interconnection arrangement existed between Zhejiang Mobile and the Zhejiang PTA with respect to GSM network in Zhejiang. However, no formal interconnection arrangements existed for the Group's TACS and GSM networks in Guangdong or for the Group's TACS network in Zhejiang. In September 1997, Guangdong Mobile and Zhejiang Mobile entered into interconnection agreements with the Guangdong PTA and the Zhejiang PTA, respectively, each for a term of one year from October 20, 1997.

Under such agreements, with respect to incoming local calls originating on the fixed line public network and terminating on the Group's networks, the Group receives from the relevant PTA, in addition to the cellular usage fee it collects from its subscriber receiving the call, 10% of the PTA's fixed line PSTN tariff. With respect to outgoing local calls originating on the Group's networks and terminating on the public fixed line network, the Group collects the cellular usage fee from the subscriber making the call and pays to the relevant PTA 80% of the PTA's fixed line PSTN tariff.

With respect to long distance calls made by the Group's subscribers, the Group collects from its subscribers the applicable fixed line long distance PSTN tariffs, and pays a portion (in the case of domestic long distance calls) or the full amount (in the case of international long distance calls) of such revenues to the relevant PTA. The rates at which the Group makes such payments to the relevant PTA are applicable to all cellular operators. With respect to long distance calls made to the Group's subscribers by fixed line subscribers or subscribers to other cellular networks, the Group receives from the relevant PTA a portion of the applicable fixed line PSTN tariffs collected by the PTA from the callers. Settlement of interconnection payments between the Group and the relevant PTAs is made on a monthly basis.

The Group's subscribers can also make calls to and receive calls from subscribers of China Unicom Telecommunications Incorporated ("Unicom") through interconnection with the PSTN. Interconnection revenue and cost sharing arrangements between the Group and the relevant PTAs with respect to such calls are calculated on the same basis as calls between the Group's subscribers and users of the PT System's PSTN.

Roaming Services

The Group offers automatic roaming services to its subscribers, which permit its subscribers to make and receive telephone calls while they are outside of their local service area including while in the coverage area of other cellular networks with which the user's home system has a roaming arrangement. Both the Group's TACS and GSM networks in Guangdong and Zhejiang offer roaming services throughout China (except Ningxia in the case of the TACS networks). In addition, the Group's GSM networks offer roaming in 22 countries and regions, including Singapore, Malaysia, Indonesia, Germany, France, the United Kingdom, Australia, Hong Kong, Taiwan and Macau. The scope of international roaming is determined by applicable agreements between the DGT, on behalf of the Group and other cellular service providers within the PT System, and international cellular operators.

A cellular telephone customer using roaming services is charged at the Group's roaming usage rate for both incoming and outgoing calls, plus applicable long distance charges. See "— Tariffs". Under current MII regulations, the Group is entitled to 20% of the roaming usage revenues generated by its subscribers for roaming in another operator's service area in China, with the balance paid to the local cellular system operator in whose coverage area the roaming customers make or receive the call. Conversely, the Group is entitled to 80% of the roaming usage revenues charged by other Chinese cellular operators from customers who roam within the Group's coverage area. With respect to roaming in Hong Kong, Taiwan and Macau and international roaming, the Group shares roaming revenues with other cellular operators in accordance with the applicable roaming agreements entered into between the DGT and such operators. All payments relating to roaming are settled by the Group through the DGT.

Value Added Service Features

The Group offers a number of optional value added services to its subscribers. Such services include call forwarding, call waiting, conference calling and call limitation (which allows a subscriber to limit calls made or received). Certain advanced functions, such as caller identification, BPS data transfer (which allows a user to dial into modem access using a cellular handset) and facsimile transmissions, are also available on the Group's GSM networks. The Group has also introduced stored value cards and public mobile phone cards for users with an intermittent need for cellular telecommunications. The Group intends to expand its range of value added services, which it believes can be achieved with modest expenditures. The Group intends to concurrently educate its subscribers about the benefits of value added services through enhanced marketing and promotional efforts, as the Group believes that the extent to which it will expand its value added service features depends more on customer awareness and demand than on technical capabilities of its networks.

Customer Service and Billing

The Group provides a full range of services that emphasize customer care from the point of sale onward. At the point of sale, after all application procedures have been completed, the Group is generally able to activate new subscriber connections within a few hours for its GSM services and within 24 hours for its TACS services. The Group's after-sales customer support services include customer service hotlines in the Group's service areas in Guangdong and Zhejiang. Such hotlines provide customers with billing and service information, as well as receive customer reports of network problems. In addition, 30 of the Group's 85 retail outlets in Guangdong and all of the Group's 73 retail outlets in Zhejiang provide customers with handset repair services.

Generally, the Group has the same settlement policy for its subscribers in Guangdong and Zhejiang, requiring such subscribers to settle their individual accounts on a monthly basis. Subscribers may make payment either through direct debit accounts established at certain branches of banks and certain post offices, or by paying in person at retail outlets owned and operated by the Group, or at retail outlets owned and operated by the PTBs in each city and county. In Guangdong, a subscriber can also pay in person at outlets operated by any of the Group's authorized dealers within the PT System. Detailed statements are made available upon the subscriber's request. The Group is currently developing pre-paid SIM cards designed to make payment more convenient for its customers, and at the same time, to minimize bad debt.

The Group imposes a late payment fee on each subscriber whose account is not paid by the monthly due date. The Group's current policy is to deactivate the subscriber's services (i.e. an involuntary deactivation) if such subscriber's account remains overdue after 30 days. Subscribers whose services have been involuntarily deactivated must pay all overdue amounts, including applicable late payment fees, to reactivate services. The Group does not require subscribers to post any deposit before the initiation of service. Despite the lack of widely available credit information services in China, the Group has implemented certain subscriber registration procedures, such as identity checking and background checking for corporate customers, to assist in credit control. The Group provides for all accounts overdue for 90 days. The total amount of the provision for doubtful accounts for each of the three years ended December 31, 1995, 1996 and 1997 was RMB 59.2 million, RMB 227.4 million and RMB 449.1 million, respectively, or 0.8%, 2.2% and 2.9% of total operating revenue, respectively.

Information Systems

The Group’s information technology infrastructure consists primarily of three computerized information systems: the business operations support system (“BOSS”), the management information system (“MIS”), and the Group’s internal business communications network. The BOSS is the Group’s principal cellular network operations management system, and produces data so that technical staff can monitor call traffic, engage in troubleshooting and adjust operations to address congestion and network equipment difficulties on a timely basis. The Group's MIS collects data, including from BOSS, so that management and marketing personnel can monitor subscriber satisfaction, analyze trends in calling patterns, target network expansion and develop appropriate marketing strategies. The MIS also includes subscriber registration and account systems that provide the Group’s customer service personnel with on-line access to network data in order that they can effectively address customer inquiries, including through the Group’s customer service hotlines. The Group's MIS for its TACS and GSM networks in Guangdong and its GSM network in Zhejiang is currently centralized, while the MIS for its TACS network in Zhejiang is currently operated as 11 separate local systems by PTBs, with information compiled on a regional basis within the province. The Group is currently in the process of centralizing and upgrading this system, with the goal of improving efficiencies in data collection and customer service.

In order to safeguard against any risks associated with the “Year 2000 problem”, the Group is currently examining its information systems and, where appropriate, upgrading or modifying such systems. See “Item 9.

Management's Discussion and Analysis of Financial Condition and Results of Operations — Year 2000 Compliance".

Service Distribution and Marketing

As the first commercial cellular network operator in Guangdong and Zhejiang and the only commercial operator in such provinces before July 1995 and March 1997, respectively, the Group maintained a low level of marketing and advertising expenses. Since early 1997, however, the Group has significantly expanded its marketing and distribution efforts to attract a growing number and increasingly diverse base of potential subscribers, and expects that marketing and advertising expenses will increase in the future as the Group continues to expand its marketing and distribution efforts. The Group's marketing strategies focus on expanding its distribution network, and emphasizing the wide coverage of its networks, customer service and the development of its brand name image.

Distribution Channels. The Group markets its cellular services through a wide network of authorized dealers and through its own retail outlets. As of December 31, 1997, the Group had 737 authorized dealers in Guangdong and 399 authorized dealers in Zhejiang, consisting of 536 and 263 dealers in Guangdong and Zhejiang, respectively, that are owned and operated by various entities within the PT System, and 201 and 136 dealers in Guangdong and Zhejiang, respectively, that are unaffiliated with the PT System. Many of the Group's authorized dealers are telecommunications retail outlets and post offices within the PT System that offer such other services as the sale of handsets and paging services. In addition to marketing the Group's services, such dealers also perform various services for the Group, such as payment collection and the provision of billing information and other customer services. As part of the Restructuring, the Group entered into various distribution and marketing agreements, typically for terms of one year, that prohibit its authorized dealers from acting as distributors for other cellular network operators. The authorized dealers market and sell the Group's cellular services in Guangdong and Zhejiang at prices determined by the relevant PTAs. In connection with such sales, such dealers pay to the Group in advance all related connection fees and other miscellaneous fees payable upon initial connection. The Group in turn pays such dealers RMB 300 per new subscriber acquired. The commission structure has been determined taking into account factors such as the results of market research and the revenues and costs of the products and is the same for all dealers whether or not they are affiliated with the PT System. The Group offers training to the sales employees of its dealers and its own sales force with respect to the Group's system, products and services so that such sales employees and agents, in turn, can provide information to current and prospective customers.

The Group also owns and operates 85 retail outlets in Guangdong and 73 retail outlets in Zhejiang. In addition to serving as outlets where customers can subscribe for the Group's network services, certain of such outlets also sell handsets and most offer customers after-sales support services, including the repair of handsets and collection of payment. The Group is seeking to develop other distribution channels in order to further strengthen its marketing efforts.

The Group has established an additional channel for the distribution of its cellular services through certain distribution agreements entered into by Guangdong Mobile between August 1996 and June 1997 with certain distributors of telecommunications services (the "Resellers"). Pursuant to such agreements, Guangdong Mobile has agreed to allocate up to an aggregate of 250,000 cellular numbers for its GSM network to such distributors, who will act as resellers of Guangdong Mobile's cellular services. As of December 31, 1997, agreements with seven Resellers independent from the Company were in effect. The Resellers are required to comply with the marketing and tariff guidelines established by Guangdong Mobile. As of December 31, 1997, a total of 158,041 numbers had been allocated to and paid for by the Resellers.

Brand Name. As the first and the dominant cellular telephone services provider in its markets, the Group believes it is well positioned to develop the image of its brand name. Pursuant to a non-exclusive license agreement with the DGT, the Group markets its services under the "China Telecom" logo, which is a registered trademark owned by the DGT. "China Telecom" is the marketing name used throughout China by all telecommunications services providers within the PT System, including the Guangdong PTA and the Zhejiang PTA. The term of the license agreement is six years from October 20, 1997 or such period that the DGT has ownership of the trademark, whichever period is longer. No license fee is payable by the Group for the first three years and the fees payable thereafter, if any, shall be no less favorable than fees paid by other entities within the PT System for the use of such trademark logo. The

DGT may license the trademark to other parties but may not unilaterally terminate the license agreement. The Group intends to invest in a combination of television, radio, newspaper and billboard advertising and promotional programs that emphasize the Group's wide network coverage, range of available service features, and quality customer services.

Cellular Networks

Each of the Group's GSM networks consists of (i) cell sites, which are physical locations equipped with a base transceiver station containing transmitters, receivers and other equipment that communicate through radio channels with cellular telephone handsets within the range of a cell, (ii) base station controllers, which connect to, and control, the base transceiver station within each cell, (iii) mobile switching centers, which in turn control the base station controllers and the routing of calls, and (iv) leased transmission lines, which link the mobile switching centers, base station controllers, base transceiver stations and the PT System's PSTN. The Group's TACS networks are identical to its GSM networks in terms of network infrastructure, except that the TACS networks do not employ base station controllers. Instead, base transceiver stations are controlled by, and communicate directly with, the mobile switching centers.

Historical Development

Guangdong. The Group commenced offering cellular telephone services in Guangdong with the establishment of a TACS network in November 1987. The capacity of the TACS network expanded to approximately 30,000 subscribers by the end of 1991 and to approximately 1.2 million subscribers by December 31, 1997. In July 1995, the Group launched its GSM cellular network in larger cities in the province, including Guangzhou, Shenzhen and Zhuhai. The Group’s TACS and GSM networks currently provide coverage in all cities and counties in the province, as well as major provincial highways, and certain mountainous regions. By December 31, 1997, the GSM network had reached a capacity of approximately 2.5 million subscribers.

The following table sets forth certain selected information regarding the Group's TACS and GSM networks in Guangdong for the periods indicated:

	As of December 31,		
	1995	1996	1997
Subscribers (in thousands)			
TACS	944	1,140	1,072
GSM	64	428	1,430
Total	1,008	1,568	2,502
Subscriber capacity (in thousands)			
TACS	1,180	1,340	1,190
GSM	250	1,230	2,490
Total	1,430	2,570	3,680
Mobile switching centers			
TACS	25	26	26
GSM	12	15	34
Total	37	41	60
Base station controllers*			
GSM	17	26	53
Base transceiver stations			
TACS	840	1,127	1,139
GSM	692	1,101	1,751
Total	1,532	2,228	2,890

* In a TACS system, the base transceiver stations are connected directly to the mobile switching centers. Accordingly, the Group's TACS networks do not utilize any base station controllers.

Zhejiang. The Group launched cellular telephone services in Zhejiang in May 1992 with the installation of a TACS system. The Zhejiang TACS network presently covers all cities and counties in the province, with total capacity reaching approximately 650,000 subscribers as of December 31, 1997. In December 1995, the Group launched full scale commercial operation of the GSM network, expanding its coverage to include Hangzhou, the provincial capital, and other cities and counties. The Zhejiang GSM network reached a capacity of approximately 1,250,000 subscribers by December 31, 1997.

The following table sets forth certain selected information regarding the Group's TACS and GSM cellular networks in Zhejiang for the periods indicated:

	As of December 31,		
	1995	1996	1997
Subscribers (in thousands)			
TACS	248	376	447
GSM	0.2	99	456
Total	248	475	903
Subscriber capacity (in thousands)			
TACS	358	472	650
GSM	57	230	1,250
Total	415	702	1,900
Mobile switching centers			
TACS	20	23	25
GSM	3	6	13
Total	23	29	38
Base station controllers*			
GSM	5	36	73
Total	5	36	73
Base transceiver stations			
TACS	383	626	656
GSM	77	363	1,434
Total	460	989	2,090

* In a TACS system, the base transceiver stations are connected directly to the mobile switching centers. Accordingly, the Group's TACS networks do not utilize any base station controllers.

Transmission Infrastructure

The physical infrastructure linking the Group's base transceiver stations, base station controllers and mobile switching centers and interconnecting the Group's networks to the PSTN consists of transmission lines, which provide the backbone infrastructure by which cellular call traffic is carried. The Group currently leases transmission lines from the Guangdong PTA and the Zhejiang PTA, and pays the relevant PTA a fee based on tariff schedules stipulated by the MII. See "Item 13. Interest of Management in Certain Transactions". The Group is also capable of developing its own transmission infrastructure, and, when necessary, may build its own lines in certain areas where the PTAs do not currently have any transmission lines in place. See "— Network Capacity Expansion Plans".

Network Operations and Maintenance

The Group believes that it has acquired considerable experience and technical expertise in developing and operating the first cellular telecommunications networks in Guangdong and Zhejiang. As of December 31, 1997, the Group employed approximately 2,900 and 700 engineers and technicians in Guangdong and Zhejiang, respectively, who are responsible for day-to-day traffic management, troubleshooting and system maintenance. Technical staff are available for emergency repair work 24 hours a day. In addition, the Group employs specialist teams of 46 and 28 persons in Guangdong and Zhejiang, respectively, which are primarily responsible for central maintenance of the networks. The Group continues to seek to attract and retain qualified technical staff. Currently, most technical difficulties relating to the networks are resolved by the Group's staff, although the Group's equipment suppliers also provide back-up maintenance and technical support. The Group maintains stocks of certain spare parts, such as circuit boards and antennae, and believes that it would be able to obtain suitable replacements for parts which it does not stock in a timely and commercially reasonable manner. In addition, the Group compiles and analyzes information relating to the amount of usage and the volume of blocked calls and dropped calls on a weekly basis in Zhejiang and on a monthly basis in Guangdong. To date, the Group has not experienced any technical difficulties which have resulted in a material interruption in cellular network services.

Network Capacity Expansion Plans

The Group intends to continue its network development in Guangdong and Zhejiang, with an emphasis on increasing the coverage and capacity of its GSM networks, and improving the operating efficiency of its TACS networks. The Group plans to expand its Guangdong GSM services to reach a capacity of approximately 6.5 million subscribers by the end of 2000, bringing the total capacity of its Guangdong TACS and GSM networks to approximately 7.5 million subscribers. The Group also plans to expand the Zhejiang GSM network to reach a capacity of approximately 2.4 million subscribers by 2000, bringing the total capacity of its Zhejiang TACS and GSM networks to approximately 3.2 million subscribers. The timing and extent of building such infrastructure will depend on factors such as the Group's business demands for coverage and the relevant PTA's transmission infrastructure development plans.

The Group intends to achieve its planned capacity expansion by adding cell sites in areas already within its network coverage and by expanding coverage, including expanding coverage along railways and highways and improving indoor coverage. The Group's network expansion plans depend to a large extent upon the availability of sufficient spectrum. As GSM networks offer greater capacity given the same spectrum bandwidth, the Group may, from time to time, reallocate part of its allotted spectrum from its TACS networks to its GSM networks to accommodate capacity expansion requirements. In addition, in order to alleviate moderate congestion that has developed in certain major urban centers with a high density of cellular subscribers, the Group also plans to introduce GSM-compatible DCS 1800 systems to add capacity in such areas.

To complete the Group's planned expansion in capacity and coverage, the Group currently estimates that required capital expenditures from 1998 through the end of 2000 will amount to approximately US$1,591 million for Guangdong and approximately US$735 million for Zhejiang. The actual rate of network expansion in Guangdong and Zhejiang, however, will depend upon an increase in subscriber demand and the Group's ability to finance its capital expenditure requirements. The realization of the Group's future expansion programs will also be subject to the receipt of relevant Government approvals. There can be no assurance that the Group will be able to implement its network expansions as planned.

Spectrum

A cellular system's capacity is to a certain extent limited by the amount of frequency spectrum available for use by the system. The Group has been approved by the State Radio Regulatory Commission (the “SRRC”) to use 19 MHz of spectrum in the 900 MHz frequency band for an indefinite term in each of Guangdong and Zhejiang and, in addition, 5 MHz of spectrum in the 900 MHz frequency band in each of Guangdong and Zhejiang until 2005. Such spectrum allocation may be renewed with approval of the SRRC. The Group is permitted to use 1 MHz of additional spectrum in the 900 MHz frequency band in Guangdong pursuant to approval of the Guangdong Provincial Radio Regulatory Commission. Fees for the Group’s spectrum usage in 1995, 1996 and 1997 were RMB 3.6 million, RMB 11.6 million and RMB 18.2 million, respectively, in Guangdong and approximately RMB 3.9 million, RMB 4.5 million and RMB 1.9 million, respectively, in Zhejiang. The Group currently allocates its total 25 MHz of spectrum in Guangdong and 24 MHz of spectrum in Zhejiang in the 900 MHz frequency band as follows: in Guangdong, 13 MHz for its TACS network and 12 MHz for its GSM network, and in Zhejiang, 15.6 MHz for its TACS network and 8.4 MHz for its GSM network. The Group may reallocate its allotted spectrum from its TACS networks to its GSM networks to satisfy anticipated capacity requirements. The Group expects that technical development of its networks will result in more efficient use of frequency spectrum and that, subject to approval by SRRC, by reallocating available spectrum between its TACS and GSM networks as required, the Group will be able to return the temporary spectrum allocation on a timely basis without any material adverse effect on its total capacity or service, in the event that approval from the SRRC for permanent use of such spectrum is not obtained. When necessary, the DGT may also apply to the SRRC for additional spectrum allocation on behalf of the Group.

The Group also has been given permission to use 10 MHz of spectrum in the 1800 MHz frequency band for an indefinite term in each of Guangdong and Zhejiang, which was allocated to the DGT by the SRRC in December 1996. The Group plans to use such spectrum to introduce DCS 1800 systems in order to expand the capacity of its GSM networks by adding cell sites in certain areas with a high-density of cellular subscribers. The development of services utilizing DCS 1800 systems will depend on, among other things, the commercial availability of dual band handsets that are compatible with different frequencies.

Base Station Sites

In urban areas, the Group's base transceiver station sites are located mostly on existing structures, typically at the top of tall buildings. In rural areas, masts are often constructed for locating base transceiver stations. Of the Group’s 4,980 total base transceiver stations as of December 31, 1997, approximately 58% were in Guangdong and 42% were in Zhejiang. Typically, such properties are of limited size, as base transceiver station equipment does not generally require significant space. Generally, depending on the length of time required for negotiation with respect to use of the land or buildings, construction of a base transceiver station takes approximately one to three months in an urban area and approximately three to six months in a rural area. The Group anticipates that it will need a significant number of new sites in connection with the expansion of its cellular networks. However, there can be no assurance that the Group will be able to obtain the requisite number of sites on reasonable commercial terms. The establishment of each base transceiver station also requires the approval of the relevant provincial bureau of the SRRC. Certain of such approvals are currently pending. The Group has not experienced and does not expect to experience difficulty in obtaining permission to establish additional sites.

Equipment Suppliers

The Group selects its principal suppliers from among leading international manufacturers of cellular equipment and in accordance with technical standards set by the MII and the SRRC. In Guangdong, the Group's TACS and GSM networks use equipment primarily from Ericsson. In Zhejiang, the Group's TACS network uses equipment primarily from Motorola and Ericsson, while the Zhejiang GSM network uses equipment primarily from Motorola, Nokia and Alcatel. The Group's top three suppliers, Ericsson, Nokia and Motorola, accounted for approximately 69%, 21% and 3% of the Group's network equipment purchases in 1997, respectively, and these three suppliers, together with Allen and Alcatel, accounted for an aggregate of 95% of the Group's network equipment purchases in 1997. Equipment purchases are denominated in US Dollars.

Handsets

The Group's subscribers are able to use on the Group's networks most of the popular handset models currently available in the market, including those manufactured by Motorola, Ericsson, Nokia and Siemens. Although the Group's primary focus is to provide network services, the Group also sells certain handset models through its own retail outlets, in order to provide greater convenience for its customers. MII regulations require that any cellular handset model approved by the MII and bearing a network access mark must be allowed access to cellular networks. The pricing of handsets is subject to regulation by the MII and other relevant authorities, including the PTAs and the Price Bureaus. See "—Regulation — Tariff Setting and Price Controls". In recent years, the average prices of cellular telephone handsets have experienced steady declines, while the quality of handsets has improved. The Group believes that such developments have increased the number of subscribers and enhanced the use of the Group's network services.

Competition

The Group was the only provider of commercial cellular network services in its provincial markets until Unicom commenced operation of its GSM cellular networks in Guangdong and Zhejiang, in July 1995 and March 1997, respectively. Unicom was established pursuant to an approval of the State Council dated December 1993. Unicom is aggressively marketing its services in order to build its subscriber base, and is seeking to expand its network coverage and capacity. As investment in cellular networks is largely fixed and tariffs are subject to maximum limits set by Government authorities, profitability in the cellular telephone industry is fundamentally driven by subscriber growth. The Group believes that it has a significant advantage in the competition for subscribers due to its wider network coverage, high network performance standards, greater roaming capabilities, wide range of value added service features offered, and its relationship with the PT System, which allows the Group to market its services under the "China Telecom" brand name through an extensive network of distributors within the PT System. However, there can be no assurance that the State Council will not approve additional cellular service providers in the future that will compete with the Group. In general, the Group believes that the introduction of orderly competition has had a positive impact on the market for cellular telecommunications services by stimulating network buildup and improvements in service quality, increasing awareness of cellular services among potential subscribers, and advancing the pace of the search for technical innovations and efficiency improvements.

In August 1995, the PT System and China Electronics Systems Engineering Company initiated a joint project to explore the feasibility of deploying 800 MHz CDMA technology in public cellular networks in China (the "CDMA Project"). The CDMA Project, if successful, could result in increased competition to the Group. The MII has undertaken to the Company that the PT System will not participate, directly or indirectly, in the provision of cellular services in any province in which the Group currently operates or may operate in the future. In connection therewith, the MII has undertaken to contribute to the Group, at the Group's option, the entire interest, if any, held by the PT System in the CDMA Project in any such province when and if the CDMA Project, after trial operations, becomes commercially feasible.

The Group also faces indirect competition from providers of other wireless communications services, such as paging. Although these services offer substantially lower prices for services, the Group does not believe that such services constitute significant competition, as they provide a much more limited range of services compared to cellular telecommunications services.

The Group's operations, along with those of other cellular network operators, are subject to a high degree of regulation by the MII. See "—Regulation". In connection with the Company's initial public offering, the MII has undertaken to the Group that, to the extent within its power, the Group and its subsidiaries will be treated equally with all other cellular telephone operators in respect of all approvals, transactions and arrangements between the Group and its subsidiaries, on the one hand, and entities within the PT System, on the other hand.

Regulation

The cellular telecommunications industry is subject to a high degree of regulation by the Government. Regulations issued or implemented by the State Council, the MII and other relevant Government authorities, including the SRRC and the SPC, encompass virtually every aspect of cellular network operations, including entry into the telecommunications industry, scope of permissible business, interconnection and transmission line arrangements, technology and equipment standards, tariff policy, capital investment priorities, foreign investment and spectrum allocation.

The MII, under the leadership of the State Council, is responsible for formulating overall industry policy and regulations, coordinating telecommunications projects and networks at the national level, enforcing industry standards, and in general, supervising the operations of telecommunications service providers and managing the day-to-day administration of the national telecommunications sector. Under the control of the MII, there are 33 provincial level PTAs and over 2,385 PTBs at the municipal and county levels. The PTAs exercise regulatory responsibility over the telecommunications industry in their respective provinces.

In order to provide a uniform regulatory framework to encourage the orderly development of the telecommunications industry, the MII, under the direction of the State Council, is currently preparing a draft of the Telecommunications Law. The draft law, when formulated, will be submitted to the National People's Congress for review and adoption. It is unclear when and if the Telecommunications Law will be adopted. If the Telecommunications Law is adopted by the National People's Congress, it is expected to become the basic telecommunications statute and the legal source of telecommunications regulations in China. Although the Group expects that the Telecommunications Law would have a positive effect on the overall development of the telecommunications industry in China, the nature and scope of regulation envisaged by the Telecommunications Law are not fully known. There can be no assurance that the Telecommunications Law, if adopted, would not have a material adverse effect on the Group's business, financial condition and results of operations.

Pursuant to the State Council document approving the Restructuring and the Company's initial public offering, the MII adopted guidelines (the "Guidelines") to regulate the domestic operations of the Company's subsidiaries in China. The Guidelines provide, among other things, that the existing regulatory framework governing PRC state-owned telecommunications companies also applies with equal effect to the Company's subsidiaries. Although the Group does not expect the implementation of the Guidelines to affect the regulatory framework within which it operates, there can be no assurance that the implementation of the Guidelines would not have a material adverse effect on the Group's business, financial condition and results of operations.

In 1997, the Government issued a notice aimed at increasing the Government's control over the injection of assets by mainland PRC entities into their Hong Kong subsidiaries or affiliates. There can be no assurance that such notice will not limit or otherwise materially impair the Group's expansion strategy.

Entry into the Industry

Until 1993, China's telecommunications regulations and policies did not permit entities outside of the PT System to engage in public telecommunications operations in China. In August 1993, the Government opened certain non-basic sectors of the telecommunications industry, such as paging, to Chinese entities not affiliated with the former MPT. Cellular network operators and providers of basic telecommunications services, such as local and long distance fixed line telephone services, must receive specific approval from the State Council in order to provide such services. Currently, in addition to the Group and entities within the PT System, the State Council has granted approval to Unicom to provide cellular services and, in areas where public fixed network coverage or capacity is limited or as otherwise authorized by the State Council and approved by the MII, fixed line telephone network services in China.

Current Chinese regulations prohibit foreign-invested enterprises and foreign individuals from owning, operating or participating in the operation of telecommunications services in China without approval from the State Council. The Company was granted special authorization from the State Council to effect the Restructuring and its initial public offering.

Spectrum Usage

The Radio Administration Regulations of the PRC, effective on September 11, 1993, promulgated pursuant to a joint statement issued by the State Council and the PRC Central Military Commission, empowers the SRRC, under the joint leadership of the State Council and the PRC Central Military Commission, to undertake the centralized regulation of all radio frequencies. In coordination with the MII and the relevant provincial PTAs, the SRRC allocates frequency, including the 900 MHz and the 1800 MHz frequency bands (which are reserved for mobile cellular applications). The frequency assigned to an entity is not allowed to be leased, or, without approval of the SRRC, transferred by the entity. Pursuant to a joint circular from the SPC and the Ministry of Finance, effective May 1, 1997, the DGT determines the amount of fees to be paid to the SRRC for spectrum usage by each cellular network operator under the MII's control based on bandwidth of the frequency used and the number of base transceiver stations within the operator's network, subject to the limitation that the total annual payment by all such operators in China shall equal RMB 1.0 million per MHz of frequency allocated by the SRRC.

Tariff Setting and Price Controls

The Group's tariffs are subject to regulation by various Government authorities, including the SPC, the MII, the relevant Price Bureaus and the relevant PTAs. The connection fee is based on a guidance price range set jointly by the MII and the SPC, with the actual tariff determined by the relevant PTAs in consultation with the relevant Price Bureau. In general, base usage charges, domestic roaming usage charges and tariffs for all long distance and international calls are fixed jointly by the MII and the SPC. International roaming charges are set by the MII pursuant to agreements between the DGT and the relevant foreign cellular operators.

The former MPT's Circular Regarding the Maximum Limit of the Price of the Mobile Handsets, effective April 1, 1997, sets maximum prices for 13 types of handsets, and provides that such limits are subject to review on a quarterly basis. The PTAs are given flexibility to determine the price for other models within guidelines established by the former MPT. In addition, the Circular on Further Decentralizing the Interconnection and Usage of Handsets Owned by Subscribers, issued by the former MPT and effective September 27, 1996, requires that any cellular handset model approved by the former MPT and bearing a network access mark must be allowed access to any public cellular networks.

Interconnection Arrangements

Cellular networks must interconnect with the PT System's PSTN to enable subscribers to a cellular network to communicate with fixed line subscribers and subscribers to other cellular networks and to place and receive domestic and international long distance calls. The MII is responsible for approving applications for interconnection with the PSTN and for designing and regulating technical plans for the interconnection, while the DGT is responsible for implementing such plans. The applicable regulations provide that switching, transmission and other equipment must conform with the technical standards approved by the MII. See "— Technical Standards". The MII also determines the amounts of lease payments to be collected by the PTAs, which operate the PSTN, with respect to leasing of transmission lines that facilitate interconnection to be made between cellular networks and the PSTN. The PTAs and PTBs are responsible for the maintenance of the transmission lines and related equipment.

Technical Standards

The MII sets technical standards and controls the type of cellular equipment used in public networks by requiring all network operators within the PT System to purchase their equipment from suppliers who have obtained prior certification from the MII. In addition, the Provisions on the Management of Import of Radio Transmission Equipment, jointly issued by the SRRC, the State Economics and Trade Commission (the "SETC"), the Ministry for Foreign Trade and Economic Cooperation and the Customs General Administration, effective January 1, 1996, provides that before radio transmission equipment (including cellular equipment) may be imported into China, an importer must obtain the necessary certification from the SRRC and the State Mechanical and Electrical Products Import and Export Office under the SETC.

To ensure the quality of interconnection and integration of cellular networks with the PSTN, applicable regulations provide that a network access permit must be obtained from the MII with respect to each specific type of terminal equipment to be used for interconnection, whether such equipment is imported or manufactured domestically.

Capital Investment

The SPC is empowered by the State Council to exercise responsibility over the approval of all major investment projects, including cellular network development projects, involving total capital investment in excess of RMB 50 million. Accordingly, project proposals and feasibility study reports for such projects, following review and approval by the MII or the relevant PTAs, are required to be submitted for approval to the SPC or its relevant provincial bureau. The establishment of each base transceiver station also requires approval of the relevant provincial bureaus of the SRRC. Certain of such approvals are currently pending. The Group has not experienced and does not expect to experience difficulty in obtaining permission to establish additional sites.

Employees

As of December 31, 1997, the Group had 8,582 permanent employees, including 6,711 employees in Guangdong, 1,853 employees in Zhejiang and 18 employees in the Company, classified as follows:

	Guangdong	Zhejiang
Management	584	324
Technical and engineering	2,939	661
Sales and marketing	1,946	620
Financial and accounting	322	155
General administration	920	93
Total	6,711	1,853

In addition, the Group had 1,266 and 119 temporary employees in Guangdong and Zhejiang, respectively. Approximately 30% of the Group's permanent employees have college or graduate degrees. The Company provides certain benefits to its employees, including housing, retirement benefits and hospital, maternity, disability and dependent medical care benefits. The Group's employees are members of a labor association. The Group has not experienced any strikes, slowdowns or labor disputes that have interfered with its operations, and the Group believes that its relations with its employees are good.

Recent Developments

At the first session of the Ninth National People’s Congress in March 1998, a motion was passed to implement the restructuring of Government bodies. The MII was established to assume all the Government functions of the former MPT. The Group believes that this institutional reform, which created a demarcation between Government and enterprise functions, will help to establish a fairer and a more orderly competitive environment, and that it will not only be beneficial to the overall development of the telecommunications industry in China, but will also contribute towards improving the management, operations and service quality of the Group. The MII has become the Company’s ultimate controlling shareholder, and the Group has received reassurance that the MPT will assume all undertakings given by the former MII at the time of the Company’s initial public offering. See “Item 4. Control of Registrant” and “Item 13. Interest of Management in Certain Transactions”.

On April 28, 1998, the Company entered into a conditional acquisition agreement with its controlling shareholder, China Telecom Hong Kong (BVI) Limited, to acquire the entire interest in Jiangsu Mobile BVI at a cash consideration of HK$22,475 million (US$2,900 million). Jiangsu Mobile BVI holds the entire interest in Jiangsu Mobile, the dominant provider of cellular telecommunications in Jiangsu province. The Acquisition was completed on June 4, 1998.

Jiangsu Mobile operates TACS and GSM networks in Jiangsu province. Jiangsu had a population of approximately 71.5 million at the end of 1997 and is one of the largest and most economically developed provinces in China. According to statistics provided by the MII, Jiangsu has the largest number of cellular subscribers in China after Guangdong and Zhejiang. Jiangsu Mobile’s total subscriber base grew at a compound annual growth rate of approximately 95%, from approximately 231,400 subscribers at December 31, 1995 to approximately 879,800 subscribers at December 31, 1997. At December 31, 1997, the cellular penetration rate in Jiangsu was approximately 1.24%. In 1997, Jiangsu Mobile had operating revenue of RMB 3,634.6 million, EBITDA of RMB 1,952.9 million and net profit of RMB 1,244.8 million (all on the basis of Hong Kong GAAP). Jiangsu Mobile plans to invest approximately RMB 9,975 million between the years 1998 to 2000 to improve and increase the quality of its existing networks and to expand network capacity.

In connection with the Acquisition, Jiangsu Mobile has entered into certain arrangements with the Jiangsu PTA and the DGT, including arrangements with respect to the leasing of transmission lines, interconnection, roaming, collection services, distribution and marketing, leasing of certain properties and use of the China Telecom trademark. Such arrangements are similar to the arrangements entered into between the Group, the DGT and the Guangdong and Zhejiang PTAs. See "Item 13. Interest of Management in Certain Transactions".

The Group expects that the Acquisition will have a material impact on the Group's overall results of operations. See "Item 9. Management's Discussion and Analysis of Financial Condition and Results of Operations — Acquisition of Jiangsu Mobile".

The Company furnished to the Securities and Exchange Commission reports on Form 6-K relating to the Acquisition on April 29, 1998 and May 12, 1998. Such reports contain a description of the Acquisition and other related transactions, as well as a description of Jiangsu Mobile's business and financial and other information.

Item 2. Description of Property.

The Group's principal executive offices are located in Hong Kong, and are sub-leased from Telpo Communications (Group) Limited, an affiliate of the Company, pursuant to a tenancy agreement which will expire on June 30, 2000. The Group's regional headquarters are located in Guangzhou and Hangzhou. The Group has interests in approximately 70 properties which are land and buildings for offices, administrative centers, staff quarters, retail outlets and technical facilities. The Group is in the process of obtaining land use right certificates and property title certificates for these properties. The Group also leases approximately 500 offices, administrative centers, staff quarters, retail outlets and technical facilities in the PRC. In addition, the Group leases from the Guangdong PTA and the Zhejiang PTA or otherwise has the right to use various properties for cell sites and switching equipment. The Group believes that all of its owned and leased properties are well maintained and are suitable and adequate for their present use.

Item 3. Legal Proceedings.

The Group is not involved in any litigation, arbitration or administrative proceedings relating to claims which could have a significant effect on the results of operation and financial condition of the Group taken as a whole, and, so far as the Group is aware, no such litigation, arbitration or administrative proceedings are pending or threatened.

Item 4. Control of Registrant.

The following table sets forth certain information regarding ownership of the Company's capital stock as of December 31, 1997 by all persons who own more than ten percent (10%) of the Ordinary Shares, par value HK$0.10 per share (the "Shares"), of the Company.

Shareholder	Number of Shares Owned	Percentage of Outstanding Shares
China Telecom Hong Kong (BVI) Limited	9,010,000,000	76.5%

China Telecom Hong Kong (BVI) Limited is a wholly-owned subsidiary of China Telecom (Hong Kong) Group Limited, which is indirectly controlled by the MII.

As of December 31, 1997, the Directors and executive officers of the Company beneficially owned an aggregate of 2,000 Shares. The Company is not aware of any arrangement which may at a subsequent date result in a change of control of the Company.

Item 5. Nature of Trading Market.

In connection with its initial public offering, the Company's American Depositary Shares (the "ADSs"), each representing 20 Shares, were listed and commenced trading on the New York Stock Exchange (the "NYSE") on October 22, 1997 under the symbol "CHL". The Shares were listed and commenced trading on the Hong Kong Stock Exchange on October 23, 1997. Prior to such listings, there was no public market for the Company's equity securities. The NYSE and the Hong Kong Stock Exchange are the principal trading markets for the Company's ADSs and Shares, which are not listed on any other exchanges in or outside the United States.

As of December 31, 1997, there were 11,780,788,000 Shares issued and outstanding. As of December 31, 1997, there were 72 registered holders of American Depositary Receipts ("ADRs") evidencing 5,911,675 ADSs. Since certain of the ADSs are held by nominees, the above number is not representative of the actual number of U.S. beneficial holders of ADSs or the number of ADSs beneficially held by U.S. persons. The Depositary of the ADSs is The Bank of New York (the "Depositary").

The high and low sale prices for shares of the Shares on the Hong Kong Stock Exchange and of the ADSs on the NYSE for each full quarterly period since listing, are as follows:

	Price per Share		Price per ADS	
	High	**Low**	**High**	**Low**
1997				
Fourth Quarter	HK$14.40	HK$10.55	US$38.000	US$27.625
1998				
First Quarter	HK$16.25	HK$10.30	US$42.625	US$27.625

Item 6. Exchange Controls and Other Limitations Affecting Security-Holders.

There are no limitations on the right of non-resident or foreign owners to remit dividends or to hold or vote the Shares or the ADSs imposed by Hong Kong law or by the Memorandum and Articles of Association or other constituent documents of the Company.

Item 7. Taxation.

The taxation of income and capital gains of holders of Shares or ADSs is subject to the laws and practices of Hong Kong and of jurisdictions in which holders of Shares or ADSs are resident or otherwise subject to tax. The following summary of certain relevant taxation provisions under Hong Kong law is based on current law and practice, is subject to changes therein and does not constitute legal or tax advice. The discussion does not deal with all possible tax consequences relating to an investment in the Shares or ADSs. Accordingly, each prospective investor (particularly those subject to special tax rules, such as banks, dealers, insurance companies, tax-exempt entities and holders of 10% or more of the Company's voting capital stock) should consult its own tax adviser regarding the tax consequences of an investment in the Shares and ADSs. The discussion is based upon laws and relevant interpretations thereof in effect as of the date of this Annual Report, all of which are subject to change. There is no reciprocal tax treaty in effect between Hong Kong and the United States.

Tax on Dividends

Under the current practices of the Hong Kong Inland Revenue Department, no tax is payable in Hong Kong in respect of dividends paid by the Company unless such dividends are attributable to a trade, profession or business carried on in Hong Kong.

Profits Tax

No tax is imposed in Hong Kong in respect of capital gains from the sale of property (such as the Shares and ADSs). Trading gains from the sale of property by persons carrying on a trade, profession or business in Hong Kong where such gains are derived from or arise in Hong Kong from such trade, profession or business will be chargeable to Hong Kong profits tax which is currently imposed at the rate of 16% on corporations and at a maximum rate of 15% on individuals. Gains from sales of the Shares effected on the Hong Kong Stock Exchange may be considered to be derived from or arise in Hong Kong. Liability for Hong Kong profits tax may thus arise in respect of trading gains from sales of Shares or ADSs realized by persons carrying on a business or trading or dealing in securities in Hong Kong.

Stamp Duty

Hong Kong stamp duty, currently charged at the rate of HK$1.25 per HK$1,000 or part thereof on the higher of the consideration for or the value of the Shares, will be payable by the purchaser on every purchase and by the seller on every sale of Shares (i.e., a total of HK$2.50 per HK$1,000 or part thereof is currently payable on a typical sale and purchase transaction involving Shares). In addition, a fixed duty of HK$5 is currently payable on any instrument of transfer of Shares. The withdrawal of Shares upon the surrender of ADSs, and the issuance of ADSs upon the deposit of Shares, will also attract stamp duty at the rate described above for sale and purchase transactions unless the withdrawal or deposit does not result in a change in the beneficial ownership of the Shares under Hong Kong law, in which case only a fixed duty of HK$5 is payable on the transfer. The issuance of the ADSs upon the deposit of Shares issued directly to the Depositary or for the account of the Depositary does not attract stamp duty. No Hong Kong stamp duty is payable upon the transfer of ADSs outside Hong Kong.

Estate Duty

The Shares are Hong Kong property under Hong Kong law, and accordingly such Shares may be subject to estate duty on the death of the beneficial owner of such Shares (regardless of the place of the owner's residence, citizenship or domicile). Hong Kong estate duty is imposed on a progressive scale from 5% to 15%. The rate of and the threshold for estate duty has, in the past, been adjusted on a fairly regular basis. No estate duty is payable when the aggregate value of the dutiable estate does not exceed HK$7.5 million, and the maximum rate of duty of 15% applies when the aggregate value of the dutiable estate exceeds HK$10.5 million.

Item 8. Selected Financial Data.

Selected Financial Information

The following tables present selected historical financial data of the Group as of and for each of the years in the four-year period ended December 31, 1997. The selected historical income statement data for the years ended December 31, 1995, 1996 and 1997 and the selected historical balance sheet data as of December 31, 1996 and 1997 set forth below are derived from, and should be read in conjunction with, and are qualified in their entirety by reference to, the audited Consolidated Financial Statements of the Group, including the notes thereto, included elsewhere in this Annual Report. The selected historical income statement data for the year ended December 31, 1994 and the selected historical balance sheet data as of December 31, 1995 are derived from audited financial statements of the Group that are not included herein. The selected historical balance sheet data as of December 31, 1994 set forth below are unaudited, but, in the opinion of the Company, reflect the adjustments necessary for a fair presentation of such data. The Consolidated Financial Statements of the Group are prepared and presented in accordance with Hong Kong GAAP. For a discussion of material differences between Hong Kong GAAP and US GAAP, see Note 23 to the Consolidated Financial Statements.

In connection with the Restructuring, the Group entered into certain arrangements, including (i) new agreements with respect to interconnection revenue and costs, including an adjustment to the risk sharing arrangement with the relevant PTAs for uncollectible subscriber receivables for DDD and IDD calls, (ii) a new leased line agreement in Guangdong, (iii) an agreement with the Guangdong PTA allowing the Group to retain certain local network service charge revenues, (iv) new service agreements, (v) a change in the tax treatment of connection fees and certain surcharge revenue for the Group's services and (vi) the revaluation of fixed assets as of May 31, 1997. The Group’s financial results for 1997 reflect the impact of such arrangements as of the dates they became effective. For a description of such arrangements, see “Item 9. Management’s Discussion and Analysis of Financial Condition and Results of Operations — Restructuring and Other Recent Developments”.

	As of or for the year ended December 31,				
	1994	1995	1996	1997	1997
	RMB	RMB	RMB	RMB	US$
	(in millions, except per Share and per ADS information)				
Income Statement Data:					
Hong Kong GAAP					
Operating revenue	4,590.3	7,598.1	10,367.2	15,487.8	1,863.8
Operating expenses	1,614.8	2,856.2	5,404.8	10,073.6	1,212.2
Operating profit	2,975.6	4,741.9	4,962.4	5,414.2	651.5
Profit before tax and minority interest	3,021.1	4,954.3	4,940.8	5,953.3	716.4
Income tax	201.5	285.7	427.5	991.0	119.3
Net profit	2,819.6	4,668.6	4,509.2	4,955.4	596.3
Net profit per pro forma Share(1) . . .			0.50	0.52	0.06
Net profit per pro forma ADS(1)			10.02	10.39	1.25
US GAAP					
Net profit		4,582.1	4,419.9	5,294.0	637.1
Basic net profit per pro forma Share(1)			0.49	0.56	0.07
Basic net profit per pro forma ADS(1)			9.82	11.11	1.34
Balance Sheet Data:					
Hong Kong GAAP					
Current assets					
Cash and cash equivalents	2,314.0	3,127.6	2,976.2	40,070.7	4,822.0
Accounts receivable	610.4	807.3	1,087.4	1,591.9	191.6
Fixed assets	3,828.5	7,345.8	11,536.0	18,634.2	2,242.4
Total assets	8,672.2	13,562.8	18,135.7	64,950.1	7,815.9
Short-term bank and other loans	377.5	512.8	1,504.3	2,147.6	258.4
Long-term bank and other loans	1,118.3	2,004.0	1,946.4	2,870.3	345.4
Total liabilities	3,624.0	4,522.1	5,657.3	10,386.2	1,249.8
Shareholders' equity	5,048.2	9,040.7	12,471.1	54,549.7	6,564.3
US GAAP					
Fixed assets		7,199.3	11,554.2	15,593.7	1,876.5
Total assets		13,416.2	18,131.9	61,885.4	7,447.1
Shareholders' equity		8,735.5	12,103.2	52,715.6	6,343.6

	As of or for the year ended December 31,				
	1994	1995	1996	1997	1997
	RMB	RMB	RMB	RMB	US$
			(in millions)		
Other Financial Data:					
Hong Kong GAAP					
Capital expenditures	2,284.0	2,652.5	5,510.9	5,806.8	698.8
Operating cash flow(2)	3,400.2	4,450.3	4,213.3	8,203.0	987.1
EBITDA(3)	3,372.6	5,707.0	6,435.7	8,179.7	984.3
US GAAP					
Operating cash flow		5,126.4	5,518.0	8,424.9	1,013.8

(1) Net profit per pro forma Share and net profit per pro forma ADS under Hong Kong GAAP and basic net profit per pro forma Share and basic net profit per pro forma ADS under US GAAP for the years ended December 31, 1996 and December 31, 1997 have been computed by dividing net profit under Hong Kong GAAP and US GAAP, respectively, by the pro forma weighted average number of shares and pro forma weighted average number of ADSs outstanding as if 9,010,000,000 Shares and 450,500,000 ADSs (based on a ratio of 20 Shares to one ADS) issued in the Restructuring were outstanding for the years shown.

(2) Net cash inflows from operating activities less net cash outflows from returns on investments and servicing of finance and taxation.

(3) EBITDA represents earnings before interest income, interest expense, non-operating income (expense), income taxes, depreciation and amortization. EBITDA is commonly used in the telecommunications industry to analyze companies on the basis of operating performance, leverage and liquidity. EBITDA is not intended to represent cash flow for the period nor has it been presented as an alternative to net profit as an indicator of operating performance. The items of net profit excluded from EBITDA are significant components in understanding and assessing the Group's financial performance, and the Group's computation of EBITDA may not be comparable to other similarly titled measures of other companies. See "Item 9. Management's Discussion and Analysis of Financial Condition and Results of Operations" and the Consolidated Statements of Cash Flows of the Group contained elsewhere in this Annual Report.

Exchange Rate Information

China

The following table sets forth certain information concerning exchange rates between Renminbi and U.S. Dollars for the periods indicated:

	Noon Buying Rate(1)			
Period	Period End	Average	High	Low
		(RMB per US$1)		
1993	5.8145	5.7776	5.8245	5.7076
1994	8.4662	8.6303	8.7409	8.4662
1995	8.3374	8.3852	8.5000	8.2916
1996	8.3284	8.3395	8.3549	8.3002
1997	8.3100	8.3193	8.3290	8.2911

(1) Prior to 1994, the Noon Buying Rate was based on the Official Exchange Rate. Since April 1994, the Noon Buying Rate has been based on the base exchange rate published by the People's Bank of China (the "PBOC Rate"). As a result, since

April 1994, the Noon Buying Rate and the PBOC Rate have been substantially similar. The PBOC Rate on December 31, 1997 was 8.2798, compared with 8.3100 for the Noon Buying Rate.

Hong Kong

The following table sets forth certain information regarding the exchange rates between Hong Kong Dollars and U.S. Dollars for the periods indicated:

	Noon Buying Rate			
Period	**Period End**	**Average***	**High**	**Low**
		(HK$ per US$1)		
1993	7.7280	7.7348	7.7650	7.7230
1994	7.7375	7.7284	7.7530	7.7225
1995	7.7323	7.7354	7.7665	7.7300
1996	7.7347	7.7341	7.7440	7.7310
1997	7.7495	7.7440	7.7550	7.7275

* The average of the Noon Buying Rates on the last day of each month during the relevant period.

Dividend Payments

The Company has not declared or paid any dividends since its formation in September 1997.

Item 9. Management's Discussion and Analysis of Financial Condition and Results of Operations.

The following discussion and analysis should be read in conjunction with the Consolidated Financial Statements of the Group, together with the notes thereto, included elsewhere in this Annual Report. The Consolidated Financial Statements have been prepared in accordance with Hong Kong GAAP, which differ in certain material respects from US GAAP. Note 23 to the Consolidated Financial Statements summarizes the material differences between Hong Kong GAAP and US GAAP as they relate to the Group and provides a reconciliation to US GAAP of net profit, shareholders' equity and the statement of cash flows. The Consolidated Financial Statements of the Group present, and the discussion and analysis herein pertains to, the consolidated financial position and results of operations of the Company and its subsidiaries from the date of the Restructuring. The consolidated financial position and results of operations prior to September 27, 1997 represent the former combined operations of Guangdong Mobile and Zhejiang Mobile.

Overview

During the three-year period ended December 31, 1997, the Group's cellular network capacity, subscriber base and operations experienced significant growth. See "Item 1. Description of Business". The Group believes that with the development of China's economy and increases in per capita income, the telecommunications industry will continue to grow rapidly. In particular, the Group expects that demand for cellular services will continue to grow as consumers increasingly value the convenience and quality of cellular telecommunications. Accordingly, the Group believes that there is potential for significant future subscriber growth. The Group intends to continue to focus on expanding its subscriber base in Guangdong, Zhejiang and Jiangsu and increasing subscriber usage by enhancing its network performance, expanding the range of value added services it offers to subscribers, increasing its marketing and distribution efforts and improving the quality of its services. The Group believes that with its present network capacity and projected capacity increase pursuant to its network expansion plan, as well as with its current dominant market share, it is well positioned to take advantage of the anticipated growth in demand for cellular services in its markets.

Although the Group's GSM cellular networks in Guangdong and Zhejiang commenced operations in July 1995 and December 1995, respectively, they have grown rapidly, accounting for 55.4% of the Group's total subscribers as of December 31, 1997 and 55.8% of the Group's total operating revenue during the year ended December 31, 1997. The Group expects that, in the next few years, its GSM cellular operations will continue to grow at a faster rate than its TACS cellular operations as a result of subscriber preference for the wider range of functional capability and enhanced security of digital telecommunications, together with the Group's emphasis on the development of its GSM cellular networks. See "Item 1. Description of Business — Operations — Network Capacity Expansion Plans".

The Group's results of operations, like those of other cellular network operators, are substantially dependent on the number of subscribers, the level of subscriber usage, the level and structure of tariffs and interconnection and transmission line arrangements with other telecommunications operators. In addition, like other cellular network operators, the Group operates in an extensively regulated environment and its operations and financial performance are significantly affected by the Government's regulation of, and policies regarding, the telecommunications industry, including with respect to interconnection and transmission line arrangements, technology and equipment standards, capital investment priorities and tariff structure. See "Item 1. Description of Business — Regulation". The Group's financial performance is affected by a number of other variables external to the Group and the telecommunications industry, such as economic and social conditions in China and foreign currency exchange fluctuations.

On June 4, 1998, the Company acquired Jiangsu Mobile. The Group expects that the Acquisition will have a material impact on the Group's overall results of operations. See "Item 1. Description of Business — Recent Developments" and "— Acquisition of Jiangsu Mobile".

Restructuring and Other Recent Developments

The current structure of the Group was established pursuant to the Restructuring completed in September 1997. See "Item 1. Description of Business — History of the Group and Restructuring". Pursuant to the Restructuring, the Company acquired a 100% interest in Guangdong Mobile and a 99.63% interest in Zhejiang Mobile, the subsidiaries conducting the Group's cellular operations in Guangdong and Zhejiang, respectively. In connection with the Restructuring, the Group has entered into certain arrangements to facilitate the transfer of the operations from the Guangdong PTA and the Zhejiang PTA to the Group, to integrate such operations within the Group and to improve the Group's overall operational efficiency. Such arrangements include (i) new agreements with respect to interconnection revenue and costs, including an adjustment to the risk sharing arrangement with the relevant PTAs for uncollectible subscriber receivables for IDD and DDD calls, (ii) a new leased line agreement in Guangdong, (iii) an agreement with the Guangdong PTA allowing the Group to retain certain local network service charge revenues, (iv) new service agreements, (v) a change in the tax treatment of connection fees and certain surcharge revenue for the Group's services and (vi) the revaluation of fixed assets as of May 31, 1997. The Group expects that such arrangements and changes will have a material impact on the Group's overall results of operations. The Group's financial results for 1997 reflect the impact of such arrangements as of the dates they became effective.

Implementation of New Interconnection Agreements

The Group's networks interconnect with the PT System's PSTN, allowing the Group's subscribers to make calls to and receive calls from fixed line subscribers and subscribers of other cellular networks and to place and receive domestic and international long distance calls. Prior to the Restructuring, Zhejiang Mobile had an interconnection arrangement with the Zhejiang PTA with respect to the Group's GSM network in Zhejiang. However, no interconnection agreements existed for the Group's TACS and GSM networks in Guangdong or for the Group's TACS network in Zhejiang.

In September 1997, Guangdong Mobile and Zhejiang Mobile entered into interconnection agreements with the Guangdong PTA and the Zhejiang PTA, respectively. These agreements set forth the amounts payable to the Group for inbound calls to the Group's subscribers which originate from the PT System's PSTN and the amounts payable by the Group for outbound calls from the Group's subscribers which terminate on the PT System's PSTN. See "Item 1. Description of Business — Operations — Interconnection Revenue and Costs" and "Item 13. Interest of Management in Certain Transactions — Interconnection Arrangements". The Group currently reflects amounts billed to its subscribers as operating revenue and record amounts payable by the Group to the relevant PTAs as operating expenses.

Prior to the Restructuring, with respect to the DDD and IDD charges payable to the Group by its subscribers, to the extent such amounts were in turn payable by the Group to the Zhejiang PTA and the Guangdong PTA, the Group and the relevant PTAs shared equally the risk of default on payments by the Group's subscribers. Pursuant to the new interconnection agreements, the Group bears the full amount of such risk and losses. Accordingly, the Group has increased its provision for doubtful accounts. The Group believes that the new risk bearing arrangements are consistent with industry practice in other countries.

Implementation of New Leased Line Agreements

The Group leases certain transmission lines from the Guangdong PTA and the Zhejiang PTA in order to link the Group's base transceiver stations, base station controllers and mobile switching centers and to interconnect the Group's network to the PT System's PSTN. Transmission lines are critical to the operation of a cellular network as they provide the "backbone" transmission infrastructure by which cellular call traffic is carried. See "Item 1. Description of Business — Cellular Networks — Transmission Infrastructure". Prior to the Restructuring, the Group paid to the Guangdong PTA a portion of Guangdong Mobile's operating revenues as a monthly fee for the leasing of local transmission lines and a fixed monthly fee per line for the leasing of long distance transmission lines. In

Zhejiang, the Group paid to the Zhejiang PTA a fixed fee for the leasing of both local and long distance transmission lines.

In September 1997, Guangdong Mobile and Zhejiang Mobile entered into new leased line agreements with the Guangdong PTA and the Zhejiang PTA, respectively. The Group entered into such agreements on normal commercial terms following the Restructuring in order to ensure that it will continue to be able to use transmission lines owned by the PTAs. The agreements set forth the terms and conditions, including the schedules of fees payable by the Group, for leasing of transmission lines. See "Item 13. Interest of Management in Certain Transactions — Leasing of Transmission Lines".

Retention of Certain Local Network Service Charge Revenue

In Guangdong, the Group's subscribers are subject to a local network service charge of RMB 0.40 per minute imposed by the Guangdong PTA on intra-regional calls made by such subscribers. Prior to the Restructuring, revenue from such local network service charge was collected by Guangdong Mobile and paid in its entirety to the Guangdong PTA and was therefore excluded from the Group's operating revenue.

In September 1997, Guangdong Mobile and the Guangdong PTA entered into an agreement allowing the Group to retain RMB 0.30 of the RMB 0.40 per minute local network service charge on such intra-regional calls. The Group currently reflects as usage fees the entire amount of such charge collected from its subscribers and records the amount it pays to the Guangdong PTA as operating expenses.

Implementation of New Service Agreements

Billing and Collection Services. Historically, billing and collection services relating to the Group's cellular service were performed by the Guangdong PTA and the Zhejiang PTA and the relevant PTBs, as well as by a billing data processing company in Guangdong. Because the Group was part of the PT System prior to the Restructuring, it was required to pay the relevant PTAs and PTBs only a relatively small amount of fees for such billing and collection services. In connection with the Restructuring, Zhejiang Mobile entered into an agreement with the Zhejiang PTA for the provision of billing services to Zhejiang Mobile. Under the agreement, Zhejiang Mobile will pay the Zhejiang PTA a fee of RMB 0.20 for each bill processed. In Guangdong, Guangdong Mobile has entered into an agreement with the Guangdong PTA for the provision of collection services at the rate of RMB 0.01 per RMB 1.00 collected and will continue its current arrangement with the billing data processing company. The Group intends to implement its own centralized billing and collection system by the end of 1998. See "Item 1. Description of Business — Operations — Customer Services and Billing".

Distribution and Sales. Prior to the Restructuring, the Group's cellular services were marketed by and through outlets within the PT System, including telecommunications retail outlets and post offices that also sell other telecommunications services related to the PT System's fixed line and other businesses. In addition, the Group sold its cellular services through retail outlets owned by the Group, as well as through independent dealers. In connection with the Restructuring, the Group entered into distribution and marketing agreements with various authorized dealers within and outside the PT System, pursuant to which the Group will pay such dealers sales commissions or other payments for marketing and selling the Group's services. In addition, the Group intends to establish additional retail outlets and otherwise expand its own distribution and sales channels. See "Business — Operations — Service Distribution and Marketing". The Group expects that its selling and promotion expenses will increase, reflecting the terms of these new agreements, as well as the Group's greater emphasis on marketing and distribution.

Taxation of Connection Fees and Surcharges

The Group charges a connection fee for each new subscriber to the Group's services. See "Item I. Description of Business -- Operations -- Tariffs". Prior to the Restructuring, connection fees were excluded from taxable income. Certain surcharges by the Group to its subscribers, including (i) in Guangdong, a surcharge of RMB 0.25

per minute on intra-provincial DDD calls and (ii) in Zhejiang, a surcharge of RMB 12.50 on the monthly fee and a surcharge of RMB 0.10 on the base usage charge for all calls, were also excluded from taxable income. See "Item 1. Description of Business — Operations — Tariffs". Such tax treatment was part of the Government's policy to ensure adequate capital was available to finance the development of the cellular telecommunications sector. The Group paid PRC business tax and government surcharges on connection fees and such surcharges at the statutory rate of 3.3%.

Following the Restructuring, revenues from connection fees and such surcharges will be fully taxable, resulting in a higher effective tax rate for the Group. The Group will continue to pay the business tax and government surcharges on connection fees and such surcharges at the statutory rate of 3.3%. Additionally, in 1997, the Group was required to pay a central irrigation construction levy of approximately 3% of certain connection and surcharge revenue.

Revaluation of the Group's Assets; Increase in Depreciation Expense

In connection with the Restructuring, pursuant to applicable PRC regulations, the Group's fixed assets were revalued as of May 31, 1997 to reflect their fair market value as of such date, and such revaluation has been included in the Consolidated Financial Statements of the Group as of such date. The revaluation has resulted in an overall net increase in the carrying amount of the Group's fixed assets of RMB 3,529.1 million. Such revaluation would not be recorded under US GAAP because fixed assets are generally required to be stated at their historical cost under US GAAP. Furthermore, the effect on future depreciation expense under Hong Kong GAAP will be excluded from the determination of US GAAP net profit. However, under US GAAP, a deferred tax asset relating to the exclusion of the revaluation reserve has been created and will be realized in the future to the extent that the revalued tax bases of the Group's fixed assets under PRC tax rules are utilized.

Other Recent Developments

In addition to the new arrangements and changes discussed above, the Group expects that implementation of certain reseller agreements with certain Resellers of telecommunications services in Guangdong may have a material impact on the Group's overall results of operations and financial condition.

Between August 1996 and June 1997, Guangdong Mobile entered into certain distribution agreements (as amended and restated in September 1997, the "Reseller Agreements") with certain Resellers of telecommunications services in order to expand its distribution and marketing network and to increase funding for the Group's planned cellular network expansion. Agreements with seven Resellers independent from the Company are currently in effect. Pursuant to the Reseller Agreements, Guangdong Mobile has agreed to allocate up to an aggregate of 250,000 cellular numbers for resale to subscribers through the Resellers, who will market and sell Guangdong Mobile's GSM cellular services. The Resellers will pay to Guangdong Mobile, in one to three installments prior to receiving such allocation, a fee of RMB 9,167 for each cellular number to be allocated. In return, the Resellers will receive the right to certain revenues generated by subscribers with respect to such numbers, including all revenues from connection fees, monthly fees, usage fees, telephone number selection fees, system function fees and 50% of fees for value added services for a period of seven years from the date of the relevant agreement. The Resellers bear interconnection costs and receive a portion of interconnection revenues with respect to local calls. During the term of the Reseller Agreements, the Group will be entitled to other revenue generated by such subscribers, including all domestic and international long distance revenues, roaming revenues, long distance surcharges and 50% of revenues for value added services. The Group is responsible for paying the applicable portion of such revenues to the relevant PTA pursuant to its interconnection agreements. After the expiration of such Reseller Agreements, the Group will be entitled to all revenue generated by the subscribers of such cellular numbers. The Resellers will bear the full risk and losses arising from any default on payment by such subscribers during the term of the Reseller Agreements. As of December 31, 1997, a total of 158,041 numbers had been allocated to and paid for by the Resellers.

The Group records the fees received pursuant to the Reseller Agreements as deferred revenue and amortizes that revenue in equal installments over the seven-year term of the Reseller Agreements. A corresponding adjustment is made on the Group's statement of cash flows to reflect the non-cash nature of the amortized revenue. While the Reseller Agreements provide the Group with an immediate source of operating cash flow and may reduce the costs associated with marketing and distribution during such period, the revenue recognized and the cash received by the Group from subscribers of such cellular numbers will likely be substantially less than the revenue and cash flow that would have been recognized and received, respectively, if Guangdong Mobile had retained the rights to all the revenue generated from the subscribers of such cellular numbers. The Group does not intend to enter into agreements on terms substantially similar to the Reseller Agreements in the foreseeable future.

Acquisition of Jiangsu Mobile

The Company acquired Jiangsu Mobile on June 4, 1998. See "Item 1. Description of Business — Recent Developments". The Group expects that the Acquisition will have a material impact on the Group's overall results of operations. In particular, the Group anticipates that operating revenue and operating expenses (especially depreciation expenses) will increase as a result of the Acquisition. The Group also anticipates that interest income will decrease substantially following the Acquisition as the payment of the cash consideration for the Acquisition will result in a substantial decrease in cash and cash equivalents. See "— Liquidity and Capital Resources".

Review of Historical Performance

The following discussion is based on the Group's historical results of operations. As a result of the factors discussed above in "— Restructuring and Other Recent Developments" and "— Acquisition of Jiangsu Mobile", such results of operations may not be indicative of the Group's future operating performance.

Operating Revenue

The Group derives operating revenues principally from usage fees, monthly fees, and one-time connection fees charged to new subscribers. The Group also receives fees for other services it provides, including fees charged for certain value added services and telephone number selection and for roaming services provided to other cellular networks' subscribers.

The following table sets forth the items comprising the Group's operating revenue, and such items expressed as percentages of the Group's total operating revenue, during the periods indicated.

	Year ended December 31,					
	1995		1996		1997	
			(RMB in millions)			
Operating revenue:						
Usage fees(1)	3,243.1	42.7%	5,527.9	53.3%	8,718.1	56.3%
Monthly fees	939.5	12.4%	1,658.2	16.0%	2,692.2	17.4%
Connection fees	2,981.2	39.2%	2,673.4	25.8%	3,173.5	20.5%
Others(2)	434.3	5.7%	507.7	4.9%	904.0	5.8%
Total	7,598.1	100.0%	10,367.2	100.0%	15,487.8	100.0%

(1) Usage fees represent standard local usage fee for airtime and, where applicable, DDD charges receivable from subscribers for the use of the Group's cellular networks and facilities, revenue from the Reseller Agreements and fees in respect of roaming out calls made by the Group's subscribers outside the local service areas. See "Item 1. Description of Business — Operations — Tariffs" and Note 3(i) to the Consolidated Financial Statements of the Group.

(2) Others primarily represents telephone number selection fees, charges for value added services and roaming in fees in respect of calls made by other cellular networks' subscribers using the Group's cellular networks. See Note 3(iv) to the Consolidated Financial Statements of the Group.

The Group's tariffs are subject to regulation by the Government. As part of the Government's policy to support the development of the cellular telecommunications sector, the Group's connection fees were set at relatively high levels during the initial period of the Group's cellular operations in Guangdong and Zhejiang. Such high levels were maintained to ensure that adequate capital was available to finance the Group's network expansion in order to meet the rapidly growing demand for cellular telecommunications services in the two provinces. As the Group's cellular operations developed, the Group gradually reduced connection fees, as well as certain other charges, in accordance with tariff policies and guidance prices set by the Government. The average connection fee charged to each new subscriber decreased from RMB 4,385 in 1995 to RMB 3,396 in 1996 and RMB 2,330 in 1997. The Group believes that the tariff reductions have helped to expand the Group's subscriber base and resulted in increased total subscriber usage of the Group's cellular services, thereby contributing to the Group's revenue growth during the past three years. See “Item 1. Description of Business - Operations - Tariffs”.

The Group has experienced significant growth in revenues in the past three years, with operating revenue increasing at a compound annual growth rate of 42.8% over the three years from 1995 to 1997. Excluding the one-time connection fees charged to new subscribers, the Group's operating revenue grew at a compound annual growth rate of 63.3% during such period. The Group's revenue growth has been driven principally by growth in the Group's subscriber base due mainly to the increased demand for cellular telecommunications services in Guangdong and Zhejiang. In addition, the expansion of fixed line telecommunications networks in China, as well as the growth in the total cellular subscriber base in China, has significantly expanded the calling destinations for the Group's subscribers. This, in turn, increased the total number of calls made or received by the Group's subscribers. The Group believes that the expansion of its own cellular networks and the enhanced level of network performance and value added services offered have also stimulated the usage of the Group's cellular telecommunications services. In addition, as the Group, like other cellular network operators in China, imposes usage charges on their subscribers both when they make calls and when they receive calls, the increased usage of its cellular services has resulted in significant increases in the Group's operating revenues during the past three years. The expansion of the Group's network capacity has also facilitated calls between the Group's subscribers, or “on-net" calls, for which the Group retains revenues from both the caller and recipient of such calls and avoids interconnection costs because such calls are routed over transmission lines already leased by the Group.

During the early periods of the Group's cellular operations, the majority of its subscribers were business users with relatively high usage characteristics. However, as cellular penetration increases in the Group's markets, proportionally more subscribers to the Group's services are non-business users with relatively lower usage characteristics, as is typical in many countries with developing cellular markets. Accordingly, monthly usage per subscriber decreased from 527 minutes in 1995 to 507 minutes in 1996 and 441 minutes in 1997. Together with reductions in the Group's tariffs, this resulted in a decrease in average monthly revenue per subscriber (including connection fees) from RMB 691 in 1995 to RMB 524 in 1996 and RMB 474 in 1997. The Group believes that these trends are likely to continue. Although average monthly usage per subscriber decreased, the rapid increase in total subscribers resulted in an increase in total usage at a compound annual growth rate of 57.6% from 5,798 million minutes in 1995 to 14,400 million minutes in 1997.

Operating Expenses

Historically, the Group's operating expenses included principally leased line payments, depreciation expense relating to the Group's cellular network and other fixed assets, and personnel costs for salary and benefits. Currently, the Group's operating expenses also include selling, general and administrative (“SG&A”) and other expenses which primarily consist of selling and promotion expenses, network maintenance costs, provision for doubtful accounts, and operating lease charges (relating to land, building and certain facilities leased by the Group from the Guangdong

PTA and the Zhejiang PTA). The following table sets forth the items comprising the Group's operating expenses, expressed as percentages of the Group's total operating expenses, for the periods indicated.

	Year ended December 31,		
	1995	**1996**	**1997**
Leased lines	43.5%	41.0%	31.1%
Interconnection	0.9	3.6	12.1
Depreciation	27.6	26.4	26.6
Personnel	7.5	7.7	7.5
SG&A and others:			
Selling and promotion	9.0	8.0	6.2
Network maintenance	3.7	3.7	3.4
Provision for doubtful accounts	2.1	4.2	4.4
Operating lease charges	2.3	2.3	2.3
Others	3.4	3.1	6.4
Total SG&A and others	20.5	21.3	22.7
Total operating expenses	100.0%	100.0%	100.0%

As the Group's networks and operations have expanded, total operating expenses have increased at a compound annual growth rate of 87.8% from RMB 2,856.2 million in 1995 to RMB 10,073.6 million in 1997. This increase was due primarily to increases in leased line payments and depreciation charges as a result of network expansion and the revaluation of fixed assets. The continued expansion and improvement of the Group's networks will require significant additional expenditures and will result in further increases in depreciation expense. Interconnection expenses also increased significantly in 1997 as a result of the new interconnection arrangements entered into by the Group in connection with the Restructuring. Operating expenses are also likely to increase as a result of higher corporate overhead and other expenses as the Group becomes a stand-alone commercial entity. The new service agreements for the Group's billing and collections and its marketing and distribution will also increase the Group's operating expenses, as such agreements are based on commercially negotiated rates. In addition, the Group anticipates higher selling and promotion expenses as it increases its marketing and distribution efforts. Furthermore, although the Group's results of operations have not been materially affected by competition in Guangdong and Zhejiang due to the Group's dominant market share in each of the two provinces, increased competition may increase the Group's marketing and distribution costs, resulting in higher operating expenses.

Provision for doubtful accounts has increased substantially in recent periods as a percentage of the Group's total operating expenses. In addition, as a percentage of recurring revenue (i.e. total operating revenue less connection fees) provision for doubtful accounts has increased from 1.3% in 1995 to 3.0% in 1996 and 3.6% in 1997. This trend is due primarily to an increase in illegal cloning activities. This trend, if it continues, could be exacerbated by the Group's new risk sharing arrangements, whereby the Group will bear the full amount of the risk and losses associated with IDD and DDD charges. See "— Restructuring and Other Recent Developments — Implementation of New Interconnection Agreements". While there can be no assurance that this trend will not continue, the Group has taken various steps to address this trend, including the implementation of enhanced subscriber registration procedures and imposition of credit limits for high usage subscribers. The Group has also started to implement procedures to monitor daily high usage subscribers to reduce potential losses caused by cloning activities. The Group also intends to implement real-time billing for roaming services. See "Item 1. Description of Business — Operations — Customer Service and Billing".

EBITDA, Operating Margin and Net Profit Margin

EBITDA represents earnings before interest income, interest expense, non-operating income (expense), income taxes, depreciation and amortization. Although EBITDA is not presented as a measure of performance in accordance with Hong Kong GAAP or US GAAP and should not be considered as representing net cash flows from operating activities, it is commonly used in the telecommunications industry worldwide as an indicator of operating performance, leverage and liquidity. The items of net profit excluded from EBITDA are significant components in understanding and assessing the Group's financial performance and the Group's computation of EBITDA may not be comparable to other similarly titled measures of other companies. The Group's EBITDA increased at a compound annual growth rate of 19.7% from RMB 5,707.0 million in 1995 to RMB 8,179.7 million in 1997. The following table sets forth certain information relating to EBITDA and EBITDA margins during the periods indicated.

	Year ended December 31,		
	1995	**1996**	**1997**
EBITDA (RMB in millions)	5,707.0	6,435.7	8,179.7
EBITDA growth	69.2%	12.8%	27.1%
EBITDA margin*	75.1%	62.1%	52.8%

* EBITDA as a percentage of operating revenue.

The Group's operating margin (operating profit as a percentage of operating revenue) declined from 62.4% in 1995 to 47.9% in 1996 and 35.0% in 1997. The decrease in operating margin was primarily due to increased operating expenses for the reasons described above, coupled with slower growth in operating revenue resulting from tariff reductions (especially reductions in connection fees) and the addition of a larger number of subscribers with lower usage characteristics. As a result of the foregoing and an increase in the tax rate applicable to Guangdong Mobile from 18% in 1994 and 1995 to 33% in 1996, the Group's net profit margin (net profit as a percentage of operating revenue) also declined from 61.4% in 1995 to 43.5% in 1996 and 32.0% in 1997. Although the Group expects further increases in operating expenses, which will exert downward pressure on its operating margin and net profit margin, the Group believes that it will be able to increase its network utilization rate by continuing to expand its subscriber base and increase total subscriber usage, thereby mitigating the impact of any increase in operating expenses on its overall results of operations.

The Group's net cash inflows from operating activities increased from RMB 5,331.2 million in 1995 to RMB 6,418.4 million in 1996 and RMB 8,825.5 million in 1997, generally reflecting the growth in operating revenue due to the increase in the Group's subscriber base and the receipt of net proceeds from the Company's initial public offering in October 1997. See "— Liquidity and Capital Resources".

Geographical Markets

The Group conducts its cellular operations in Guangdong and Zhejiang. While both provinces are among the most economically developed regions in China, the two provinces differ in population size, geographical characteristics, economic strength, social environment and certain other respects. The Group believes that such differences have directly or indirectly contributed to the differences in the Group's results of operations in the two provinces. In addition, the Group's cellular operations in Guangdong were launched approximately five years earlier than its cellular operations in Zhejiang. The following table sets forth certain historical financial information with respect to Guangdong Mobile and Zhejiang Mobile:

	Year ended December 31,					
	1995		1996		1997	
	Guangdong Mobile	Zhejiang Mobile	Guangdong Mobile	Zhejiang Mobile	Guangdong Mobile	Zhejiang Mobile
Operating revenue (RMB in millions)	5,801.1	1,797.0	7,708.5	2,658.8	11,074.7	4,413.0
Operating margin	59.3%	72.5%	45.5%	54.6%	36.6%	31.2%
EBITDA margin	72.9%	82.4%	59.9%	68.4%	53.8%	50.8%

The Group's networks in Guangdong have greater capacity, serve the majority of the Group's subscribers and account for the majority of the Group's operating revenue and operating income. As of December 31, 1997, the Group's subscribers in Guangdong represented 73.5% of the Group's total subscribers. During 1995, 1996 and 1997, the Group's operations in Guangdong accounted for 76.3%, 74.4% and 71.5% of the Group's operating revenue and 72.5%, 70.7% and 75.0% of the Group's operating profit, respectively. In 1995 and 1996, the Group's operating margin and EBITDA margin in Zhejiang were higher than those in Guangdong, and the Group believes that this was primarily attributable to (i) the higher subscriber growth rate in Zhejiang, which resulted in a proportionally greater increase in connection fees as a percentage of total operating revenue, (ii) lower leased line expenses as a percentage total operating expenses in Zhejiang and (iii) lower personnel expenses per employee in Zhejiang. The Group believes that its lower operating margin and EBITDA margin in Zhejiang in 1997 was primarily attributable to (i) increase in the number of leased lines in Zhejiang, (ii) increase in interconnection charges in Zhejiang, and (iii) increased marketing expenses associated with the launching of several advertising compaigns.

Results of Operations

The following table sets forth selected statement of income data, expressed as percentages of operating revenue, for the periods indicated.

	Year ended December 31,		
	1995	1996	1997
Operating revenue:	100.0%	100.0%	100.0%
Usage fees	42.7	53.3	56.3
Monthly fees	12.4	16.0	17.4
Connection fees	39.2	25.8	20.5
Others	5.7	4.9	5.8
Operating expenses:			
Leased lines	16.4	21.4	20.2
Interconnection	0.3	1.9	7.8
Depreciation	10.4	13.7	17.3
Personnel	2.8	4.0	4.9
SG&A and others	7.7	11.1	14.8
Total operating expenses	37.6	52.1	65.0
Operating profit	62.4	47.9	35.0
Other income	2.3	0.5	0.5
Interest expense	(1.2)	(1.6)	(1.1)
Non-operating income	1.6	0.9	4.1
Profit before tax and minority interests	65.1	47.7	38.4
Income tax	(3.8)	(4.1)	(6.4)
Profit before minority interests	61.4	43.5	32.0
Minority interests	—	—	—
Net profit	61.4%	43.5%	32.0%

Year Ended December 31, 1997 Compared to Year Ended December 31, 1996

Operating Revenue. Operating revenue increased 49.4% from RMB 10,367.2 million in 1996 to RMB 15,487.8 million in 1997, due primarily to subscriber growth, leading to increases in usage fees, monthly fees and connection fees. The Group's total number of subscribers increased 66.7% from 2.04 million at the end of 1996 to 3.4 million at the end of 1997. Excluding connection fees, operating revenue increased 60.1% from RMB 7,693.8 million in 1996 to RMB 12,314.3 million in 1997. Average monthly revenue per subscriber (excluding connection fees) decreased 3.1% from RMB 389 in 1996 to RMB 377 in 1997, principally as a result of the expansion of the Group's subscriber base to include a greater number of lower usage subscribers.

Revenue from usage fees increased 57.7% from RMB 5,527.9 million in 1996 to RMB 8,718.1 million in 1997, due primarily to the increase in subscribers and the expanded communications opportunities for subscribers as a result of the expansion and improvement of fixed line and cellular networks throughout China. In addition, effective October 20, 1997, usage fees reflect amounts billed to the Group's subscribers and payable as interconnection costs for certain calls which interconnect with the PT System's PSTN, as well as local network service charges in Guangdong. As a percentage of operating revenue, usage fees increased from 53.3% in 1996 to 56.3% in 1997.

Revenue from monthly fees increased 62.4% from RMB 1,658.2 million in 1996 to RMB 2,692.2 million in 1997, due to the increase in total subscribers. As a percentage of operating revenue, monthly fees increased from 16.0% in 1996 to 17.4% in 1997.

Revenue from connection fees increased 18.7% from RMB 2,673.4 million in 1996 to RMB 3,173.5 million in 1997, due to the increase in total subscribers. The average connection fee for each new subscriber decreased 31.4% from RMB 3,396 in 1996 to RMB 2,330 in 1997. The Group believes that reduction of the average connection fee has helped to expand the Group's subscriber base and resulted in increased total subscriber usage of the Group's cellular services. As a percentage of operating revenue, connection fees decreased from 25.8% in 1996 to 20.5% in 1997.

Other operating revenue increased 78.0% from RMB 507.8 million in 1996 to RMB 904.0 million in 1997, reflecting primarily increases in revenue from fees charged to non-subscribers for roaming into the Group's service areas, interconnection revenue and fees charged to subscribers for value-added services such as call forwarding and incoming caller display functions.

Operating Expenses. Operating expenses increased 86.4% from RMB 5,404.8 million in 1996 to RMB 10,073.6 million in 1997, primarily due to higher leased line payments, interconnection expenses, depreciation charges, personnel expenses and SG&A and other expenses. Of the total increase in operating expenses, 19.7%, 21.8%, 26.9%, 7.3% and 24.3% was accounted for by the increase in leased line payments, interconnection expenses, depreciation charges, personnel expenses and SG&A and other expenses, respectively.

Total leased line payments increased 41.6% from RMB 2,213.6 million in 1996 to RMB 3,134.3 million in 1997, due primarily to network expansion to include new coverage areas, as well as to increased network transmission capacity within existing coverage areas. As a percentage of operating expenses, leased line payments decreased from 41.0% in 1996 to 31.1% in 1997.

Interconnection expenses increased from RMB 196.4 million in 1996 to RMB 1,214.2 million in 1997, due primarily to amounts payable of approximately RMB 739 million to the Guangdong and Zhejiang PTAs as a result of the implementation of new interconnection agreements. As a percentage of operating expenses, interconnection expenses increased from 3.6% in 1996 to 12.1% in 1997.

Depreciation expense increased 88.2% from RMB 1,424.3 million in 1996 to RMB 2,680.5 million in 1997, primarily reflecting increased capital expenditures made by the Group to improve and expand its networks, as well as the impact of the revaluation of the Group's fixed assets as of May 31, 1997. As a percentage of operating expenses, depreciation expense was 26.4% in 1996 and 26.6% in 1997.

Personnel expenses increased 81.4% from RMB 416.5 million in 1996 to RMB 755.5 million in 1997, due primarily to the hiring of additional employees and the maintenance of a competitive salary package to retain experienced employees in 1997 to support network expansion and operation growth. As a percentage of operating expenses, personnel expenses were 7.7% in 1996 and 7.5% in 1997.

SG&A and other operating expenses increased 98.3% from RMB 1,154.1 million in 1996 to RMB 2,289.0 million in 1997, reflecting primarily increases of 43.6% in selling and promotion expenses, 70.8% in network maintenance costs and 97.5% in the provision for doubtful accounts. The increase in selling and promotion expenses was due primarily to the Group's increased efforts on marketing and distribution, including a successful marketing program introduced during 1997 in Zhejiang that added approximately 130,000 new subscribers to Zhejiang Mobile's subscriber base. The increase in the provision for doubtful accounts in 1997 was primarily due to an increase in illegal cloning activities on the Group's TACS networks in 1997. As a percentage of operating revenue, provision for doubtful accounts increased from 2.2% in 1996 to 2.9% in 1997. The Group has implemented various procedures in order to minimize losses through cloning activities. See "— Review of Historical Performance — Operating Expenses".

Operating Profit. Operating profit increased 9.1% from RMB 4,962.4 million in 1996 to RMB 5,414.2 million in 1997. Operating margin declined from 47.9% to 35.0%, primarily due to increased expenses as a result of the Group's network expansion and development, as well as changes implemented in connection with the Restructuring and the Company's initial public offering.

EBITDA. EBITDA represents earnings before interest income, interest expense, non-operating income (expense), income taxes, depreciation and amortization. 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 performance in accordance with generally accepted accounting principles and should not be considered as representing net cash flows from operating activities.

EBITDA increased 27.1% from RMB 6,435.7 million in 1996 to RMB 8,179.7 million in 1997. EBITDA margin decreased from 62.1% in 1996 to 52.8% in 1997.

Other Income; Non-operating Income; Interest Expense. Other income, which includes primarily gross profit from sales of SIM cards, handsets and accessories, increased 73.5% from RMB 49.0 million in 1996 to RMB 85.0 million in 1997, reflecting primarily increased sales of SIM cards resulting from the increase in subscribers to the Group's GSM networks.

Non-operating income, which includes mainly interest income and penalty income on overdue accounts, increased from RMB 96.5 million in 1996 to RMB 629.5 million in 1997, primarily as a result of interest income on the net proceeds of the Company's initial public offering.

Interest expense increased 4.9% from RMB 167.1 million in 1996 to RMB 175.3 million in 1997, primarily due to increased borrowing to finance the Group's network expansion plan prior to the Company's initial public offering.

Profit before tax and minority interests increased 20.5% from RMB 4,940.8 million in 1996 to RMB 5,953.3 million in 1997.

Taxation. The Group incurred income tax expense of RMB 427.5 million in 1996 and RMB 991.0 million in 1997, reflecting an effective tax rate of 8.7% and 16.6%, respectively. The increase in the effective tax rate was primarily due to the fact that connection fee revenue and certain surcharge revenue became subject to taxation upon completion of the Company's initial public offering.

Net Profit. Net profit increased 9.9% from RMB 4,509.2 million in 1996 to RMB 4,955.4 million in 1997. Net profit margin decreased from 43.5% to 32.0%.

Year Ended December 31, 1996 Compared to Year Ended December 31, 1995

Operating revenue. Operating revenue increased 36.4% from RMB 7,598.1 million in 1995 to RMB 10,367.2 million in 1996, due primarily to substantial growth of the Group's subscriber base, leading to increases in revenue from usage fees and monthly fees, partially offset by a decrease in revenue from connection fees. Excluding connection fees, operating revenue increased 66.6% from RMB 4,616.9 million in 1995 to RMB 7,693.8 million in 1996. Average monthly revenue per subscriber (excluding connection fees) decreased 7.4% from RMB 420 in 1995 to RMB 389 in 1996, principally as a result of the expansion of the Group's subscriber base to include a greater number of lower usage subscribers.

Revenue from usage fees increased 70.5% from RMB 3,243.1 million in 1995 to RMB 5,527.9 million in 1996, due primarily to a 62.7% increase in subscribers from 1.3 million at December 31, 1995 to 2.0 million at December 31, 1996. Approximately 58.6% of the increase in the number of subscribers in 1996 was accounted for by the net addition of approximately 461,000 subscribers to the Group's GSM networks, which were launched commercially in Guangdong and Zhejiang in July 1995 and December 1995, respectively. Thus, a substantial portion of the new subscribers in 1995 were added during the last few months in 1995. In 1995, such new subscribers generated revenue for the Group only during the last few months, while in 1996, these subscribers generated revenue for the full year. As a result, revenue from usage fees increased from 1995 to 1996 at a faster rate than the increase in total subscribers. Also contributing to the increased usage fees were the increase in total usage as a result of the expanded communications opportunities for the Group's subscribers, including the increase in on-net calls between the Group's subscribers resulting from the Group's expanded network coverage, and the addition of new value added services. As a percentage of operating revenue, usage fees increased from 42.7% in 1995 to 53.3% in 1996.

Revenue from monthly fees increased 76.5% from RMB 939.5 million in 1995 to RMB 1,658.2 million in 1996, due to the increase in total subscribers. The more rapid increase in monthly fees compared to the increase in total subscribers was due to the relative concentration of new subscribers in the last few months of 1995 as described above. As a percentage of operating revenue, monthly fees increased from 12.4% in 1995 to 16.0% in 1996.

Revenue from connection fees decreased 10.3% from RMB 2,981.2 million in 1995 to RMB 2,673.4 million in 1996, reflecting the reductions in connection fees payable by new subscribers, partially offset by the increase in total subscribers. As a percentage of operating revenue, connection fees decreased from 39.2% in 1995 to 25.8% in 1996.

Other operating revenue increased 16.9% from RMB 434.3 million in 1995 to RMB 507.8 million in 1996, reflecting primarily increases in revenue from fees charged to non-subscribers for roaming into the Group's service areas and fees charged to subscribers for telephone number selection.

Operating Expenses. Operating expenses increased 89.2% from RMB 2,856.2 million in 1995 to RMB 5,404.8 million in 1996, primarily due to increases in leased line payments and depreciation charges, as well as higher SG&A and other expenses. Of the total increase of RMB 2,548.6 million in operating expenses, 38.1%, 24.9% and 22.4% was accounted for by the increase in leased line payments, depreciation and SG&A and other expenses, respectively.

Total leased line payments increased 78.0% from RMB 1,243.7 million in 1995 to RMB 2,213.6 million in 1996, due primarily to network expansion to include new coverage areas, as well as to increased network transmission capacity within existing coverage areas. As a percentage of operating expenses, total leased line payments decreased from 43.5% in 1995 to 41.0% in 1996.

Depreciation expense increased 80.5% from RMB 789.0 million in 1995 to RMB 1,424.3 million in 1996, the first full year of depreciation after the commencement of operations of the Group's GSM networks in Guangdong and Zhejiang. The increased depreciation charges also reflect capital expenditures made by the Group to improve its TACS networks in both provinces. As a percentage of operating expenses, depreciation expense decreased from 27.6% in 1995 to 26.4% in 1996.

Personnel expenses increased 94.7% from RMB 213.9 million in 1995 to RMB 416.5 million in 1996, due primarily to the hiring of additional employees in 1996 to support network expansion and operation growth. The higher personnel expenses in 1996 were also attributable to the introduction in 1996 of a performance-linked salary structure in Guangdong based on Guangdong Mobile's operating performance.

SG&A and other operating expenses increased 97.8% from RMB 583.4 million in 1995 to RMB 1,154.1 million in 1996, reflecting mainly an increase of 68.4% in selling and promotion to RMB 433.8 million in 1996, an increase of 86.6% in network maintenance costs to RMB 198.5 million in 1996, and an increase of 284.2% in the provision for doubtful accounts to RMB 227.4 million in 1996. The Group provides for doubtful accounts based upon its evaluation of the recoverability of the receivables at the balance sheet date. The increase in the provision for doubtful accounts in 1996 was primarily due to an increase in accounts receivable derived from increased revenue and increasing illegal cloning activities in 1996. The increases in selling and promotion expense were due primarily to the Group's increased efforts on marketing and distribution. Network maintenance costs increased in 1996 primarily due to the Group's network expansion.

The Group did not incur any interconnection expense in 1995. The interconnection expense of RMB 45.3 million in 1996 was incurred in connection with the Group's GSM operations in Zhejiang.

Operating Profit. Operating profit increased 4.7% from RMB 4,741.9 million in 1995 to RMB 4,962.4 million in 1996. Operating margin declined from 62.4% to 47.9% primarily as a result of the lower increase in operating revenue compared to the increase in operating expenses.

EBITDA. EBITDA increased 12.8% from RMB 5,707.0 million in 1995 to RMB 6,435.7 million in 1996. EBITDA margin decreased from 75.1% in 1995 to 62.1% in 1996.

Other Income; Interest Expense; Non-operating Income. Other income decreased 72.2% from RMB 176.1 million in 1995 to RMB 49.0 million in 1996. The decrease was primarily due to the deregulation of the handset market in China commencing in 1996, which enabled the Group's subscribers to purchase handsets and certain accessories from third-party suppliers. The decrease was also attributable to a change in the Group's handset sale strategy in 1996 from raising revenue to attracting new subscribers to the Group's services.

Interest expense increased 87.8% from RMB 89.0 million in 1995 to RMB 167.1 million in 1996, primarily due to increased borrowing in Guangdong to finance equipment purchases pursuant to the Group's network expansion plan.

Non-operating income decreased 23.0% from RMB 125.3 million to RMB 96.5 million in 1996, reflecting a decrease of RMB 14.7 million in interest income and a decrease of RMB 19.7 million in foreign exchange gain, partially offset by an increase of RMB 13.8 million in penalty income on overdue accounts.

Profit before tax and minority interests was RMB 4,954.3 million in 1995 and RMB 4,940.8 million in 1996.

Taxation. The Group incurred income tax expense of RMB 285.7 million in 1995 and RMB 427.5 million in 1996, reflecting an effective tax rate of 5.8% and 8.7% in 1995 and 1996, respectively. The effective tax rate increased in 1996 due to the application of a higher income tax rate of 33% to Guangdong Mobile, compared to 18% in 1995, as a result of changes in provincial tax policy, partially offset by the tax exemption for Zhejiang Mobile's taxable income from its GSM operations in 1996, the first year of such operations. The Group's effective tax rates in 1995 and 1996 were lower than the statutory income tax rates applicable to Guangdong Mobile and Zhejiang Mobile, primarily due to the exclusion of connection fees and certain surcharges from the Group's taxable income in 1995 and 1996. The Group only provides deferred income tax benefit on provision for obsolete inventory; all other timing differences between taxable income and income for financial reporting purposes are not recognized.

Net Profit. Net profit decreased 3.4% from RMB 4,668.6 million in 1995 to RMB 4,509.2 million in 1996. Net profit margin decreased from 61.4% to 43.5%.

Liquidity and Capital Resources

Historically, the Group's operations in Guangdong and Zhejiang were directly or indirectly owned by or under the control of the Guangdong PTA and the Zhejiang PTA, respectively, which constituted part of the PT System. As a result, a significant portion of the Group's working capital, capital expenditure and other capital requirements was subject to the requirements of, and managed pursuant to, the overall budgetary and other economic plans of the Guangdong PTA and the Zhejiang PTA. Pursuant to the Restructuring, the Group became a separate entity operationally and financially. As a result, the Group will need to finance its various future capital requirements independently. Therefore, the historical information contained herein concerning liquidity and capital resources of the Group may not be indicative of the liquidity and capital resources of the Group in the future or what the liquidity and capital resources will be or would have been had the Group been a separate, stand-alone entity during the periods presented. In addition, the recent acquisition of Jiangsu Mobile will affect the liquidity and capital resources of the Group.

Working Capital, Cash Flows and Financing

As of December 31, 1997, the Group had a working capital surplus (current assets minus current liabilities) of RMB 36,468.1 million and cash and cash equivalents of RMB 40,070.7 million, compared to RMB 1,493.8 million and RMB 2,976.2 million, respectively, as of December 31, 1996. The increases in working capital and cash and cash equivalents were due primarily to proceeds received from the Company's initial public offering. Working capital and cash and cash equivalents are expected to decrease substantially as a result of the payment of the cash consideration of HK$22,475 million for the acquisition of Jiangsu Mobile. See "— Acquisition of Jiangsu Mobile". As of December 31, 1996 and 1997, accounts receivable totaled RMB 1,087.4 million and RMB 1,591.9 million, respectively. The increases in accounts receivable were primarily a result of increased sales of the Group's services. Short-term and long-term bank and other loans totaled RMB 3,450.7 million and RMB 5,017.9 million as at December 31, 1996 and 1997, respectively.

	Year ended December 31,		
	1995	**1996**	**1997**
		(RMB in millions)	
Net cash inflows from operating activities	5,331.2	6,418.4	8,825.5
Net cash outflow from returns on investments and servicing of finance and taxation	(880.9)	(2,205.1)	(622.5)
Net cash outflow from investing activities	(3,169.4)	(5,263.6)	(5,327.1)
Net cash inflow/(outflow) before financing activities	1,280.9	(1,050.3)	2,876.0
Net cash inflow/(outflow) from financing activities	(467.3)	898.9	34,218.5
Increase/(decrease) in cash and cash equivalents	813.6	(151.3)	37,094.4

Net cash inflows from operating activities increased from 1995 to 1997, generally reflecting the growth in operating revenue due to the increase in the Group's subscriber base.

Net cash outflow from returns on investments and servicing of finance and taxation increased from 1995 to 1996 primarily due to increases in distributions made by the Group to the Guangdong PTA and the Zhejiang PTA in 1996 and higher income tax paid in 1996 resulting from the increased tax rate of 33% applicable to Guangdong Mobile, as compared to 18% in 1995. Net cash outflow from returns on investments and servicing of finance and taxation decreased from 1996 to 1997 primarily due to decreases in distributions made by the Group to the Guangdong PTA and the Zhejiang PTA following the Restructuring and the Company's initial public offering.

Net cash outflow from investing activities increased from 1995 to 1997, primarily due to increased equipment purchases in connection with the Group's network expansion.

Net cash inflow or outflow from financing activities reflects net borrowings or repayments of debt, but excludes credit extended to the Group by equipment suppliers for additions to construction in progress. Net cash inflow from financing activities increased significantly in 1997 as a result of the Company's initial public offering.

As of December 31, 1997, the Group's aggregate long-term bank and other loans totaled RMB 4,190.9 million. Scheduled amounts payable in 1998, 1999 and 2000 will be approximately RMB 1,320.6 million, RMB 1,351.7 million and RMB 745.7 million, respectively.

Capital Expenditures

During 1995, 1996 and 1997, capital expenditures made by the Group were principally for the buildout and improvement of the Group's TACS networks and the development, introduction and expansion of its GSM networks in Guangdong and Zhejiang. Following the Acquisition, the Group also expects to incur capital expenditures in connection with Jiangsu Mobile's TACS and GSM networks. See "— Acquisition of Jiangsu Mobile".

The following table sets forth the Group's historical and planned capital expenditure requirements for the periods indicated. Actual future capital expenditures may differ from the amounts indicated below.

	1995	**1996**	**1997**	**1998**	**1999**	**2000**
				(RMB in millions)		
Guangdong	2,985	3,840	6,746	7,030	3,623	2,568
Zhejiang	1,144	1,938	1,971	4,014	1,238	856
Other*	—	—	2	266	299	299
Total	4,129	5,778	8,719	11,310	5,160	3,723

ï Capital expenditures relating primarily to the Company's head office and the centralization and upgrading of the Group's management information systems.

The Group anticipates that it will require approximately RMB 13,221 million (US$1,591 million) in Guangdong and RMB 6,108 million (US$735 million) in Zhejiang to finance the planned expansion of its GSM networks and improvement of its TACS networks through the end of 2000, of which approximately RMB 7,030 million (US$846 million) and RMB 4,014 million (US$483 million) is expected to be expended in Guangdong and Zhejiang, respectively, by the end of 1998. See "Item 1. Description of Business — Cellular Networks — Network Capacity Expansion Plans". In addition, the Group expects to invest approximately RMB 9,975 million (US$1,200 million) between the years 1998 and 2000 in Jiangsu to improve and increase the quality of Jiangsu Mobile's existing networks and to expand Jiangsu Mobile's network capacity. See "Item 1. Description of Business — Recent Developments".

The Group has historically relied on a combination of cash generated from operations, short-term and long-term bank and other borrowings (including borrowings from the Guangdong PTA and the Zhejiang PTA) and credit from equipment suppliers for its capital expenditures and other capital requirements. Following the Company's initial public offering, the Group has funded capital requirements primarily with the proceeds from such offering, cash generated from operations and, to the extent necessary, short-term borrowings. The Group believes that cash in hand and cash generated from future operations, together with the proceeds from the Company's initial public offering, will be sufficient to fund the capital expenditures and working capital necessary for the planned network expansion and continued growth of its cellular operations through the end of 2000. However, there can be no assurance that the Group will not be required to obtain additional sources of financing to complete its network expansion.

Foreign Exchange

The Group maintains its accounts in Renminbi and substantially all of the Group's revenue and expenses are denominated in Renminbi. The Group's capital expenditures, which are principally denominated in U.S. Dollars and incurred in connection with its purchase of imported equipment, totaled the equivalent of RMB 4,129 million, RMB 5,778 million and RMB 8,719 million, for 1995, 1996 and 1997, respectively. In addition, the Group also incurs interest expense on foreign currency (mainly U.S. Dollar) denominated borrowings. U.S. Dollar denominated long-term loans totaled the equivalent of RMB 2,403.0 million and RMB 3,390.9 million at December 31, 1996 and 1997, respectively.

Under the current foreign exchange system in China, the Company's subsidiaries may not be able to hedge effectively against currency risk, including possible future Renminbi devaluation. Although the Group does not expect significant currency risk given its current operating activities, there can be no assurance that any future movements in the exchange rate of the Renminbi against the U.S. Dollar and other currencies will not adversely affect the Group's results of operations and financial condition.

Guangdong Mobile and Zhejiang Mobile are able to purchase foreign exchange for settlement of current account transactions, as defined in applicable regulations, in order to satisfy their foreign exchange requirements.

Year 2000 Compliance

The "Year 2000 problem", which is common to most companies, concerns the improper storage and manipulation of date fields within software applications, systems, databases, and hardware. The Company has set up a dedicated team which is conducting a review of the Company's computer systems to identify the potential impact of the Year 2000 issue. The total cost of any required computer system modification has not yet been fully assessed. However, based on preliminary information available to the Group, such costs are not currently expected to have a material adverse impact on the Group's financial position or results of operations in future periods.

US GAAP Reconciliation

The Consolidated Financial Statements of the Group are prepared in accordance with Hong Kong GAAP, which differ in certain material respects from US GAAP. These differences relate primarily to (i) the computation of capitalized interest, (ii) the revaluation of fixed assets under Hong Kong GAAP, including the revaluation in connection with the Restructuring, (iii) the recognition of deferred income taxes and (iv) the non-recognition under Hong Kong GAAP of certain employee housing scheme costs not borne by the Group. See Note 23 to the Consolidated Financial Statements.

Item 9A. Quantitative and Qualitative Disclosures About Market Risk.

The Group is subject to market rate risks due to fluctuations in interest rates. The majority of the Group's debt is in the form of long-term, fixed- and variable-rate bank and other loans with original maturities ranging from one to six years. Accordingly, fluctuations in interest rates can lead to significant fluctuations in the fair value of such debt instruments. From time to time, the Group may enter into interest rate swap agreements designed to mitigate its exposure to interest rate risks. The Group did not engage in any interest rate hedging activity in 1997.

The Group is also exposed to foreign currency risk as a result of its telecommunications equipment being sourced substantially from overseas suppliers. Specifically, the Group's foreign currency exposure relates primarily to its foreign currency denominated short- and long-term debt, its firm purchase commitments and, to a limited extent, cash and cash equivalents denominated in foreign currencies. The Group may, from time to time, enter into currency swap agreements and foreign exchange forward contracts designed to mitigate its exposure to foreign currency risks. Such activity generally is expected to be limited to hedging of specific future commitments and long-term debt denominated in foreign currencies. The Group had no foreign currency hedging activity in 1997.

The following table provides information, by maturity date, regarding the Group's interest rate sensitive financial instruments, which consist of fixed and variable rate short-term and long-term debt obligations, as of December 31, 1997.

	As of December 31, 1997							
	Expected Maturity Date						Total Recorded Amount	Fair Value
	1998	1999	2000	2001	2002	Thereafter		
	(RMB equivalent in millions, except interest rates)							
Debt:								
Fixed rate bank and other loans	2,028	1,233	626	166	166	314	4,533	4,307
Average interest rate	7.98%	8.82%	7.50%	7.50%	7.50%	8.23%	8.12%	
Variable rate bank and other loans	119	119	119	120	8	—	485	485
Average interest rate(1)	5.86%	5.86%	5.86%	5.86%	6.25%	—	5.87%	

(1) The interest rates for variable rate bank and other loans is calculated based on the year end indice.

The following table provides information, by maturity date, regarding the Group's foreign currency sensitive financial instruments and transactions, which consist of cash and cash equivalents, short- and long-term debt obligations and capital commitments as of December 31, 1997.

	As of December 31, 1997							
	Expected Maturity Date						Total Recorded Amount	Fair Value
	1998	1999	2000	2001	2002	Thereafter		
	(RMB equivalent in millions, except interest rates)							
On-balance sheet financial instruments								
Cash and cash equivalents:								
In US Dollars	3,154	—	—	—	—	—	3,154	3,154
In Hong Kong Dollars	30,974	—	—	—	—	—	30,974	30,974
Debt:								
Fixed rate bank and other loans (US Dollar)	901	732	626	166	166	314	2,905	2,667
Average interest rate	7.24%	7.34%	7.50%	7.50%	7.50%	8.23%	7.46%	
Variable rate bank and other loans (US Dollar)	119	119	119	120	8	—	485	485
Average interest rate(1)	5.86%	5.86%	5.86%	5.86%	6.25%		5.87%	
Capital commitments authorized and contracted for								
In US Dollars	6,770	—	—	—	—	—	6,770	6,770

(1) The interest rates for variable rate bank and other loans is calculated based on the year end indice.

Item 10. Directors and Officers of Registrant.

The following table sets forth certain information concerning the directors ("Directors") and executive officers of the Company.

Name	Age	Position
Shi Cuiming	58	Chairman; Chief Executive Officer
Chen Zhaobin	41	Vice Chairman; President
Li Ping	44	Vice Chairman; Executive Vice President; Chief Operating Officer
Cui Xun	59	Vice Chairman
Hu Wangshan	54	Vice Chairman
Ding Donghua	61	Director; Chief Financial Officer
Lu Errui	58	Director; Vice President
Zhu Jianhua	44	Director; Vice President
Antony Leung Kam Chung . .	46	Director
Arthur Li Kwok Cheung . . .	53	Director
Zhu Min	34	Controller (Principal Accounting Officer)

Shi Cuiming is the Chairman of the Board of Directors and the Chief Executive Officer of the Company in charge of the overall management of the Company. Mr. Shi is also the Chairman and President of Telpo Communications (Group) Limited. He is a senior economist and graduated in 1963 from the Department of Management Engineering at the Beijing University of Posts and Telecommunications . Mr. Shi had served as Deputy Director of the Division of Economic Research of the Research Institute of Post and Telecommunications of the MPT and Deputy Director of the Bureau of Finance of the MPT. Prior to joining the Company in September 1997, Mr. Shi served as the Director-General of the Bureau of Finance and the Director-General of the Department of Finance of the MPT from 1987. Mr. Shi has over 35 years of experience in the Chinese posts and telecommunications industry, including considerable management experience.

Chen Zhaobin is a Vice Chairman and the President of the Company in charge of the day-to-day management and administrative matters of the Company and the Company's external relations and market development. Mr. Chen holds a bachelor's degree in engineering and graduated in 1982 from the Beijing University of Posts and Telecommunications, where he also served as a teaching assistant and lecturer. He held the post of Deputy Director of the Office of Coordination Production of the MPT from 1991 to 1993, and is currently a Director and Vice President of Telpo Communications (Group) Limited. Mr. Chen has many years of experience in corporate management and in the posts and telecommunications industry. Mr. Chen is also a company secretary of the Company.

Li Ping is a Vice Chairman and the Executive Vice President, Chief Operating Officer of the Company in charge of the business development and operations of the Company. Mr. Li is a senior engineer and graduated in 1976 from the Beijing University of Posts and Telecommunications with a major in radio telecommunications and received an MBA degree from the State University of New York in 1989. His previous positions include serving as Deputy Director General and Deputy Chief Engineer of the Heilongjiang PTA from 1994 to 1996. Prior to joining the Company in September 1997, Mr. Li was a Deputy Director General of the DGT in charge of the DGT's international, cellular mobile and satellite business sectors as well as frequency spectrum management. Mr. Li has nearly 20 years of operational and management experience in telecommunications industry.

Cui Xun is a Vice Chairman of the Company. Mr. Cui is the Director General of the Guangdong provincial PTA and the Chairman of Guangdong Mobile. He is a senior engineer and graduated in 1962 from the Beijing

University of Posts and Telecommunications with a major in fixed line communications. Mr. Cui has previously served as Deputy Chief Engineer, Deputy Director and Chief Engineer at the Guangzhou municipal PTB in Guangdong province, and Chief Engineer and Deputy Director of the Guangdong provincial PTA. Mr. Cui has 36 years of experience in the Chinese posts and telecommunications industry.

Hu Wangshan is a Vice Chairman of the Company. Mr. Hu is the Director General of the Zhejiang provincial PTA and the Chairman of Zhejiang Mobile. He is a senior engineer and graduated in 1968 from the Beijing University of Posts and Telecommunications with a major in telegraph and telephone communications. Mr. Hu has previously served as a Deputy Director and the Director of the Shaoxing municipal PTB in Zhejiang province and a Deputy Director of the Zhejiang provincial PTA. Mr. Hu has over 30 years of experience in the Chinese posts and telecommunications industry.

Ding Donghua is a Director and Chief Financial Officer of the Company in charge of overall financial management of the Company. Mr. Ding is a senior economist and graduated from the Management Engineering Faculty of the Beijing University of Posts and Telecommunications in 1961. Mr. Ding has previously served as the director of the Planning and Financial Office and deputy chief economist of the Guangdong PTA, and, prior to joining the Company in September 1997, was the chief economist and chief accountant of the Guangdong PTA from 1987. He has 37 years of experience in the Chinese posts and telecommunications industry and is experienced in the economic and financial management aspects of the industry.

Lu Errui is a Director and Vice President of the Company in charge of the operations of Guangdong Mobile. Mr. Lu is also a Director and Vice President of Guangdong Mobile. He is a senior engineer and graduated in 1966 from the Chinese University of Science and Technology with a major in radio electronics. Mr. Lu has previously served as leader of the engineering group at the Hangtian Industrial Ministry's Satellite Assembly Factory, Director of the Wireless Telecommunications Research Office of the MPT's Research Institute of Telecommunications and Transmission since 1967, Director of the MPT's Mobile Telecommunications Equipment Testing Center and General Manager of Guangdong Mobile since May 1992. Mr. Lu has over 20 years of experience in the Chinese posts and telecommunications industry.

Zhu Jianhua is a Director and Vice President of the Company in charge of the operations of Zhejiang Mobile. Mr. Zhu is also a Director and President of Zhejiang Mobile. He is a senior engineer and graduated in 1985 from the Nanjing Institute of Posts and Telecommunications with a major in communications. He received a master's degree in computer science from Zhejiang University in 1992. Mr. Zhu has previously served as Chief Engineer and Deputy Director of the Hangzhou municipal PTB. Mr. Zhu has many years of experience in the Chinese posts and telecommunications industry.

Antony Leung Kam Chung is a Director of the Company. Mr. Leung is a managing director of The Chase Manhattan Bank and Regional Manager for Greater China and the Philippines. He graduated from the University of Hong Kong and also completed the Program for Management Development at the Harvard Business School. Mr. Leung is a member of the Executive Council of the Hong Kong Special Administrative Region. Mr. Leung is also the Chairman of the Education Commission, member of the Exchange Fund Advisory Committee, and member of the Board of the Airport Authority. He also serves as Director of the Hong Kong Policy Research Institute and Trustee of the Queen Mary Hospital Charitable Trust and the Hong Kong Centre for Economic Research. Mr. Leung was a member of the Preparatory Committee of the Hong Kong Special Administrative Region.

Arthur Li Kwok Cheung is a Director of the Company. Professor Li is the Vice-Chancellor of the Chinese University of Hong Kong and a director of Glaxo Wellcome plc and the Bank of East Asia Limited. He holds a Doctor of Medicine Degree from Cambridge University. He served on the board of the Hong Kong Government Hospital Authority and was also President of the College of Surgeons of Hong Kong. Professor Li is also an Advisor on Hong Kong Affairs to the People's Republic of China and a member of the Consultative Committee of the Basic Law and was a member of the Preparatory Committee of the 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.

Zhu Min is the Controller and principal accounting officer of the Company. Ms. Zhu graduated in 1989 from the Beijing University of Posts and Telecommunications with a master's degree in management engineering. She has previously served as a deputy director and a director of the Corporate Finance Division of the MPT's Finance Department. Ms. Zhu has over nine years of experience in financial management and accounting.

There is no family relationship between any director or executive officer and any other director or executive officer of the Company.

Item 11. Compensation of Directors and Officers.

The Company was established on September 3, 1997. The aggregate amount of compensation paid by the Group to Directors and executive officers during 1997 for services performed as Directors, officers or employees of the Group was HK$3,866,357(US$498,917).

Item 12. Options to Purchase Securities from Registrant or Subsidiaries.

In connection with the Restructuring, the Company adopted a share option scheme (the "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% of the total issued share capital of the Company. The consideration payable by a participant for the grant of an option under the Share Option Scheme will be HK$1.00. The price for a Share payable by a participant upon the exercise of an option will be determined by the Directors of the Company in 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% of the average of the closing prices of Shares on the Hong Kong Stock Exchange 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 in their discretion, except that no option may be exercised later than 10 years after the adoption date of the scheme. As of June 15, 1998, six options exercisable for an aggregate of 12 million Shares had been granted to Directors of the Company under the Share Option Scheme. Such options are exercisable at a price of HK$11.10 per Share during the period from March 9, 1998 through March 8, 2006.

Item 13. Interest of Management in Certain Transactions.

As of December 31, 1997, the MII indirectly owned an aggregate of 76.5% of the Company's issued share capital. The MII and the DGT have jointly undertaken that they will extend their support to the Group's present operations and future development. The Group's operations, along with those of other cellular telephone system operators in China, are subject to a high degree of regulation by the MII. The MII has undertaken that, to the extent within its power, the Group will be treated equally with any other cellular operators in respect of all approvals, transactions and arrangements between the Group, on the one hand, and entities within the PT System, on the other hand. The MII has also undertaken that the Company will be the only cellular telecommunications services company in the PT System operating in mainland China under its control that will be listed on any securities exchange in Hong Kong or outside China. In addition, the MII has undertaken that the PT System will not participate, directly or indirectly, in the provision of cellular telecommunications services in any province in which the Group currently operates or may operate in the future. In connection therewith, the MII has undertaken to contribute to the Group, at the Group's option, the entire interest, if any, held by the PT System in the CDMA Project in any such province when and if the CDMA Project, after trial operations, becomes commercially feasible.

In connection with the Restructuring, the Group entered into various agreements with the DGT and certain other entities within the PT System. These transactions are described below. In connection with the Acquisition, the Company and Jiangsu Mobile have entered into similar transactions with the Jiangsu PT Bureaus and the DGT.

Leasing of Offices and Sites for Network Equipment

The Guangdong PTA and the Zhejiang PTA have leased certain premises to the Group for use as offices, warehouses and sites for locating equipment such as base transceiver stations, base station controller and mobile switching centers, for terms of between three to fifty years. The rental payments under these lease agreements are determined with reference to market rates.

The Hong Kong head office of the Company is sub-leased from Telpo Communications (Group) Limited pursuant to a tenancy agreement which will expire on June 30, 2000. The yearly rental for the office is approximately HK$2.6 million.

Leasing of Transmission Lines

The Group leases certain transmission lines from the Guangdong PTA and the Zhejiang PTA in order to link the Group's base transceiver stations, base station controllers and mobile switching centers and to interconnect the Group's network to the PT System's PSTN. Two leased line agreements were entered into in September 1997 between Guangdong Mobile and the Guangdong PTA and between Zhejiang Mobile and the Zhejiang PTA, respectively. The Group entered into such agreements on normal commercial terms following the Restructuring in order to ensure that it will continue to be able to use transmission lines owned by the PTAs. The agreements are renewable automatically unless either party notifies the other in writing of its intention to terminate at least six months prior to the end of the term. Neither party may unilaterally terminate the lease agreements prior to the expiration of their respective terms. Lease payments are standardized and are based on tariff schedules stipulated by the MII from time to time which are applicable to other cellular and fixed line operators, and are payable semi-annually.

Prior to the Restructuring, the Group paid to the Guangdong PTA a portion of Guangdong Mobile's operating revenues as a monthly fee for the leasing of local transmission lines and a fixed monthly fee per line for the leasing of long distance transmission lines. In Zhejiang, the Group paid to the Zhejiang PTA a fixed fee for the leasing of both local and long distance transmission lines.

Interconnection Arrangements

The Group's networks interconnect with the PT System's PSTN, allowing the Group's subscribers to communicate with fixed line users and subscribers of other cellular networks and to make and receive domestic and international long distance calls. Two interconnection agreements were entered into in September 1997 between Guangdong Mobile and the Guangdong PTA and between Zhejiang Mobile and the Zhejiang PTA, respectively. Both interconnection agreements are for a term of one year from October 20, 1997. The agreements are renewable at the option of Guangdong Mobile and Zhejiang Mobile, as the case may be, subject, in the case of Guangdong Mobile, to the right of the parties to reconsider certain terms of the agreement. Neither party may unilaterally terminate the interconnection agreements.

The interconnection agreements set forth the amounts payable by the relevant PTA to the Group for inbound calls to the Group's subscribers which originate from the PT System's PSTN and the amounts payable by the Group to the relevant PTA for outbound calls from the Group's subscribers which terminate on the PT System's PSTN. See " Item 1. Description of Business — Operations — Interconnection Revenue and Costs". The agreements provide that the Group will be entitled to benefit from more favorable interconnection arrangements, if any, entered into between the Guangdong PTA or the Zhejiang PTA (as the case may be) and any other cellular operator in the future. The fees payable by the Group under the new arrangements are standard and applied uniformly to cellular operators in China, including Unicom.

Billing Services

Certain billing services relating to the Group's cellular operations in Zhejiang are provided by the Zhejiang PTA and the relevant PTBs pursuant to an agreement between Zhejiang Mobile and the Zhejiang PTA, entered into in September 1997. The agreement is for a term of one year from October 20, 1997. Pursuant to the agreement, the billing services are provided to Zhejiang Mobile at the rate of RMB 0.20 per bill. In the event that Zhejiang Mobile's own billing system is established, Zhejiang Mobile may terminate the agreement with one month's prior written notice to the Zhejiang PTA.

Collection Services

Certain payment collection services relating to the Group's cellular operations in Guangdong are provided by the Guangdong PTA and the relevant PTBs pursuant to an agreement between Guangdong Mobile and the Guangdong PTA, entered into in September 1997. The agreement is for a term of three years from October 20, 1997. The agreement is terminable at any time after two years from the date thereof upon six months' prior written notice and, unless either party notifies the other in writing at least three months prior to the end of the initial term of their intention to terminate, the agreement will be automatically extended for another three years. Pursuant to the agreement, the collection services are provided to Guangdong Mobile at the rate of RMB 0.01 per RMB 1.00 collected. Guangdong Mobile also relies on authorized distributors not affiliated with the PT System for certain collection services.

Distribution and Marketing Arrangements

The Group markets its cellular services in Zhejiang and GSM services in Guangdong, in part, through a total of approximately 800 authorized dealers within the PT System, including post offices and other outlets, pursuant to two exclusive marketing agreements between Guangdong Mobile and the Guangdong PTA and between Zhejiang Mobile and the Zhejiang PTA, each entered into in September 1997. Each agreement is for a term of one year and, unless either party notifies the other in writing at least three months prior to the end of the initial term of the termination of the agreement, will be automatically extended for another year. Pursuant to the agreements, the authorized dealers market and sell the Group's cellular services in Zhejiang and GSM services in Guangdong. In connection with such services, the Group pays such dealers RMB 300 per new subscriber acquired. In addition, the authorized dealers pay to the Group the Group's standard charges to new subscribers such as connection fees and telephone number selection fees. The payment arrangements under the agreements are similar to those between the Group and its other authorized dealers not affiliated with the PT System.

Roaming Arrangements

The Group offers automatic roaming services to its subscribers, which permits subscribers to make and receive telephone calls while they are outside of their local service area, including in the coverage area of other cellular systems with which the user's home system has a roaming arrangement. The MII has promulgated regulations governing the sharing of roaming usage revenue among cellular operators within the PT System. The Company entered into an agreement with the DGT in September 1997 with respect to domestic and international roaming services for a term of one year from October 20, 1997. The agreement provides for the sharing of roaming revenue between the Group and other cellular operators and procedures and timing of payment settlement. See “Item 1. Description of Business — Operations — Roaming Services”.

Licensing of Trademark

The DGT is the owner of the “China Telecom” logo. Pursuant to a non-exclusive license agreement entered into in September 1997 between the DGT and the Company, the Group has obtained the right to use such trademark for a term of six years from October 20, 1997, or such period that the DGT shall have the right to the trademark logo, whichever period is longer. No license fee is payable by the Group in respect of the first three years and the fees payable thereafter, if any, shall be no less favorable than fees paid by other entities within the PT System for the use of such DGT trademark logo. The DGT may license the trademark to other affiliated parties but may not unilaterally terminate the license agreement.

Loan Arrangements

Guangdong Mobile has entered into a loan agreement with Telpo Communications (Group) Limited, a company controlled by the MII, dated July 31, 1997, under which Telpo Communications (Group) Limited agreed to advance to Guangdong Mobile US$166.96 million for the purpose of acquiring cellular telecommunications facilities. The loan, which is unsecured, bears interest at 7.5% per annum and is repayable in three years in half-yearly installments.

Miscellaneous

The transactions mentioned above have been entered into in the ordinary course of business and on normal commercial terms. Under the Listing Rules of the Hong Kong Stock Exchange (the "Listing Rules"), such transactions are considered to be "connected transactions" and would normally require full disclosure and prior independent shareholders' approval on each occasion they arise. As the transactions are expected to be continued in the normal course of business, the Directors consider that such disclosure and approval would be impractical. Accordingly, the Directors have requested the Hong Kong Stock Exchange to grant a waiver from these requirements. On the basis of confirmations received that the transactions have been entered into in the usual and ordinary course of business, on normal commercial terms and are fair and reasonable, the Hong Kong Stock Exchange has indicated that a waiver would be granted from compliance with the normal approval and disclosure requirements related to connected transactions under the Listing Rules on the following conditions:

(a) details of the transactions as set out in rule 14.25(1)(A) to (D) of the Listing Rules, shall be disclosed in the Company's annual report;

(b) the Company's independent non-executive Directors shall review annually the transactions and confirm in the Company's next annual report that:

(i) the transactions have been entered into by the Company in the ordinary and usual course of its business;

(ii) the transactions have been entered into on terms that are fair and reasonable so far as the shareholders of the Company are concerned;

(iii) the transactions have been entered into on normal commercial terms and either (1) in accordance with the terms of the agreement governing such transactions or (2) (where there is no such agreement) on terms no less favorable than terms available to third parties; and

(c) the auditors of the Company shall review annually the transactions, details of which shall be set forth in the Company's annual report and accounts and confirm in the Company's next annual report as well as provide the Directors of the Company with a letter stating that;

(i) the transactions have received the approval of the Directors; and

(ii) the transactions have been conducted in the manner as stated in paragraph (b)(iii) above;

The MII, on its own behalf and on behalf of relevant entities within the PT System and the Company, have confirmed to the Hong Kong Stock Exchange that the auditors will be granted access to such records of the Company as the auditors consider necessary for the purpose of reviewing the transactions mentioned above.

The Hong Kong Stock Exchange has indicated that if any of the terms of the agreements referred to above are altered (other than as provided for in the relevant agreements) or if the Group enters into any new arrangements with connected persons in the future, the Company must comply with the relevant requirements of the Listing Rules. In respect of the interconnection arrangements described above, the Hong Kong Stock Exchange has indicated that upon the expiry of the existing agreements, or their amendment to reflect more favorable interconnection arrangements entered into between the Guangdong PTA or the Zhejiang PTA and other cellular operators in the future, the waiver requested of the Hong Kong Stock Exchange will also apply to the terms agreed upon such expiry or amendment, provided that in the opinion of an independent financial adviser the new terms are no less favorable to the Group than the previous interconnection arrangements and provided further that the Company issues a press announcement describing the new arrangements. Any other change to the existing arrangements will require full compliance with the relevant requirements of the Listing Rules.

PART II

Item 14. Description of Securities to be Registered.

Not Applicable.

PART III

Item 15. Defaults Upon Senior Securities.

None.

Item 16. Changes in Securities, Changes in Security for Registered Securities and Use of Proceeds.

Change in Securities and Changes in Security For Registered Securities

None.

Use of Proceeds

The following set forth certain information regarding the Company's initial public offering.

Effective date of the registration statement for which the use of proceeds information is being disclosed	October 15, 1997
SEC file number assigned to the registration statement . .	333-7634
Closing date	October 23, 1997
Over-allotment closing date	November 10, 1997
Managing underwriters	China International Capital Corporation Goldman Sachs (Asia) L.L.C.

Title of security	Ordinary Shares, par value HK$0.10 per share

The offering terminated upon the sale of (i) 1,440,161,000 Shares, in the form of Shares and ADSs, on October 23, 1997 (excluding 1,159,839,000 Shares sold to certain corporate investors as part of the Company's initial public offering (the "Corporate Investors") in reliance on Regulation S under the Securities Act, which Shares were not registered under the Securities Act) and (ii) a further 170,788,000 Shares, in the form of Shares and ADSs, on November 10, 1997 to cover over-allotments. The Shares registered under the registration statement specified above included 390,000,000 Shares with respect to which the Company granted the Underwriters an option to purchase to cover over-allotments, but did not include the 1,159,839,000 Shares sold to the Corporate Investors. All Shares and ADSs were sold for the account of the Company.

The following is certain information regarding the proceeds from the Company's initial public offering (excluding proceeds from the sale of Shares to corporate investors):

Amount registered	1,830,161,000 Shares
Aggregate price of offering amount registered	US$2,790,995,525
Amount sold	1,610,949,000 Shares
Aggregate offering price of amount sold	US$2,456,697,225
Direct or indirect payments for:	
Underwriting discounts and commissions	US$85,984,403
Other offering expenses	US$41,131,241
Net offering proceeds to the Company	US$2,329,581,581

The combined net proceeds of the Company's initial public offering and sale of Shares to the Corporate Investors were US$4,039,738,989. As at December 31, 1997, such proceeds were placed with banks as short term deposits. Capital expenditures in 1997 in respect of the expansion of the Group's cellular networks in Guangdong and Zhejiang were primarily funded from the Group's cashflow from operations.

PART IV

Item 17. Financial Statements.

The Company has elected to provide the financial statements and related information specified in Item 18 in lieu of Item 17.

Item 18. Financial Statements.

The following financial statements are filed as part of this Annual Report.

China Telecom (Hong Kong) Limited:

Item 19. Financial Statements and Exhibits.

(a) See Item 18 for a list of the financial statements filed as part of this Annual Report.

(b) Exhibits to this Annual Report:

None.

SIGNATURES

Pursuant to the requirements of Section 12 of the Securities Exchange Act of 1934, the registrant certifies that it meets all of the requirements for filing on Form 20-F and has duly caused this annual report to be signed on its behalf by the undersigned, thereunto duly authorized.

CHINA TELECOM (HONG KONG) LIMITED

By: /S/Chen Zhaobin
Chen Zhaobin
Vice Chairman and President

Date: June 29, 1998