China Netcom Group CORP (Hong Kong) LTD
Form 6-K
October 11, 2005

FORM 6-K

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

Report of Foreign Private Issuer
Pursuant to Rule 13a-16 or 15d-16 of
the Securities Exchange Act of 1934

For the month of October, 2005

(Indicate by check mark whether the registrant files or will file annual reports under cover of Form 20-F or Form 40-F.)

Form 20-F ____ Form 40-F _____

(Indicate by check mark whether the registrant by furnishing the information contained in this form is also thereby furnishing the information to the Commission pursuant to Rule 12g3-2(b) under the Securities Exchange Act of 1934.)

Yes ____ No ____

(If "Yes" is marked, indicate below the file number assigned to registrant in connection with Rule 12g3-2(b): 82-__________.)

N/A

China Netcom Group Corporation (Hong Kong) Limited
Building C, No. 156, Fuxingmennei Avenue
Xicheng District
Beijing, 100031 PRC

This Form 6-K consists of:

The acquisition circular of China Netcom Group Corporation (Hong Kong) Limited (the "Registrant"), made by the Registrant in English on September 23, 2005.

SIGNATURE

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the under-signed, thereunto duly authorized.

CHINA NETCOM GROUP CORPORATION (HONG KONG) LIMITED

By /s/ Zhang Xiaotie

By /s/ Oliver E Lixin

Name: Zhang Xiaotie and Oliver E Lixin

Title: Joint Company Secretaries

Date: September 23, 2005

THIS CIRCULAR IS IMPORTANT AND REQUIRES YOUR IMMEDIATE ATTENTION

If you are in any doubt as to any aspect of this circular or as to the action to be taken, you should consult your licensed securities dealer, bank manager, solicitor, professional accountant or other professional adviser.

If you have sold or transferred all your shares in China Netcom Group Corporation (Hong Kong) Limited, you should at once hand this circular together with the accompanying form of proxy to the purchaser or the transferee or to the bank, licensed securities dealer or other agent through whom the sale or transfer was effected for transmission to the purchaser or the transferee.

This circular is for the sole purpose of the extraordinary general meeting of the Company and does not constitute an invitation or offer to acquire, purchase or subscribe for any securities.

[GRAPHIC OMITTED]
CHINA NETCOM GROUP CORPORATION (HONG KONG) LIMITED
[GRAPHIC OMITTED]
(incorporated in Hong Kong with limited liability under the Companies Ordinance)
(Stock Code: 906)

MAJOR TRANSACTION,
CONNECTED TRANSACTION AND
CONTINUING CONNECTED TRANSACTIONS

Financial Advisers to China Netcom Group Corporation (Hong Kong) Limited
(in alphabetical order)

[GRAPHIC OMITTED]	[GRAPHIC OMITTED]	[GRAPHIC OMITTED]
China International Capital Corporation (Hong Kong) Limited	Citigroup Global Markets Asia Limited	Goldman Sachs (Asia) L.L.C.

Independent financial adviser to the Independent Board Committee and the Independent Shareholders
[GRAPHIC OMITTED]
Credit Suisse First Boston (Hong Kong) Limited

A notice convening an extraordinary general meeting of the Company to be held in Nathan Room, Conrad Hotel, Hong Kong, on 25 October 2005 at 10:00 a.m., is set out at the end of this circular. Whether or not you are able to attend the extraordinary general meeting, you are requested to complete the accompanying form of proxy in accordance with the instructions printed thereon and return the same to the Company's registered office at 46th Floor, Cheung Kong Center, 2 Queen's Road Central, Hong Kong, as soon as practicable and in any event at least 48 hours before the time appointed for holding the extraordinary general meeting or any adjournment thereof. Completion and return of the form of proxy will not preclude you from attending and voting in person at the extraordinary general meeting or at any adjourned meeting should you so wish.

A letter from the independent board committee of the Company containing its recommendation to the independent shareholders of the Company is set out on pages 36 to 37 of this circular. A letter from CSFB, the independent financial adviser, containing its advice to the independent board committee and the independent shareholders of the Company is set out on pages 38 to 58 of this circular.

23 September 2005

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DEFINITIONS

In this circular, unless the context otherwise requires, the following expressions have the following meanings:

"Acquisition"	the proposed acquisition by the Company of the entire issued share capital of the Target BVI Company pursuant to the Acquisition Agreement, as further described in this circular
"Acquisition Agreement"	the conditional sale and purchase agreement dated 12 September 2005 entered into among the Company, CNC BVI and China Netcom Group relating to the Acquisiti
"ADSs"	American depositary shares issued by Citibank, N.A., each representing ownership of 20 Shares, which are listed on the New York Stock Exchange, Inc.
"Asia Netcom"	Asia Netcom Corporation Limited, a wholly-owned subsidiary of the Company
"Associates"	as defined in the Hong Kong Listing Rules
"Board" or "Board of Directors"	the board of Directors
"Business Day"	a day (excluding Saturdays) on which banks are generall open in Hong Kong for the transaction of normal banking business
"China" or "PRC"	the People's Republic of China (excluding,for the purpos this circular, Hong Kong, Macau and Taiwan)
"China Mobile"	China Mobile Communications Corporation ([GRAPHIC OMITTED]), a company established under the laws of the P
"China Netcom Group"	China Network Communications Group Corporation, a company established under the laws of the PRC and the ultimate controlling shareholder of the Company
"China Telecom"	China Telecommunications Corporation ([GRAPHIC OMITTED], company established under the laws of the PRC
"China Unicom"	China United Telecommunications Corporation ([GRAPHIC OMITTED]), a company established under the laws of the P
"CICC"	China International Capital Corporation (Hong Kong) Limited, which is licensed for Type 1 regulated activity (dealing in securities), Type 4 regulated activity (advising on securities), Type 6 regulated activity (advising on corporate finance) and Type 9 regulated activity (asset management) under the Securities and Futures Ordinance and financial adviser to the Company in respect of the Acquisition
"Citigroup"	Citigroup Global Markets Asia Limited, which is deemed licensed for Type 1 regulated activity (dealing in securities), Type 4 regulated activity (advising on securities) and Type 6 regulated activity (advising on corporate finance) under the Securities and Futures Ordinance and financial adviser to the Company in respect of the Acquisition
"CNC BVI"	China Netcom Group Corporation (BVI) Limited, a company incorporated in the British Virgin Islands with limited liability and the direct controlling shareholder of the Company
"CNC China"	China Netcom (Group) Company Limited ([GRAPHIC OMITTED]), formerly known as China Netcom Corporation Limited, a company established in the PRC with limited liability as a wholly foreign owned enterprise and a wholly owned subsidiary of the Company
"Combined Group"	the Company, its existing subsidiaries and the Target Gr
"Companies Ordinance"	the Companies Ordinance (Chapter 32 of the Laws of Hong
"Company"	China Netcom Group Corporation (Hong Kong) Limited ([GRAPHIC OMITTED]), a company incorporated in Hong Kong whose Shares are listed on the Hong Kong Stock Exchange and whose ADSs are listed on the New York Stock Exchange, Inc.
"Continuing Connected Transactions"	the connected transactions described in the section headed "Continuing Connected Transactions" of the

	"Letter from the Chairman"
"CSFB" or "Independent Financial Adviser"	Credit Suisse First Boston (Hong Kong) Limited, which is deemed licensed for Type 1 regulated activity (dealing in securities), Type 4 regulated activity (advising on securities) and Type 6 regulated activity (advising on corporate finance) under the Securities and Futures Ordinance, being the independent financial adviser to the Independent Board Committee and the Independent Shareholders in respect of the Acquisition and the Non-exempt Continuing Connected Transactions
"CSRC"	China Securities Regulatory Commission ([GRAPHIC OMITTED])
"Directors"	the directors of the Company
"EANL"	East Asia Netcom Ltd., a company incorporated in Bermuda with limited liability and an indirect wholly owned subsidiary of China Netcom Group
"Equity Interest Injection Agreement"	the equity interest injection agreement dated 9 August 2 entered into among the Target BVI Company, CNC BVI and China Netcom Group
"Extraordinary General Meeting"	the extraordinary general meeting of the Company to be convened on 25 October 2005, notice of which is set out at the end of this circular, or any adjournment ther
"Financial Advisers"	CICC, Citigroup and Goldman Sachs, being the financial advisers to the Company in respect of the Acquisition
"GDP"	gross domestic product
"Goldman Sachs"	Goldman Sachs (Asia) L.L.C., which is licensed for Type 1 regulated activity (dealing in securities), Type 4 regulated activity (advising on securities), Type 5 regulated activity (advising on futures contracts), Type 6 regulated activity (advising on corporate finance) and Type 9 regulated activity (asset management) under the Securities and Futures Ordinance and financial adviser to the Company in respect of the Acquisition
"Group"	the Company and its existing subsidiaries
"HK$"	Hong Kong dollars, the lawful currency of Hong Kong
"HKFRS"	Hong Kong Financial Reporting Standards issued by Hong K Institute of Certified Public Accountants
"Hong Kong"	Hong Kong Special Administrative Region of the People's of China
"Hong Kong Listing Rules"	the Rules Governing the Listing of Securities on The Sto Exchange of Hong Kong Limited
"Hong Kong Stock Exchange"	The Stock Exchange of Hong Kong Limited
"Independent Board Committee"	the committee of Directors, consisting of John Lawson Victor Cha Mou Zing, Qian Yingyi, Hou Ziqiang and Timp Shui Ming, being all the independent non-executive D formed to advise the Independent Shareholders in respe terms of the Acquisition and the Non-exempt Continuing Transactions
"Independent Shareholders"	Shareholders other than China Netcom Group and its Assoc
"Latest Practicable Date"	8 September 2005, being the latest practicable date prio printing of this circular for ascertaining certain infor contained herein
"MII"	Ministry of Information Industry of the PRC ([GRAPHIC OM or where the context so requires, its predecessor, the f Ministry of Posts and Telecommunications ([GRAPHIC OMITT
"MOC"	the Ministry of Commerce of the PRC ([GRAPHIC OMITTED)
"Non-exempt Continuing Connected Transactions"	continuing connected transactions contemplated underthe Domestic Interconnection Settlement Agreement, the Inter Long Distance Voice Services Settlement Agreement, the Engineering and Information Technology Services Agreement and the Materials Procurement Agreement,

	such transactions and agreements are further described in the section headed "Continuing Connected Transactions" of the "Letter from the Chairman"
"Option(s)"	option(s) which have been granted under the Company's share option scheme approved and adopted by a resolution of the Shareholders passed on 30 September 2004
"Reorganisation"	the successive steps whereby China Netcom Group transferred the telecommunications operations in the Target Regions and related assets and liabilities to the Target Company, as further described in the section headed "The Reorganisation" of the "Letter from the Chairman"
"RMB"	Renminbi, the lawful currency of the PRC
"Sallmanns"	Sallmanns (Far East) Limited, a chartered surveyor and independent property valuer to the Company
"SASAC"	State-owned Assets Supervision and Administration Commission of the State Council ([GRAPHIC OMITTED])
"Securities and Futures Ordinance"	the Securities and Futures Ordinance (Chapter 571 of the Hong Kong)
"Share(s)"	ordinary shares in the Company's issued share capital with a par value of US$0.04 per share which are listed on the Hong Kong Stock Exchange "Shareholders" holders of Shares
"State Council"	the State Council of the PRC ([GRAPHIC OMITTED])
"Target BVI Company"	China Netcom Group New Horizon Communications Corporatio Limited ([GRAPHIC OMITTED]), a company incorporated in the British Virgin Islands
"Target Company"	China Netcom Group New Horizon Communications Corporation Limited ([GRAPHIC OMITTED][GRAPHIC OMITTED]), a company incorporated in the PRC and the term "Target Company" shall, if the context so requires, include any predecessor entity or person carrying on its business before the Reorganisation
"Target Group"	the Target BVI Company and the Target Company
"Target Regions"	the regions in which the Target Company operates its business, being Heilongjiang Province, Jilin Province, Neimenggu Autonomous Region, and Shanxi Province of the PRC
"Telecommunications Regulations"	The PRC Telecommunications Regulations ([GRAPHIC OMITTED]) which became effective as of 25 September 2000
"US dollars" or "US$"	United States dollars, the lawful currency of the United States of America

For your convenience and unless otherwise specified, this circular contains translations between RMB and US dollars at RMB8.0998 = US$1.00, between RMB and Hong Kong dollars at RMB1.0422 = HK$1.00, and between Hong Kong dollars and US dollars at HK$7.7718 = US$1.00, the prevailing rates on 31 August 2005. The translations are not representations that the RMB, Hong Kong dollar and US dollar amounts could actually be converted at those rates, if at all.

LETTER FROM THE CHAIRMAN

[GRAPHIC OMITTED]

CHINA NETCOM GROUP CORPORATION (HONG KONG) LIMITED

[GRAPHIC OMITTED]

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

Executive Directors:
ZHANG Chunjiang (Chairman)
TIAN Suning (Vice Chairman and Chief Executive Officer)
ZHANG Xiaotie
MIAO Jianhua

Non-Executive Directors:
JIANG Weiping
LI Liming
Jose Maria ALVAREZ-PALLETE
YAN Yixun

Independent Non-executive Directors:
John Lawson THORNTON
Victor CHA Mou Zing
QIAN Yingyi
HOU Ziqiang
Timpson CHUNG Shui Ming

Registered Office:
46th Floor
Cheung Kong Center
2 Queen's Road Central
Hong Kong

23 September 2005

To the Shareholders

Dear Sir or Madam,

MAJOR TRANSACTION,
CONNECTED TRANSACTION AND
CONTINUING CONNECTED TRANSACTIONS

Acquisition of the Target BVI Company

INTRODUCTION

On 12 September 2005, the Board of Directors announced that the Company had entered into the Acquisition Agreement, pursuant to which the Company agreed to acquire and CNC BVI, the Company's immediate holding company, agreed to sell the entire equity interest in the Target BVI Company for a purchase price of RMB12,800 million (equivalent to approximately HK$12,282 million), subject to certain conditions.

As at the Latest Practicable Date, CNC BVI beneficially owned approximately 70.49% of the issued share capital of the Company. CNC BVI is a wholly-owned subsidiary of China Netcom Group. As such, both CNC BVI and China Netcom Group are connected persons of the Company. The relevant applicable percentage ratios under Rule 14.07 of the Hong Kong Listing Rules in respect of the Acquisition exceed 25% but are below 100%. Accordingly, under the Hong Kong Listing Rules, the Acquisition constitutes both a connected transaction and a major transaction for the Company.

An Independent Board Committee has been established by the Company to advise the Independent Shareholders in respect of the terms of the Acquisition and the terms of the Non-exempt Continuing Connected Transactions. In this respect, CSFB has been retained as the independent financial adviser to the Independent Board Committee and the Independent Shareholders.

CICC, Citigroup and Goldman Sachs are the financial advisers to the Company in respect of the Acquisition.

The purpose of this circular is to provide you with further information relating to the Acquisition and the Continuing Connected Transactions and to seek your approval of the ordinary resolutions set out in the Notice of

Extraordinary General Meeting at the end of this circular. The recommendation from the Independent Board Committee to the Independent Shareholders is set out on pages 36 to 37 of this circular and the letter from CSFB is set out on pages 38 to 58 of this circular.

ACQUISITION OF THE TARGET BVI COMPANY

Acquisition Agreement

Date	:	12 September 2005		
Parties	:	(1) Vendor	:	China Netcom Group Corporation (BVI) Limited
		(2) Purchaser	:	China Netcom Group Corporation (Hong Kong) Limited
		(3) Warrantor	:	China Network Communications Group Corporation

Pursuant to the Acquisition Agreement, the Company has agreed, subject to certain conditions, to acquire from CNC BVI the entire equity interest in the Target BVI Company for a purchase price of RMB12,800 million (equivalent to approximately HK$12,282 million). Upon completion of the Acquisition, the Target BVI Company will become a wholly-owned subsidiary of the Company.

China Netcom Group has given warranties, representations and undertakings in respect of CNC BVI's title in the Target BVI Company and the Target Company, the operations and assets and liabilities of the Target Company and the legal status of those companies.

The Target BVI Company holds the entire equity interest in the Target Company which in turn owns the assets and liabilities and the business operations for the provision of fixed-line telephone services, broadband and other Internet-related services, and business and data communications services in the Target Regions in the PRC. As a result of the Acqusition, the Company will assume the bank and other loans less cash and bank deposits of the Target Company in the amount of RMB 23,209 million (equivalent to approximately HK$22,269 million) as of 30 June 2005. As of 30 June 2005, the Target Company had a total of approximately 28.86 million fixed-line subscribers and approximately 2.78 million broadband subscribers. The Target Company had approximately 90.2% market share of fixed-line telephone services and approximately 90.7% market share of broadband services in the Target Regions as of 30 June 2005.

THE CONSIDERATION FOR THE ACQUISITION

The Acquisition was negotiated and entered into on an arm's length basis and on normal commercial terms. The purchase price of the Acquisition is RMB12,800 million (equivalent to approximately HK$12,282 million), and consists of payment of an initial cash consideration and a deferred consideration.

The purchase price of the Acquisition was determined based on various factors, including the quality of the assets being acquired, their growth prospects, earnings potential, competitive advantages in their respective markets and the prospective profit contributions by the Target Company to the Group, as well as by reference to other financial and operational factors. The purchase price for the Acquisition represents a multiple of approximately 6.0 times the Target Group's forecast profit for the year ending 31 December 2005 (including an estimated upfront connection fee of approximately RMB735 million (equivalent to approximately HK$705 million)), which is unlikely to be less than RMB2,150 million (equivalent to approximately HK$2,063 million). In addition, the Company will assume the bank and other loans less cash and bank deposits of the Target Company in the amount of RMB23,209 million (equivalent to approximately HK$22,269 million) as of 30 June 2005 as a result of the Acquisition.

The initial consideration of RMB3,000 million (equivalent to approximately

HK$2,879 million) will be satisfied on completion of the Acquisition by payment in cash in RMB.

The deferred consideration, in the amount of RMB9,800 million (equivalent to approximately HK$9,403 million), represents the difference between the total consideration and the initial consideration. From the date of completion of the Acquisition, the Company will, at half-yearly intervals, repay part of the deferred consideration and pay interest to CNC BVI on the actual amount of deferred consideration remaining outstanding. The repayment of deferred consideration at each half-yearly interval will be in equal amount of RMB980 million (equivalent to approximately HK$940 million). Interest is accrued daily and is payable at the rate of 5.265% per annum, being 10% discount to the benchmark RMB lending rate of 5.85% per annum of commercial banks in the PRC in respect of loans with tenure of five years as published by the People's Bank of China and prevailing at 12:00 noon (Beijing time) on 8 September 2005, being two Business Days immediately preceding the date of the Acquisition Agreement.

The payment of the deferred consideration and the interest payments can be made in RMB or US dollars as agreed between CNC BVI and the Company. Any payment made in US dollars will be based on the Federal Reserve noon-buying rate between US dollars and RMB which is quoted as of 12:00 noon (New York City time) on the day which is two business days immediately prior to the date of payment.

The deferred consideration is payable within five years after the date of completion of the Acquisition. The Company may, from time to time, prepay all or part of the outstanding deferred consideration, at any time after completion until the fifth anniversary of the completion of the Acquisition, without penalty.

The Board takes the view that the consideration payable by the Company for the Target BVI Company and the other terms of the Acquisition are fair and reasonable. In particular, the Board is of the view that the terms of the deferred consideration are more favourable than the usual terms of a commercial bank loan of a similar size and term. The Board is of the view that the Acquisition is in the interests of the Company and its investors and recommends the Independent Shareholders to vote in favour of the ordinary resolution to approve the Acquisition at the Extraordinary General Meeting.

FINANCING OF THE ACQUISITION

The Company intends to finance the initial consideration using existing internal cash resources. The Company intends to finance the deferred consideration using internal cash resources and/or proceeds from future external financing.

CONDITIONS OF THE COMPLETION OF THE ACQUISITION

Completion of the Acquisition is conditional upon the fulfilment or waiver (where available) of the following conditions, among others, on or before 31 December 2005 or such other date as the Company, CNC BVI and China Netcom Group may agree:

(a) the passing of resolutions by the Independent Shareholders approving the Acquisition and the Non-exempt Continuing Connected Transactions;

(b) there having been no material adverse change to the financial condition, business operations, or prospects of the Target Company; and

(c) the receipt of various approvals from the relevant PRC regulatory authorities.

Certain PRC regulatory approvals have been obtained. The Target Company currently has a legal person business licence as a limited liability company. Upon approval by the relevant Chinese regulatory authorities, the legal person business licence of the Target Company will be replaced by a new one issued by the State Administration for Industry and Commerce to reflect its status as a wholly foreign-owned enterprise. The business of the Target Company will not be affected by the process of issuance of such new business licence.

The Acquisition shall be completed following the fulfilment or waiver (where applicable) of the above conditions, and is expected to take place on 31 October 2005, or such other date as may be agreed between CNC BVI, China Netcom Group and the Company, following notification by the Company to CNC BVI and China Netcom Group of the fulfilment or waiver of all the conditions. If any of the above-mentioned conditions is not fulfilled or waived by 31 December 2005, or such other date as CNC BVI, China Netcom Group and the Company may agree, the Acquisition Agreement shall lapse.

REASONS FOR AND BENEFITS OF THE ACQUISITION

The Company is a leading fixed-line telecommunications services provider in China and a leading international data communications services provider in the Asia-Pacific region. Its northern service region covers the area of Beijing Municipality, Tianjin Municipality, Hebei Province, Henan Province, Shandong Province and Liaoning Province in China. Its southern service region covers the area of Shanghai Municipality and Guangdong Province in China. It is also the only telecommunications company in China that operates an extensive regional data network and offers international data services in the Asia-Pacific region.

The Board believes that the Acquisition represents an important opportunity for the Group to increase coverage and achieve further growth, improve its service capabilities, capture operating synergy and improve management efficiency. In addition, the Acquisition will allow the Company to further benefit from the sustained growth of the telecommunications industry in China and create long-term value to Shareholders.

(A) ..Increase coverage and achieve further growth

One of the Company's strategies is to explore external growth opportunities through targeted mergers and acquisitions. The Acquisition will significantly expand the geographic coverage of the Company. The Target Regions have a total population of approximately 122 million with GDP per capita of RMB11,446 in 2004, or approximately 9.0% over China's national average, according to the National Bureau of Statistics of China. The GDP in the Target Regions grew approximately 13.8% between 2003 and 2004, compared with a growth rate of approximately 9.5% during the same period for China. The 30.5 million fixed-line subscribers in the Target Regions represented approximately 9.8% of the total fixed-line subscribers in China in 2004. With the addition of the operations of the Target Company, the Group's combined service area, subscriber base, revenue and net profit will be significantly enlarged, further solidifying the Group's position as the dominant telecommunications provider in northern China and allowing the Group to better capture the growth potentials in the Chinese telecommunications industry.

The table below sets out the pro forma revenues, EBITDA and net profit of the Combined Group for the year ended 31 December 2004 and for the six months ended 30 June 2005 assuming that the Acquisition had taken place on 1 January 2004 and 1 January 2005 respectively. The following information is derived from the unaudited pro forma combined income statements of the Combined Group for the year ended 31 December 2004 and for the six months ended 30 June 2005, which are included in Appendix IV to this circular.

	For the year ended 31 December 2004			For the six months en June 2005		
	Before Acquisition		After Acquisition	Before Acquisition		A
	The Group Historical Restated(1)	Target Group Historical audited)	Combined Group	The Group Historical (unaudited)	Target Group Historical (audited)	
	(RMB in millions)			(RMB in millions)		
Revenues	64,922	18,616	83,538	33,724	9,712	
EBITDA(2)	34,172	8,529	42,701	19,032	5,463	
Profit from operations before revaluation deficit	15,511	2,114	18,200	9,882	2,282	
Deficit on revaluation of property, plant and equipment	-	(11,318)	(11,318)	-	-	
Net profit/(loss)	9,230	(6,531)	2,594	6,358	1,330	

(1) Historical financial information of the Group for the year ended 31 December 2004 has been restated to reflect the impacts of the adoption of the new and revised HKFRS which are effective for accounting periods beginning on or after 1 January 2005.

(2) EBITDA refers to the earnings before finance costs, interest income, dividend income, taxation, depreciation and amortisation, share of loss of associated companies, and minority interests. EBITDA is not a measure of financial performance or of liquidity under HKFRS because EBITDA is not uniformly defined. EBITDA should not be considered a substitute for or superior to the Company's results prepared under HKFRS as it cannot be used to measure operating results and liquidity and does not represent operating cash flows. In addition, it may not be comparable to similarly titled indicators of other companies.

The table below sets out the subscriber bases of the Group, the Target Company, and the Combined Group on an aggregate basis as of 31 December 2004:

	The Group	Target Company	Combined Group
Fixed-line subscribers (in thousands)	80,383	27,696	108,079
Including: Personal Handyphone System ("PHS") subscribers (in thousands)	15,073	7,051	22,124
Broadband subscribers (in thousands)	6,218	2,274	8,492

(B) Improve the Group's service capabilities

In the Target Regions, the Target Company is the incumbent fixed-line operator and owns extensive local access networks and broad customer relationships. Since the Target Regions are contiguous to the Group's current northern service region, the Combined Group has significant advantages in servicing large and medium corporate customers, especially those with business operations across regions. The Combined Group can improve its service qualities and capabilities by applying knowledge from the Group's service regions to the Target Regions and through shared marketing strategies and expanded sales channels to better meet customers' evolving telecommunications demands. The Combined Group will also be able to enjoy significant cost advantages in developing and promoting broadband and value-added services.

(C) Capture operating synergy and improve management efficiency

The Board believes that the Acquisition represents an important opportunity to create additional shareholders' value for the Combined Group through streamlined organisational structure, improved management efficiency, and reduced operating cost. It is intended that, as soon as practicable after the completion of the Acquisition, the operations, assets and liabilities of the Target Company will be merged with those of CNC China. Thereafter, all of the Combined Group's telecommunications businesses in China will be conducted through CNC China. The Board believes that this streamlined organisational structure will allow the Combined Group to better manage its business across the combined service regions and improve management accountability. In addition, the Board believes that the Combined Group will be able to achieve greater economies of scale, operational efficiency and synergies from the Acquisition by consolidating various managerial functions including strategic and investment planning, corporate procurement, treasury and financial management, human resources and employee training, development and maintenance of information technology infrastructure and other general corporate services.

THE REORGANISATION

In preparation for the Acquisition, the Target Company was incorporated on 9 August 2005 as a wholly owned subsidiary of China Netcom Group and the Target BVI Company was incorporated on 27 July 2005 as a wholly owned subsidiary of CNC BVI. China Netcom Group's fixed-line telecommunications assets and related liabilities (other than the international gateway and related international network assets, as well as the inter-provincial fiber-optic network and related assets and liabilities) in the Target Regions, were transferred to the Target Company. Pursuant to the Equity Interest Injection Agreement, the entire equity interest in the Target Company was injected into CNC BVI by China Netcom Group, and then the entire equity interest in the Target Company was injected into the Target BVI Company by CNC BVI.

After the completion of the Acquisition, the Target BVI Company, which owns the entire equity interest of the Target Company, will become a wholly owned subsidiary of the Company.

Subject to relevant regulatory approvals, it is intended that as soon as practicable after the completion of the Acquisition, the operations, assets and liabilities of the Target Company will be merged with that of CNC China by way of merger by absorption so that all the telecommunications businesses of the Combined Group in China will be conducted through CNC China. It is also intended that both the Target BVI Company and the Target Company will be liquidated.

Set out below are the shareholding structures and main operating subsidiaries of the Company immediately prior to the Acquisition, immediately following completion of the Acquisition and after completion of the Acquisition and the merger by absorption.

Corporate structure immediately prior to the Acquisition

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----------------------------
|      China Network       |
|     Communications       |
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|    Group Corporation       |
| ("China Netcom Group")     |
|        (PRC)(3)            |
----------------------------
             | 100%
----------------------------    ---------------------------      ---------------------------
|    China Netcom Group      |   |                           |      |                           |
| Corporation (BVI) Limited |   |Five PRC Shareholders(1)   |      |  Public Shareholders(1)   |
|       ("CNC BVI")          |   |                           |      |                           |
|(British Virgin Islands)(3)|   |                           |      |                           |
----------------------------    ---------------------------      ---------------------------
             | 100%   |70.49%(2)             | 4.51%(2)                          |  25.00%
             |         -------------------------------------------------------
----------------------------      -------------------------
|  China Netcom Group New    |     |   China Netcom Group     |
|  Horizon Communications    |     |   Corporation (Hong      |
| Corporation (BVI) Limited |     |      Kong) Limited       |
|   ("Target BVI Company")   |     |       ("Company")        |
|(British Virgin Islands)(3)|     |      (Hong Kong)(3)      |
----------------------------      -------------------------
             |                                |
             |                       -----------------------------
             | 100%                    | 100%                          | 100%
----------------------------      ----------------------      --------------------------
|  China Netcom Group New    |     | China Netcom (Group) |   | China Netcom Corporation |
|  Horizon Communications    |     |   Company Limited    |   |  International Limited   |
|    Corporation Limited     |     |    (CNC China")      |   |      (Bermuda)(3)        |
|    ("Target Company")      |     |      (PRC)(3)        |   |                          |
|          (PRC)(3)          |     |                      |   |                          |
----------------------------      ----------------------    --------------------------
:   Operating in:(4)                 :    Operating in:(4)           |
:-  Heilongjiang Province            : -  Beijing Municipality   -----------------------
:-  Jilin Province                   : -  Tianjin Municipality  |     Asia Netcom         |
:-  Neimenggu Autonomous Region      : -  Hebei Province        | Corporation Limited     |
:-  Shanxi Province                  : -  Henan Province        |   ("Asia Netcom")       |
                                     : -  Shandong Province     |     (Bermuda)(3)        |
                                     : -  Liaoning Province      -----------------------
                                     : -  Shanghai Muncipality
                                     : -  Guangdong Province
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Corporate structure immediately following completion of the Acquisition

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----------------------------
|      China Network         |
|     Communications         |
|    Group Corporation       |
| ("China Netcom Group")     |
|        (PRC)(3)            |
----------------------------
             | 100%
----------------------------    ---------------------------      ---------------------------
|    China Netcom Group      |   |                           |      |                           |
| Corporation (BVI) Limited |   | Five PRC Shareholders(1) |      |    Public Shareholders    |
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```
|      ("CNC BVI")          |    |                          |      |                          |
|(British Virgin Islands)(3)|    |                          |      |                          |
----------------------------    ---------------------------      ---------------------------
             | 70.49%(2)                 | 4.51%(2)                             |  25.00%
             | ---------------------------------------------------------------|
                                         |
                    -----------------------------------------------------
                    |  China Netcom Group Corporation (Hong Kong)Limited)|
                    |                  ("Company")                       |
                    |                  (Hong Kong)(3)                    |
                    -----------------------------------------------------
                         |                 |
                         |                 |
             --------------                |
             |                       -------------------------------
             | 100%                  | 100%                          | 100%
----------------------------      ----------------------      --------------------------
|  China Netcom Group New   |    | China Netcom (Group) |    | China Netcom Corporation |
|  Horizon Communications   |    |   Company Limited    |    |  International Limited   |
| Corporation (BVI) Limited |    |    ("CNC China")     |    |      (Bermuda)(3)        |
|    ("Target BVI Company") |    |       (PRC)(3)       |    |                          |
|(British Virgin Islands)(3)|    |                      |    |                          |
----------------------------      ----------------------    ---------------------------
             |                   :                                  |
             |                   :                                  |
             | 100%              : - Operating in:(4)               | 100%
----------------------------     :                              -----------------------
|  China Netcom Group New   |    : -  Beijing Municipality     |     Asia Netcom         |
|  Horizon Communications   |    : -  Tianjin Municipality     | Corporation Limited     |
| Corporation Limited       |    : -  Hebei Province           |   ("Asia Netcom")       |
|   ("Target Company")      |    : -  Henan Province           |     (Bermuda)(3)        |
|         (PRC)(3)          |    : -  Shandong Province         -----------------------
----------------------------     : -  Liaoning Province
:                                : -  Shanghai Muncipality
:                                : -  Guangdong Province
:   Operating in:(4)
:-  Heilongjiang Province
:-  Jilin Province
:-  Neimenggu Autonomous Region
:-  Shanxi Province
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Corporate structure after completion of the Acquisition and the merger by absorp

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----------------------------
|      China Network        |
|     Communications        |
|    Group Corporation      |
| ("China Netcom Group")    |
|        (PRC)(3)           |
----------------------------
             | 100%
----------------------------    ---------------------------      ---------------------------
|    China Netcom Group     |    |                          |      |                          |
| Corporation (BVI) Limited |    | Five PRC Shareholders(1) |      |    Public Shareholders   |
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|      ("CNC BVI")          |    |                          |     |                          |
|(British Virgin Islands)(3)|    |                          |     |                          |
----------------------------    ---------------------------      ----------------------------
             | 70.49%(2)                  | 4.51%(2)                          |  25.00%
             | -----------------------------------------------------------------|
                                          |
                   -----------------------------------------------------
                   |  China Netcom Group Corporation (Hong Kong) Limited|
                   |                  ("Company")                       |
                   |                  (Hong Kong)(3)                    |
                   -----------------------------------------------------
                                          |
                                          |
                                          |
                                 -------------------------------
                                |                              |
                                | 100%                         | 100%
                             ----------------------    ---------------------------
                            | China Netcom (Group) |  | China Netcom Corporation |
                            |   Company Limited    |  |  International Limited   |
                            |    ("CNC China")     |  |       (Bermuda)(3)       |
                            |       (PRC)(3)       |  |                          |
                            |                      |  |                          |
                             ----------------------    ---------------------------
                              :                                  |
                              :                                  |
                              : - Operating in:(4)               | 100%
                              :                             -----------------------
                              : -  Beijing Municipality    |     Asia Netcom       |
                              : -  Tianjin Municipality    | Corporation Limited   |
                              : -  Hebei Province          |    ("Asia Netcom")    |
                              : -  Henan Province          |      (Bermuda)(3)     |
                              : -  Shandong Province        -----------------------
                              : -  Liaoning Province
                              : -  Shanghai Muncipality
                              : -  Guangdong Province
                              :-  Heilongjiang Province
                              :-  Jilin Province
                              :-  Neimenggu Autonomous Region
                              :-  Shanxi Province
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(1) The five PRC Shareholders, all of which are established in the PRC, are the Chinese Academy of Sciences, Information and Network Center of the State Administration of Radio, Film and Television, China Railways Telecommunications Center, Shanghai Alliance Investment Limited, and Shandong Provincial State-owned Assets Supervision and Administration Commission.

(2) All of the ordinary shares owned by the five PRC Shareholders are registered in the name of China Netcom Group Corporation (BVI) Limited, or CNC BVI, which holds such ordinary shares in trust for each of the five PRC Shareholders. Consequently, the ownership percentage of the five PRC Shareholders in the charts above reflects the aggregate beneficial interests of these Shareholders as held through CNC BVI. The ownership percentage of CNC BVI as indicated in the charts above reflects CNC BVI's own beneficial ownership.

(3) Indicates jurisdiction of incorporation.

(4) The provincial businesses are operated under local branch offices of CNC China or the Target Company (as the case may be) and these local branch offices are not legal entities.

FINANCIAL INFORMATION OF THE TARGET GROUP

The following are the combined income statements of the Target Group for each of the three years ended 31 December 2002, 2003 and 2004 and for the six-month periods ended 30 June 2004 and 2005, as extracted from the audited financial statements of the Target Group prepared in accordance with HKFRS included in Appendix II to this circular.

	Year ended 31 December			Six months June
	2002 RMB million	2003 RMB million	2004 RMB million	2004 RMB million
Revenues	16,232	17,700	18,616	9,315
Operating expenses				
Depreciation and amortisation	(5,988)	(6,317)	(6,426)	(3,196)
Networks, operations and support	(4,087)	(3,118)	(2,426)	(960)
Staff costs	(2,602)	(3,398)	(3,891)	(1,892)
Selling, general and administrative expenses	(2,245)	(3,269)	(3,311)	(1,736)
Other operating expenses	(380)	(537)	(459)	(225)
Total operating expenses	(15,302)	(16,639)	(16,513)	(8,009)
Operating profit before interest income and deficit on revaluation of property, plant and equipment	930	1,061	2,103	1,306
Interest income	28	16	11	5
Deficit on revaluation of property, plant and equipment	–	–	(11,318)	–
Profit/(loss) from operations	958	1,077	(9,204)	1,311
Finance costs	(1,283)	(1,270)	(998)	(500)
Profit/(loss) before taxation	(325)	(193)	(10,202)	811
Taxation	423	398	3,671	(102)
Profit/(loss) for the year/period	98	205	(6,531)	709

The following are the combined balance sheets of the Target Group as at 31 December 2002, 2003 and 2004 and as at 30 June 2005, as extracted from the audited financial statements of the Target Group prepared in accordance with HKFRS included in Appendix II to this circular.

	As at 31 December		
	2002 RMB million	2003 RMB million	2004 RMB million
Assets			

Current assets			
Cash and bank deposits	1,097	1,114	580
Accounts receivable	1,121	1,175	1,486
Inventories and consumables	291	209	302
Prepayments and other receivables	739	582	436
Due from ultimate holding company and fellow subsidiaries	141	94	714
Total current assets	3,389	3,174	3,518
Non-current assets			
Lease prepayments for land	466	450	480
Property, plant and equipment	44,588	47,719	42,110
Construction in progress	3,518	2,354	2,995
Intangible assets	58	91	66
Deferred costs	668	672	654
Deferred tax assets	1,663	2,076	1,410
Other non-current assets	14	11	9
Total non-current assets	50,975	53,373	47,724
Total assets	54,364	56,547	51,242
Liabilities and equity			
Current liabilities			
Accounts payable	5,632	5,409	6,472
Accruals and other payables	1,639	1,267	1,513
Short-term bank loans	10,219	15,774	15,543
Current portion of long-term bank and other loans	5,727	3,676	4,457
Due to ultimate holding company and fellow subsidiaries	1,231	1,448	1,836
Current portion of deferred revenues	2,140	2,170	2,223
Current portion of provisions	1,495	1,550	1,531
Taxation payable	105	185	165
Total current liabilities	28,188	31,479	33,740
Net current liabilities	(24,799)	(28,305)	(30,222)
Total assets less current liabilities	26,176	25,068	17,502
Non-current liabilities			
Long-term bank and other loans	10,924	7,863	4,191
Deferred revenues	3,963	2,981	2,171
Provisions	1,181	1,153	1,431
Deferred tax liabilities	2,497	2,759	255
Other non-current liabilities	57	29	24
Total non-current liabilities	18,622	14,785	8,072
Total liabilities	46,810	46,264	41,812
Owners' equity	7,554	10,283	9,430
Total liabilities and equity	54,364	56,547	51,242

Prior to the completion of the Reorganisation, the Target Group has distributed its profits for the six months ended 30 June 2005, which amounted to RMB930 million (equivalent to approximately HK$892 million), to China Netcom Group. Further detailed information in respect of the Target Group's historical results of operations and financial position is set out in Appendix II to this circular.

PROSPECTIVE FINANCIAL INFORMATION

The Company and the Target Group have prepared certain prospective financial information for the year ending 31 December 2005 in compliance with Rule 14A.56(8) and Rule 14.62 of the Hong Kong Listing Rules. Neither the Target Group nor the Company intends to update this information during the year or to update such information in future years, although the Directors are aware of the requirements of Rule 13.09 notes 9 and 10 of the Hong Kong Listing Rules. This information is necessarily based upon a number of assumptions that, while presented with numerical specificity and considered reasonable by the Target Group, are inherently subject to significant business, economic and competitive uncertainties and contingencies, many of which are beyond the control of the Company or the Target Group, and upon assumptions with respect to future business decisions which are subject to change. Accordingly, there can be no assurance that these results will be realised. The prospective financial information presented below may vary from actual results, and these variations may be material.

The Company and the Target Group believe that, on the bases and the assumptions discussed in Appendix V to this circular and in the absence of unforeseen circumstances, the Target Group's forecast combined profit for the year ending 31 December 2005 (including an estimated upfront connection fee of approximately RMB735 million (equivalent to approximately HK$705 million)) under HKFRS is unlikely to be less than RMB2,150 million (equivalent to approximately HK$2,063 million).

The bases and assumptions for the preparation of the profit forecast is set out in Appendix V to this circular and the texts of the letters from PricewaterhouseCoopers, CICC, Citigroup and Goldman Sachs in respect of the profit forecast are also set out in Appendix V to this circular.

The Company and the Target Group are not currently aware of any extraordinary items which have arisen or are likely to arise in respect of the year ending 31 December 2005 which would affect the prospective financial information presented.

RELATIONSHIP WITH CNC BVI AND CHINA NETCOM GROUP

CNC BVI is a company incorporated in the British Virgin Islands and is the immediate holding company of the Company. CNC BVI is an investment holding company.

China Netcom Group is a state-owned enterprise established under the laws of the PRC and is the ultimate holding company of the Company. China Netcom Group is the second largest fixed-line telecommunications operator in China. China Netcom Group owns and operates its fixed-line telecommunications networks, and provides telecommunications services including fixed-line telephone, broadband and other Internet-related services in all provinces, municipalities and autonomous regions in China (including the Target Regions prior to the completion of the Acquisition) that are outside the Group's existing northern and southern service regions (which include Beijing Municipality, Tianjin Municipality, Hebei Province, Henan Province, Shandong Province, Liaoning Province, Shanghai Municipality and Guangdong Province).

As at the Latest Practicable Date, China Netcom Group beneficially owned 100% of CNC BVI's issued share capital, and CNC BVI beneficially owned approximately 70.49% of the Company's issued share capital. CNC BVI and China Netcom Group are therefore connected persons of the Company.

In connection with the initial public offering of the Company in November 2004, China Netcom Group has, by a letter of undertakings that is legally binding indefinitely, undertaken that it will support the Group's existing operations and future development, including that the Company will be treated equally with any other operators of fixed-line telephone, broadband, Internet and certain other telecommunications services that are controlled by China Netcom Group and the Company will have the option to provide additional telecommunications services in the service regions that fall within China Netcom Group's scope of business.

CONTINUING CONNECTED TRANSACTIONS

In October 2004, CNC China, a wholly-owned subsidiary of the Company, entered into certain agreements with China Netcom Group to regulate certain ongoing transactions between CNC China on the one hand and China Netcom Group and its subsidiaries or Associates (other than the Group) on the other. These transactions are continuing connected transactions of the Company under the Hong Kong Listing Rules. In respect of some of these continuing connected transactions, annual caps representing the maximum aggregate annual value of consideration payable under these transactions have been set. The Group has complied with these caps for the financial year ended 31 December 2004 and also for the period commencing from 1 January 2005 and ending on the date of this circular.

It is expected that after completion of the Acquisition, similar ongoing transactions will be conducted between the Target Company on the one hand and China Netcom Group and its subsidiaries or Associates (other than the Combined Group) on the other. These transactions will, after completion of the Acquisition, become continuing connected transactions of the Company. In order to facilitate the management of all continuing connected transactions of the Company in China after the completion of the Acquisition, the Target Company, CNC China and China Netcom Group entered into certain connected transactions agreements on 12 September 2005 to regulate the continuing connected transactions between China Netcom Group and its subsidiaries or Associates (other than the Combined Group) on the one hand and the Combined Group on the other, in respect of the Combined Group's operations in 12 provinces, municipalities and autonomous region in China. These agreements will replace the existing connected transaction agreements between CNC China and China Netcom Group if and when the Acquisition completes. These agreements are summarised below:

Domestic Interconnection Settlement Agreement

The Target Company, CNC China and China Netcom Group entered into the Domestic Interconnection Settlement Agreement on 12 September 2005. Pursuant to the Domestic Interconnection Settlement Agreement, the parties agreed to interconnect the network of China Netcom Group on the one hand and that of CNC China and the Target Company (together with CNC China, the "Combined Operating Group") on the other and settle the charges received in respect of domestic long distance voice services within their respective service regions on a quarterly basis.

For domestic long distance voice services between China Netcom Group and the Combined Operating Group, the telephone operator in the location of the calling party makes a settlement payment to the telephone operator in the location of the called party at the rate of RMB0.06 per minute (in case where the call terminates within the network of either China Netcom Group or the Combined Operating Group) or RMB0.09 per minute (in case where the call terminates outside the network of either China Netcom Group or the Combined Operating Group).

The rates of RMB0.06 per minute and RMB0.09 per minute mentioned above shall be adjusted with reference to the relevant standards, tariffs or policies promulgated by the relevant regulatory authorities in China from time to time.

The Domestic Interconnection Settlement Agreement takes effect from the date of completion of the Acquisition and is valid until 31 December 2007. If the Combined Operating Group notifies China Netcom Group at least three months prior to the expiration of the agreement of its intention to renew the agreement, the agreement can be renewed with the same terms for further periods of three years.

International Long Distance Voice Services Settlement Agreement

CNC China and China Netcom Group entered into the International Long Distance Voice Services Settlement Agreement on 12 September 2005. Pursuant to the International Long Distance Voice Services Settlement Agreement, the parties agreed to interconnect the networks of China Netcom Group and CNC China and settle the charges received in respect of international long distance voice services on a quarterly basis.

For outbound international calls, China Netcom Group reimburses CNC China for any amount it has paid to overseas telecommunications operators. The revenues received by China Netcom Group less the amount paid to overseas telecommunications operators are shared between China Netcom Group and CNC China in proportion to the estimated costs incurred by China Netcom Group and the Combined Operating Group in connection with the provision of outbound international long distance voice services.

For inbound international calls, the revenues received by CNC China from overseas telecommunications operators (other than the Company and its controlled entities) less the amount paid to China Netcom Group at the rate of RMB0.06 per minute (in case where the call terminates within the network of China Netcom Group) or RMB0.09 per minute (in case where the call terminates within the network of other operators) are shared between China Netcom Group and CNC China in proportion to the estimated costs incurred by China Netcom Group and the Combined Operating Group in connection with the provision of inbound international long distance voice services.

The rates of RMB0.06 per minute and RMB0.09 per minute mentioned above shall be adjusted with reference to the relevant standards, tariffs or policies promulgated by the relevant regulatory authorities in China from time to time.

The International Long Distance Voice Services Settlement Agreement takes effect from the date of completion of the Acquisition and is valid until 31 December 2007. If CNC China notifies China Netcom Group at least three months prior to the expiration of the agreement of its intention to renew the agreement, the agreement can be renewed with the same terms for further periods of three years.

The transactions under the Domestic Interconnection Settlement Agreement and the International Long Distance Voice Services Settlement Agreement will be subject to reporting and announcement requirements set out in Rules 14A.45 to 14A.47 of the Hong Kong Listing Rules and the independent shareholders' approval requirements under Rule 14A.48 of the Hong Kong Listing Rules.

Property Leasing Agreement

The Target Company, CNC China and China Netcom Group entered into the Property Leasing Agreement on 12 September 2005. Pursuant to the Property Leasing Agreement:

(i) the Combined Operating Group leases to China Netcom Group a total of 54 buildings and units with an aggregate floor area of approximately 4,300 square metres located throughout the Combined Operating Group's service regions, for use as offices and other ancillary purposes; and

(ii) China Netcom Group leases to the Combined Operating Group a total of 22 parcels of land with an aggregate site area of approximately 26,700 square metres and 42,097 buildings and units with an aggregate floor area of approximately 9,264,000 square metres located throughout the Combined Operating Group's service regions, for use as offices, telecommunications equipment sites and other ancillary purposes.

The charges payable by the Combined Operating Group and by China Netcom Group under the Property Leasing Agreement are based on market rates or the depreciation and maintenance charges in respect of each property, provided such depreciation and maintenance charges shall not be higher than the market rates. The charges are payable quarterly in arrears and are subject to review every year to take into account the then prevailing market rates of the properties leased in that year. Sallmanns, the independent property valuer of the Company, has reviewed the Property Leasing Agreement, and has confirmed that the rental charges payable by the Combined Operating Group under the Property Leasing Agreement are no higher than prevailing market rates and the rental charges payable by China Netcom Group under the Property Leasing Agreement are fair and reasonable.

The Property Leasing Agreement takes effect from the date of completion of the Acquisition and is valid until 31 December 2007. If the Combined Operating Group notifies China Netcom Group at least three months prior to the expiration of the agreement of its intention to renew the agreement, the agreement can be renewed with the same terms for further periods of three years.

For the three years ended 31 December 2002, 2003 and 2004, the rental charges that the Combined Operating Group paid to China Netcom Group amounted to RMB 43.79 million, RMB 52.56 million and RMB 316 million, respectively. For the same periods, the rental charges paid by China Netcom Group to the Combined Operating Group amounted to RMB 1 million, RMB 4 million and RMB 3.11 million, respectively.

Prior to the restructuring implemented for the purpose of the Company's listing in 2004, CNC China only leased a small number of properties (less than 2,000 in each of the two years ended 31 December 2002 and 2003). Prior to the Reorganisation, the Target Company also only leased a very small number of properties. As a result of the restructuring for the Company's listing and the Acquisition, many more properties will be leased from China Netcom Group to the Combined Operating Group and from the Combined Operating Group to China Netcom Group under the Property Leasing Agreement. The total rental charges payable by the Combined Operating Group to China Netcom Group in each of the three financial years ending 31 December 2005, 2006 and 2007 are not expected to exceed RMB1,250 million, and the total rental charges receivable by the Combined Operating Group from China Netcom Group in each of the three financial years ending 31 December 2005, 2006 and 2007 are not expected to exceed RMB35 million. Accordingly, these amounts have been set as the proposed caps for this connected transaction.

Property Sub-leasing Agreement

The Target Company, CNC China and China Netcom Group entered into the Property Sub-leasing Agreement on 12 September 2005. Pursuant to the Property Sub-leasing Agreement, China Netcom Group agreed to sub-let to the Combined Operating Group a total of 84 parcels of land and 6,263 building and units owned by and leased from independent third parties, for use as offices, telecommunications equipment sites and other ancillary purposes.

The amounts payable by the Combined Operating Group under the Property Sub-leasing Agreement are the same as the rental charges and other fees (including management fees) payable by China Netcom Group to the relevant third parties.

The Property Sub-leasing Agreement takes effect from the date of completion of the Acquisition and is valid until 31 December 2007. If the Combined Operating Group notifies China Netcom Group at least three months prior to the expiration of the agreement of its intention to renew the agreement, the agreement can be renewed with the same terms for further periods of three years.

The above property sub-leasing arrangement did not exist in respect of CNC China prior to the restructuring implemented for the purpose of the Company's listing in 2004. Such arrangement also did not exist in respect of the Target Company prior to the Reorganisation. The total amount paid by the Group for sub-let properties for the second half of the financial year ended 31 December 2004 (during which period the restructuring for the Company's listing has been effective) was RMB 33 million. Based on the number of properties to be sub-let under the Property Sub-leasing Agreement and the rental charges and other fees payable under the underlying lease agreements, the total amount payable by the Combined Operating Group to China Netcom Group for property sub-leasing in each of the three financial years ending 31 December 2005, 2006 and 2007 is not expected to exceed RMB100 million. Accordingly, the amount has been set as the proposed cap for this connected transaction.

Master Sharing Agreement

The Target Company, CNC China and China Netcom Group entered into the Master Sharing Agreement on 12 September 2005. Pursuant to the Master Sharing Agreement:

(a) the Combined Operating Group will provide customer relationship management services for large enterprise customers of China Netcom Group;

(b) the Combined Operating Group will provide network management services to China Netcom Group;

(c) the Combined Operating Group will share with China Netcom Group the services provided by administrative and managerial staff in respect of central management of the business operations, financial control, human resources and other related matters of both the Combined Operating Group and China Netcom Group;

(d) the Combined Operating Group will provide to China Netcom Group supporting services such as billing and settlement provided by the business support centre;

(e) China Netcom Group will provide to the Combined Operating Group supporting services, including telephone card production, development and related services and IC card inter-provincial and inter-network clearing services;

(f) China Netcom Group will provide to the Combined Operating Group certain other shared services, including advertising, publicity, research and development, business hospitality, maintenance and property management;

(g) China Netcom Group will provide certain office space in its headquarters to the Combined Operating Group for use as its principal executive office; and

(h) the Combined Operating Group and China Netcom Group will share the revenues received by China Netcom Group from other operators whose networks interconnect with the Internet backbone network of China Netcom Group and will share the monthly connection fee that China Netcom Group pays to the State Internet Switching Centre.

The Combined Operating Group and China Netcom Group own certain equipment and facilities forming the Internet backbone network of China Netcom Group. This Internet backbone network interconnect with the networks of other operators. Such interconnection generates revenue which is settled with China Netcom Group and shared between China Netcom Group and the Combined Operating Group under the Master Sharing Agreement. Prior to the Master Sharing Agreement coming into effect, the revenue generated from such interconnection was shared between the Group and China Netcom Group although the transaction is not regulated by the existing Master Sharing Agreement between CNC China and China Netcom Group. The interconnection revenue received by the Group from China Netcom Group and the connection fee paid by the Group to China Netcom Group in the second half of 2004, as well as in the first half of 2005, do not exceed the 0.1% threshold under Rule 14A.33 of the Hong Kong Listing Rules.

The services set out in paragraphs (a) to (g) above and the revenue and fee set out in paragraph (h) above are shared between the Combined Operating Group and China Netcom Group on an on-going basis from time to time and the aggregate costs incurred by the Combined Operating Group or China Netcom Group for the provision of the services set out in paragraphs (a) to (g) above and the revenue and fee receivable and payable by China Netcom Group as referred to in paragraph (h) above are apportioned between the Combined Operating Group and China Netcom Group according to their respective total assets value as shown in their respective financial statements on an annual basis.

The costs of the services provided under the Master Sharing Agreement are not directly related to the volumes of business or revenues of the parties. After completion of the Acquisition, China Netcom Group's primary fixed-line telephone business in the northern part of China will be injected into the Combined Operating Group, and the Group's revenues will be increased as a result. Accordingly, the Board considers that it is more appropriate for the costs of the services, revenues and fees payable or receivable under the Master Sharing Agreement to be shared on the basis of the parties' respective total assets value as opposed to their respective revenues.

The Master Sharing Agreement takes effect from the date of completion of the Acquisition and is valid until 31 December 2007. If the Combined Operating Group notifies China Netcom Group at least three months prior to the expiration of the agreement of its intention to renew the agreement, the agreement can be renewed with the same terms for further periods of three years.

All of the above provision or sharing of services and revenue and fee did not exist in respect of CNC China prior to the restructuring implemented for the purpose of the Company's listing in 2004. Such provision or sharing of services and revenue and fee also did not exist between the Target Company and China Netcom Group prior to the Reorganisation. The total amount paid by the Group to China Netcom Group for the sharing of services under paragraphs (e) to (g) above for the second half of the financial year ended 31 December 2004 (during which period the restructuring for the Company's listing has been effective) was RMB 213 million and the total amount paid by China Netcom Group to the Group for the sharing of services under paragraphs (a) to (d) above for the same period was RMB19 million. Based on the aggregate historical expenditures incurred for the provision of relevant services described in paragraphs (a) to (g) above, the aggregate historical revenue generated from the interconnection of the Internet backbone network (which interconnection revenue amounted to approximately RMB5.98 million for the second half of 2004) and the projected total assets values of China Netcom Group and the Combined Operating Group, respectively, the aggregate amount receivable by the Combined Operating Group from China Netcom Group in respect of services set out in paragraphs (a) to (d) above and in respect of the revenue set out in paragraph (h) above in each of the three financial years ending 31 December 2005, 2006 and 2007 is not expected to exceed RMB180 million, and the total amount payable by the Combined

Operating Group to China Netcom Group in respect of services set out in paragraphs (e) to (g) and in respect of the fee set out in paragraph (h) above in each of the three financial years ending 31 December 2005, 2006 and 2007 is not expected to exceed RMB485 million. Accordingly, these amounts have been set as the proposed caps for this connected transaction.

Engineering and Information Technology Services Agreement

The Target Company, CNC China and China Netcom Group entered into the Engineering and Information Technology Services Agreement on 12 September 2005 to govern the arrangements with respect to the provision of certain engineering and information technology-related services to the Combined Operating Group by China Netcom Group. These services include:

(a) the provision of planning, surveying and design services in relation to telecommunications engineering projects;

(b) the provision of construction services in relation to telecommunications engineering projects;

(c) the provision of supervision services in relation to telecommunications engineering projects; and

(d) the provision of information technology services, including office automation, software testing, network upgrade, new business development and support system development.

The charges payable for engineering and information technology-related services described above are determined with reference to market rates. In addition, where the value of any single item of engineering design or supervision-related service exceeds RMB0.5 million or where the value of any single item of engineering construction-related service exceeds RMB2 million, the award of such services will be subject to tender. The charges are settled between the Combined Operating Group and China Netcom Group as and when the relevant services are provided.

The Engineering and Information Technology Services Agreement takes effect from the date of completion of the Acquisition and is valid until 31 December 2007. If the Combined Operating Group notifies China Netcom Group at least three months prior to the expiration of the agreement of its intention to renew the agreement, the agreement can be renewed with the same terms for further periods of three years.

For the three years ended 31 December 2002, 2003 and 2004, the service charges paid by the Combined Operating Group to China Netcom Group in respect of engineering and information technology-related services amounted to RMB3,759 million, RMB4,198 million and RMB3,821 million, respectively. Based on the historical service charges paid by the Combined Operating Group to China Netcom Group and the extent and volume of the engineering and information technology-related services the Combined Operating Group expects China Netcom Group to provide, the total amount payable by the Combined Operating Group to China Netcom Group for provision of engineering and information technology-related services in each of the three financial years ending 31 December 2005, 2006 and 2007 is not expected to exceed RMB4,400 million. Accordingly, this amount has been set as the proposed cap for this connected transaction.

Materials Procurement Agreement

The Target Company, CNC China and China Netcom Group entered into the Materials Procurement Agreement on 12 September 2005 under which:

(a) the Combined Operating Group may request China Netcom Group to act as its agent for the procurement of imported and domestic telecommunications equipment and other domestic non-telecommunications equipment;

(b) the Combined Operating Group may purchase from China Netcom Group certain products, including cables, modems and yellow pages telephone directories; and

(c) China Netcom Group will provide to the Combined Operating Group storage and transportation services related to the procurement and purchase of materials or equipment under the agreement.

Commission and/or charges for the domestic materials procurement services referred to in paragraph (a) above shall not exceed the maximum rate of 3% of the contract value. Commission and/or charges for the above imported materials procurement services shall not exceed the maximum rate of 1% of the contract value. The price for the purchase of China Netcom Group's products referred to in paragraph (b) above is determined with reference to the following pricing principles and limits:

- the government fixed price;
- where there is no government fixed price but a government guidance price exists, the government guidance price;
- where there is neither a government fixed price nor a government guidance price, the market price; or
- where none of the above is applicable, the price to be agreed between the relevant parties and determined on a cost-plus basis.

Commission charges for the storage and transportation services referred to in paragraph (c) above are determined with reference to market rates.

Payments under the Materials Procurement Agreement will be made as and when the relevant equipment or products have been procured and delivered.

The Materials Procurement Agreement takes effect from the date of completion of the Acquisition and is valid until 31 December 2007. If the Combined Operating Group notifies China Netcom Group at least three months prior to the expiration of the agreement of its intention to renew the agreement, the agreement can be renewed with the same terms for further periods of three years.

For the three years ended 31 December 2002, 2003 and 2004, the historical volumes of sale and purchase of equipment and products for the Combined Operating Group amounted to RMB4,910 million, RMB4,892 million and RMB2,944 million, respectively.

Prior to the restructuring implemented for the purpose of the Company's listing in 2004, nearly all of the products and equipment purchased by the Combined Operating Group from China Netcom Group were made as direct purchases, where the relevant products and materials were purchased by China Netcom Group and then resold to the Company. Accordingly, China Netcom Group acted primarily as principal rather than as our agent earning commissions, and no historical figures of a comparable nature are available. Based on the historical volumes of purchases made by the Combined Operating Group and with reference to the level of commission charges set out in the Materials Procurement Agreement, the total amount payable by the Combined Operating Group to China Netcom Group, including both commissions and purchase prices, for each of the three financial years ending 31 December 2005, 2006 and 2007 is not expected to exceed RMB2,000 million. Accordingly, this amount has been set as the proposed cap for this connected transaction.

Ancillary Telecommunications Services Agreement

The Target Company, CNC China and China Netcom Group entered into the Ancillary Telecommunications Services Agreement on 12 September 2005 to govern the arrangements with respect to the provision of ancillary telecommunications services to the Combined Operating Group by China Netcom Group. These services include certain telecommunications pre-sale, on-sale and after-sale services such as assembling and repairing of certain telecommunications equipment, sales agency services, printing and invoice delivery services, maintenance of telephone booths, customers acquisition and servicing and other customers' services.

The charges payable for the services described above are determined with reference to the following pricing principles and limits:

- the government fixed price;
- where there is no government fixed price but a government guidance price exists, the government guidance price;
- where there is neither a government fixed price nor a government guidance price, the market price; or
- where none of the above is applicable, the price to be agreed between the relevant parties and determined on a cost-plus basis.

The service charges are settled between the Combined Operating Group and China Netcom Group as and when the relevant services are provided.

The Ancillary Telecommunications Services Agreement takes effect from the date of completion of the Acquisition and is valid until 31 December 2007. If the Combined Operating Group notifies China Netcom Group at least three months prior to the expiration of the agreement of its intention to renew the agreement, the agreement can be renewed with the same terms for further periods of three years.

For the three years ended 31 December 2002, 2003 and 2004, the services charges paid by the Combined Operating Group to China Netcom Group for ancillary telecommunications services amounted to RMB1,373 million, RMB1,880 million and RMB789 million, respectively. Based on the historical service charges paid and the estimated extent and volume of ancillary telecommunications services required from China Netcom Group, the total amount payable by the Combined Operating Group to China Netcom Group for provision of ancillary telecommunications services in each of the three financial years ending 31 December 2005, 2006 and 2007 is not expected to exceed RMB1,200 million. Accordingly, this amount has been set as the proposed cap for this connected transaction.

Support Services Agreement

The Target Company, CNC China and China Netcom Group entered into the Support Services Agreement on 12 September 2005. Under the Support Services Agreement, China Netcom Group provides the Combined Operating Group with various support services, including equipment leasing (other than equipment covered under the Telecommunications Facilities Leasing Agreement) and maintenance services, motor vehicles services, security services, basic construction agency services, research and development services, employee training services and advertising services and other support services.

The charges payable for the services described above are determined with reference to the following pricing principles and limits:

- the government fixed price;
- where there is no government fixed price but a government guidance price exists, the government guidance price;
- where there is neither a government fixed price nor a government guidance price, the market price; or
- where none of the above is applicable, the price to be agreed between the relevant parties and determined on a cost-plus basis.

The service charges are settled between the Combined Operating Group and China Netcom Group as and when relevant services are provided.

The Support Services Agreement takes effect from the date of completion of the Acquisition and is valid until 31 December 2007. If the Combined Operating Group notifies China Netcom Group at least three months prior to the expiration of the agreement of its intention to renew the agreement, the agreement can be renewed with the same terms for further periods of three years.

For the three years ended 31 December 2002, 2003 and 2004, the support service charges paid by the Combined Operating Group to China Netcom Group amounted to RMB1,385 million, RMB1,481 million and RMB1,073 million, respectively. Based on the historical service charges paid and the estimated extent and volume of support services required from China Netcom Group, the total amount payable by the Combined Operating Group to China Netcom Group for provision of support services in each of the three financial years ending 31 December 2005, 2006 and 2007 is not expected to exceed RMB1,610 million. Accordingly, this amount has been set as the proposed cap for this connected transaction.

Telecommunications Facilities Leasing Agreement

The Target Company, CNC China and China Netcom Group entered into the Telecommunications Facilities Leasing Agreement on 12 September 2005, under which:

(a) China Netcom Group leases inter-provincial fiber-optic cables within the Combined Operating Group's service regions to the Combined Operating Group;

(b) China Netcom Group leases certain international telecommunications resources (including international telecommunications channel gateways, international telecommunications service gateways, international submarine cable capacity, international land cables and international satellite facilities) to the Combined Operating Group; and

(c) China Netcom Group leases certain other telecommunications facilities required by the Combined Operating Group for its operations.

The rental charges for the leasing of inter-provincial fiber-optic cables, international telecommunications resources and other telecommunications facilities are based on the annual depreciation charges of such fiber-optic cables, resources and telecommunications facilities provided that such charges shall not be higher than market rates. The Combined Operating Group shall be responsible for the on-going maintenance of such inter-provincial fiber-optic cables and international telecommunications resources. The Combined Operating Group and China Netcom Group shall determine and agree which party is to provide maintenance service to the telecommunications facilities referred to in paragraph (c) above. Unless otherwise agreed by the Combined Operating Group and China Netcom Group, such maintenance service charges shall be borne by the Combined Operating Group. If China Netcom Group shall be responsible for maintaining any telecommunications facilities referred to in paragraph (c) above, the Combined Operating Group shall pay to China Netcom Group the relevant maintenance service charges which shall be determined with reference to market rates. Where there are no market rates, the maintenance charges shall be agreed between the parties and determined on a cost-plus basis. The net rental charges and service charges due to China Netcom Group under the Telecommunications Facilities Leasing Agreement will be settled between the Combined Operating Group and China Netcom Group on a quarterly basis.

The Telecommunications Facilities Leasing Agreement takes effect from the date of completion of the Acquisition and is valid until 31 December 2007. If the Combined Operating Group notifies China Netcom Group at least three months prior to the expiration of the agreement of its intention to renew the agreement, the agreement can be renewed with the same terms for further periods of three years.

The above telecommunications facilities leasing arrangement did not exist in respect of CNC China prior to the restructuring implemented for the purpose of the Company's listing in 2004. Such arrangement also did not exist in respect of the Target Company prior to the Reorganisation. The total charges paid by the Group to China Netcom Group for the lease of telecommunications facilities for the second half of the financial year ended 31 December 2004 (during which period the restructuring for the Company's listing has been effective) was RMB138 million. Based on the annual depreciation charges, the current market rates and the expected telecommunications facilities required to be leased from China Netcom Group, the total amount payable by the Combined Operating Group to China Netcom Group under this leasing agreement in each of the three financial years ending 31 December 2005, 2006 and 2007 is not expected to exceed RMB600 million. Accordingly, this amount has been set as the proposed cap for this connected transaction.

Continuing connected transactions relating to Asia Netcom

In preparation for the Company's listing in 2004, certain continuing connected transactions were entered into between Asia Netcom, a wholly owned subsidiary of the Company, and EANL, an indirect wholly owned subsidiary of China Netcom Group. These continuing connected transactions relate to the purchase and lease of telecommunications capacity by Asia Netcom from EANL and the provision of certain management services by Asia Netcom to EANL. These continuing connected transactions will not be affected by the Acquisition and the terms and the annual caps applicable to such transactions will remain unchanged.

COMPLIANCE WITH THE HONG KONG LISTING RULES

Following completion of the Acquisition, the Combined Operating Group will continue to enter into transactions described in the section headed "Continuing Connected Transactions" above. Such transactions would constitute continuing connected transactions for the Company under the Hong Kong Listing Rules for so long as members of China Netcom Group remain as connected persons within the meaning of the Hong Kong Listing Rules.

The Board (including the members of the Independent Board Committee) is of the opinion that the terms of the Continuing Connected Transactions described in the section headed "Continuing Connected Transactions" above have been entered into, and will be carried out, in the ordinary and usual course of business of the Combined Operating Group and on normal commercial terms which are fair and reasonable so far as the interests of the Independent Shareholders of the Company are concerned.

It is expected that, the proposed annual cap for the years 2005 to 2007 for each category of Continuing Connected Transactions under the Master Sharing Agreement, the Ancillary Telecommunications Services Agreement, the Support Services Agreement and the Telecommunications Facilities Leasing Agreement, and the proposed annual cap for the years 2005 to 2007 for charges payable by the Combined Operating Group under both the Property Leasing Agreement and the Property Sub-leasing Agreement and for the charges payable by China Netcom Group under the Property Leasing Agreement, will be less than the 2.5% threshold under Rule 14A.34 of the Hong Kong Listing Rules. Accordingly, these transactions will be exempt from the independent shareholders' approval requirements under the Hong Kong Listing Rules, but such transactions will still be subject to the reporting and announcement requirements set out in Rules 14A.45 to 14A.47 of the Hong Kong Listing Rules.

For each category of Continuing Connected Transactions under the Engineering and Information Technology Services Agreement and the Materials Procurement Agreement, as the proposed annual cap will exceed the 2.5% threshold under Rule 14A.34 of the Hong Kong Listing Rules, such transactions will constitute non-exempt continuing connected transactions under Rule 14A.35 of the Hong Kong Listing Rules and will be subject to the reporting and announcement requirements set out in Rules 14A.45 to 14A.47 of the Hong Kong Listing Rules and the independent shareholders' approval requirements under Rule 14A.48 of the Hong Kong Listing Rules.

Under Rule 14A.35(2) of the Hong Kong Listing Rules, in respect of a continuing connected transaction which is not fully exempted, a cap must be set and disclosed. The caps for the Continuing Connected Transactions (other than those under the Domestic Interconnection Settlement Agreement and the International Long Distance Voice Services Settlement Agreement) for each of three years ending 31 December 2005, 2006 and 2007 are set out below:

Continuing Connected Transactions	Proposed annual cap (RMB in millions)
Property Leasing Agreement	payable by the Combined Operating Group payable by China Netcom Group - 35
Property Sub-leasing Agreement	100
Master Sharing Agreement	payable by the Combined Operating Group payable by China Netcom Group - 180
Engineering and Information Technology Services Agreement	4,400
Materials Procurement Agreement	2,000
Ancillary Telecommunications Services Agreement	1,200
Support Services Agreement	1,610
Telecommunications Facilities Leasing Agreement	600

Special circumstances exist for both the Domestic Interconnection Settlement Agreement and the International Long Distance Voice Services Settlement Agreement and no cap is proposed in respect of the settlement of domestic and international long distance voice services for the following reasons:

(i) any growth in the domestic and international long distance voice services will necessarily result in increased transaction volumes under the Domestic Interconnection Settlement Agreement and the International Long Distance Voice Services Settlement Agreement, which the Company will not be able to control as it depends entirely on customer usage. Any caps on these transactions will therefore potentially limit the Company's ability to conduct or expand its business in the ordinary course; and

(ii) the settlement rates in respect of long distance voice services are determined with reference to the relevant standard tariff or policies promulgated by the relevant regulatory authorities in China, which are subject to change from time to time, and the Company is not in a position to set the settlement rates at its discretion.

The Company has applied to the Hong Kong Stock Exchange that no caps be proposed for the transactions contemplated under the Domestic Interconnection Settlement Agreement and the International Long Distance Voice Services Settlement Agreement. Such transactions will be subject to the reporting and announcement requirements set out in Rule 14A.45 to 14A.47 of the Hong Kong Listing Rules and the independent shareholders' approval requirements under Rule 14A.48 of the Hong Kong Listing Rules.

EXTRAORDINARY GENERAL MEETING

A notice of the Extraordinary General Meeting to be held in Nathan Room, Conrad Hotel, Hong Kong on 25 October 2005 at 10:00 a.m., is set out at the end of this circular. At the Extraordinary General Meeting, ordinary resolutions will be proposed to approve the Acquisition and the Non-exempt Continuing Connected Transactions. The vote of the Independent Shareholders at the Extraordinary General Meeting on the resolutions approving the Acquisition and the Non-exempt Continuing Connected Transactions shall be taken by poll.

In accordance with the Hong Kong Listing Rules, China Netcom Group, the ultimate holding company of the Company which, through CNC BVI, was beneficially interested in approximately 70.49% of the issued share capital of the Company as at the Latest Practicable Date, and its Associates, will abstain from voting on the resolutions to approve the Acquisition and the Non-exempt Continuing Connected Transactions at the Extraordinary General Meeting.

A form of proxy for use at the Extraordinary General Meeting is enclosed with this circular. Whether or not you are able to attend the Extraordinary General Meeting, you are requested to complete the accompanying form of proxy in accordance with the instructions printed thereon and return the same to the Company's registered office at 46th Floor, Cheung Kong Center, 2 Queen's Road Central, Hong Kong, as soon as practicable and in any event at least 48 hours before the time appointed for holding the Extraordinary General Meeting or any adjournment thereof. Completion and return of the form of proxy will not preclude a Shareholder from attending and voting in person at the Extraordinary General Meeting or any adjournment thereof should he so wishes.

RECOMMENDATION

CSFB has been retained as the independent financial adviser to advise the Independent Board Committee and the Independent Shareholders in respect of the terms of the Acquisition and the terms of the Non-exempt Continuing Connected Transactions. CSFB considers that the terms of the Acquisition are on normal commercial terms, and that the terms of the Non-exempt Continuing Connected Transactions are on normal commercial terms and are conducted in the ordinary and usual course of business. Furthermore, CSFB considers that the terms of the Acquisition and the Non-exempt Continuing Connected Transactions to be fair and reasonable from a financial perspective, so far as the Independent Shareholders are concerned, and are in the interest of the Company and its Shareholders as a whole. Accordingly, CSFB advises the Independent Board Committee and the Independent Shareholders that the Independent Shareholders should vote in favour of the Acquisition and the Non-exempt Continuing Connected Transactions. The text of the letter from CSFB containing its advice and the principal factors and reasons it has taken into consideration in arriving at its advice is set out on pages 38 to 58 of this circular.

The Independent Board Committee, having taken into account the advice of CSFB, considers that the terms of the Acquisition and the terms of the Non-exempt Continuing Connected Transactions are fair and reasonable so far as the Independent Shareholders are concerned, and in the interests of the Company and its Shareholders as a whole. Accordingly, the Independent Board Committee recommends that Independent Shareholders vote in favour of the ordinary resolutions to be proposed at the Extraordinary General Meeting to approve the Acquisition and the Non-exempt Continuing Connected Transactions, as detailed in the notice of the Extraordinary General Meeting set out at the end of this circular. The text of the letter from the Independent Board Committee is set out on pages 36 to 37 of this circular.

ADDITIONAL INFORMATION

Your attention is also drawn to the letter from the Independent Board Committee which sets out its recommendation to the Independent Shareholders, the letter from CSFB which contains its advice to the Independent Board Committee and the Independent Shareholders, and the additional information set out in the appendices to this circular.

By Order of the Board
China Netcom Group Corporation
(Hong Kong) Limited
Zhang Chunjiang
Chairman

LETTER FROM THE INDEPENDENT BOARD COMMITTEE

[GRAPHIC OMITTED]
CHINA NETCOM GROUP CORPORATION (HONG KONG) LIMITED
[GRAPHIC OMITTED]
(incorporated in Hong Kong with limited liability under the Companies Ordinance)

23 September 2005

To the Independent Shareholders

Dear Sir or Madam,

MAJOR TRANSACTION,
CONNECTED TRANSACTION AND
CONTINUING CONNECTED TRANSACTIONS

We refer to the circular (the "Circular") dated 23 September 2005 issued by the Company to its Shareholders of which this letter forms part. The terms defined in the Circular shall have the same meanings when used in this letter, unless the context otherwise requires.

On 12 September 2005, the Board announced that the Company had entered into the Acquisition Agreement, pursuant to which the Company agreed to acquire and CNC BVI, the Company's immediate holding company, agreed to sell the entire equity interest in the Target BVI Company, subject to certain conditions.

The Independent Board Committee was formed on 15 August 2005 to make a recommendation to the Independent Shareholders as to whether or not the terms of the Acquisition and the terms of the Non-exempt Continuing Connected Transactions, from a financial perspective, are fair and reasonable so far as the Independent Shareholders are concerned, and whether or not the Acquisition and the Non-exempt Continuing Connected Transactions are in the interests of the Company and the Shareholders as a whole. CSFB has been retained as independent financial adviser to advise the Independent Board Committee and the Independent Shareholders on the fairness and reasonableness of the terms of the

Acquisition and the terms of the Non-exempt Continuing Connected Transactions from a financial perspective.

The terms and the reasons for the Acquisition (including arrangements regarding the financing of the Acquisition) are summarised in the Letter from the Chairman set out on pages 6 to 35 of the Circular. The terms of the Non-exempt Continuing Connected Transactions are also summarised in the Letter from the Chairman.

As your Independent Board Committee, we have discussed with the management of the Company the reasons for the Acquisition, the terms of the Non-exempt Continuing Connected Transactions and the basis upon which their terms have been determined. We have also considered the principal factors and reasons taken into account by CSFB in arriving at its opinion regarding the terms of the Acquisition and the terms of the Non-exempt Continuing Connected Transactions as set out in the letter from CSFB on pages 38 to 58 of the Circular, which we urge you to read carefully.

The Independent Board Committee, after taking advice from CSFB, concurs with the views of CSFB and considers, from a financial perspective, that the terms of the Acquisition Agreement and the terms of the Non-exempt Continuing Connected Transactions are fair and reasonable so far as the Independent Shareholders are concerned, and in the interests of the Company and its Shareholders as a whole. Accordingly, the Independent Board Committee recommends that Independent Shareholders vote in favour of the ordinary resolutions to approve the Acquisition and the Non-exempt Continuing Connected Transactions, as detailed in the notice of the Extraordinary General Meeting set out at the end of the Circular.

Yours faithfully
John Lawson Thornton
Victor Cha Mou Zing
Qian Yingyi
Hou Ziqiang
Timpson Chung Shui Ming
Independent Board Committee

LETTER FROM CSFB

The following is the text of a letter, prepared for the purpose of inclusion in this circular, received from CSFB in connection with the Acquisition and the Non-exempt Continuing Connected Transactions. @#

[GRAPHIC OMITTED]
Credit Suisse First Boston (Hong Kong) Limited
45/F, Two Exchange Square
Central
Hong Kong

23 September 2005

The Independent Board Committee
China Netcom Group Corporation (Hong Kong) Limited
46th Floor, Cheung Kong Center
2 Queen's Road Central
Hong Kong

The Independent Shareholders

MAJOR TRANSACTION,
CONNECTED TRANSACTIONS AND
CONTINUING CONNECTED TRANSACTIONS

Acquisition of the Target BVI Company

Dear Sirs,

INTRODUCTION

We refer to the Acquisition Agreement and the Continuing Connected Transactions, details of which are set out in the Company's circular dated 23 September 2005 (the "Circular"), which contains this letter. Terms defined in the Circular shall have the same meanings herein, unless the context otherwise requires.

Under the Hong Kong Listing Rules, the Acquisition constitutes both a major transaction and a connected transaction for the Company and, pursuant to the provisions thereof, is subject to, among other things, approval by the Independent Shareholders at the Extraordinary General Meeting.

The Combined Group, which includes the Company and its wholly-owned subsidiary CNC China through which the Company has contracted in several instances, on the one hand, and China Netcom Group and its subsidiaries or Associates (other than the Combined Group) on the other, have entered into a number of Continuing Connected Transactions in relation to the operations of the Combined Group, which constitute connected transactions for the Company under the Hong Kong Listing Rules. Certain of these Continuing Connected Transactions, namely the Domestic Interconnection Settlement Agreement, the International Long Distance Voice Services Settlement Agreement, the Engineering and Information Technology Services Agreement and the Materials Procurement Agreement, described in the section entitled "Continuing Connected Transactions" of the "Letter from the Chairman" (the "Non-exempt Continuing Connected Transactions") are subject to approval by the Independent Shareholders at the Extraordinary General Meeting.

We have been appointed to act as the Independent Financial Advisor to advise the Independent Board Committee and Independent Shareholders in respect of the terms of the Acquisition and the terms of the Non-exempt Continuing Connected Transactions, from a financial point of view. This letter has been prepared and delivered for the purpose of assisting the Independent Board Committee in its duty to evaluate the abovementioned aspects and for no other reasons or purposes.

In formulating our opinion, we have reviewed, among other things, the Circular, the Company's initial public offering prospectus dated 4 November 2004, the Acquisition Agreement, the Engineering and Information Technology Services Agreement, the Materials Procurement Agreement, the Domestic Interconnection Settlement Agreement and the International Long Distance Voice Services Settlement Agreement, as well as the information and financial projections prepared by the Company and the Target Company relating to the Target Company. In arriving at our opinion, we have relied upon and assumed, without independent verification, the accuracy and completeness of all information that was publicly available or was furnished to us by, or on behalf of, the management of the Company or the Target Company or otherwise reviewed by us (which information includes, without limitation, the information cited herein), and we have not assumed any responsibility or liability therefor, nor have we conducted independent legal due diligence or due diligence investigation of the business, assets, liabilities, properties, operations, condition (financial and otherwise), results of operations, contingent liabilities, material agreements and prospects of the Target Company and each of its subsidiaries. We have further considered, as stated in the "Letter from the Chairman" that: (i) the Acquisition is negotiated and entered into on an arm's length basis and on normal commercial terms, (ii) the terms, including the purchase price are fair and reasonable, and (iii) the Acquisition is in the best interest of the Company and its Shareholders. The Directors have collectively and individually accepted full responsibility for the accuracy of the information and views contained in the Circular and have confirmed, having made all reasonable enquiries that, to the best of their knowledge and belief, there are no other facts the omission of which would make any statement in the Circular misleading.

We have also assumed that each of the Acquisition Agreement and the agreements relating to the Non-exempt Continuing Connected Transactions is enforceable against each of the parties thereto in accordance with its terms and that each of the parties will perform, and will be able to perform, its obligations thereunder, and as otherwise described in the Circular, in full when due. We have further assumed that all material governmental, regulatory or other consents and approvals necessary for the completion of the Acquisition and the entering into of the Non-exempt Continuing Connected Transactions will be obtained without any adverse effect on the Company or on the contemplated benefits of the Acquisition and the transactions contemplated under the Non-exempt Continuing Connected Transactions to the Company. We have not conducted any valuation or appraisal of any assets or liabilities, nor have any such valuations or appraisals been provided to us. In relying on financial analyses and forecasts provided to us, we have assumed that they have been reasonably prepared based on assumptions reflecting the best currently available estimates and judgments by the management of the Company and the Target Company as to the expected future results of operations and the financial condition of the Company or the Target Company to which such analyses or forecasts relate.

Our opinion is necessarily based on the legal and regulatory environment, economic market and other conditions as in effect on, and the information made available to us as at, the date hereof. It should be understood that subsequent developments (including any material deviations from the financial analyses and forecasts provided to us) may affect and/or change this opinion and that we do not have any obligation to update, revise, or reaffirm this opinion.

Our opinion is also subject to the following qualifications:

(a) We are instructed as the Independent Financial Adviser to the Independent Board Committee in relation to the Acquisition and the Non-exempt Continuing Connected Transactions. As such, the scope of our review, and consequentially, our opinion, is limited by reference to a financial point of view only and does not include any statement or opinion as to the merits or otherwise of the Acquisition, or the Non-exempt Continuing Connected Transactions from any other point of view;

(b) We do not express any opinion or statement as to whether any similar terms or transactions akin to the terms proposed for the Acquisition, and the Non-exempt Continuing Connected Transactions are or might be available from any independent third parties, nor as to whether any independent third parties might offer similar or better terms for similar transactions;

(c) It is not possible to confirm whether or not the Acquisition and the Non-exempt Continuing Connected Transactions are in the interests of each individual Independent Shareholder and each Independent Shareholder should consider his/her/its vote on the merits or otherwise of the Acquisition and the Non-exempt Continuing Connected Transactions in his/her/its own circumstances and from his/her/its own point of view having regard to all the circumstances (and not only the financial perspectives offered in this letter) as well as his/her/its own investment objectives;

(d) In preparing this letter and in giving any opinion or advice, we have only had regard to the Acquisition and the Non-exempt Continuing Connected Transactions in isolation, and not in connection with any other business plan or strategy, past or present with regard to the Company or the Group as a whole, nor have we viewed these as part of a series of other transactions or arrangements;

(e) We express no opinion as to whether the Acquisition, or the Non-exempt Continuing Connected Transactions will be completed nor whether they will be successful;

(f) Nothing contained in this letter should be construed as us expressing any view as to the trading price or market trends of any securities of the Company at any particular time;

(g) Nothing contained in this letter should be construed as a recommendation to hold, sell or buy any securities of the Company; and

(h) We were not requested to and did not provide advice concerning the structure, the specific amount of the consideration, the timing, pricing, size, feasibility, or any other aspects of the Acquisition or the Non-exempt Continuing Connected Transactions, or to provide services other than the delivery of this opinion. We did not participate in negotiations with respect to the terms of the Acquisition, or the Non-exempt Continuing Connected Transactions or any related transactions.

We will receive a fee from the Company for the delivery of this opinion.

TERMS OF THE PROPOSAL

In arriving at our opinion, we have taken into consideration each of the principal factors and reasons set out below. Our conclusions are based on the results of all analyses taken as a whole.

1. The Acquisition

A. Overview

Pursuant to the Acquisition Agreement dated 12 September 2005, the Company agreed, subject to certain conditions, to acquire from CNC BVI the entire equity interest in the Target BVI Company for a purchase price of RMB 12,800 million (equivalent to approximately HK$12,282 million). The Target BVI Company holds the entire equity interest in the Target Company, which in turn owns the assets and liabilities and the business operations in the Target Regions in the PRC. The purchase price consists of payment of an initial cash consideration of RMB3,000 million (equivalent to approximately HK$2,879 million) payable on the completion date of Acquisition and a deferred consideration of RMB9,800 million (equivalent to approximately HK$9,403 million). The Company intends to finance the initial consideration by using existing internal cash resources and the deferred consideration by using internal cash resources and/or proceeds from future external financing. The conditions precedent to the completion of the Acquisition must be satisfied on or before 31 December 2005 or such other date as agreed to by the parties. China Netcom Group has given warranties, representations and undertakings in respect of CNC BVI's title in the Target BVI Company and the Target Company, the operations and assets and liabilities of the Target Company and the legal status of those companies.

We understand that the corporate structure of the Company and its principal subsidiaries immediately after the Acquisition is set out below.

Corporate structure immediately following the completion of the Acquisition

```
----------------------------
|      China Network        |
|     Communications        |
|    Group Corporation      |
| ("China Netcom Group")    |
|        (PRC)(3)           |
----------------------------
             | 100%
----------------------------    ---------------------------      ---------------------------
|    China Netcom Group     |   |                          |     |                           |
| Corporation (BVI) Limited |   | Five PRC Shareholders(1) |     |    Public Shareholders    |
|       ("CNC BVI")         |   |                          |     |                           |
|(British Virgin Islands)(3)|   |                          |     |                           |
----------------------------    ---------------------------      ---------------------------
             | 70.49%(2)                   | 4.51%(2)                               |  25.00%
             | ---------------------------------------------------------------|
                                           |
                      -----------------------------------------------------
                      | China Netcom Group Corporation (Hong Kong) Limited)|
                      |                  ("Company")                       |
                      |                  (Hong Kong)(3)                    |
                      -----------------------------------------------------
                           |                 |
                           |                 |
             --------------                  |
             |                       -------------------------------
             | 100%                  | 100%                         | 100%
----------------------------      ----------------------     --------------------------
|  China Netcom Group New   |    | China Netcom (Group) |   | China Netcom Corporation |
|  Horizon Communications   |    |   Company Limited    |   |  International Limited   |
| Corporation (BVI) Limited |    |    ("CNC China")     |   |       (Bermuda)(3)       |
|   ("Target BVI Company")  |    |       (PRC)(3)       |   |                          |
|(British Virgin Islands)(3)|    |                      |   |                          |
----------------------------      ----------------------    ---------------------------
             |                   :                                   |
             |                   :                                   |
             | 100%              : - Operating in:(4)                | 100%
----------------------------     :                              -----------------------
|  China Netcom Group New   |    : -  Beijing Municipality    |     Asia Netcom         |
|  Horizon Communications   |    : -  Tianjin Municipality    | Corporation Limited     |
| Corporation Limited       |    : -  Hebei Province          |   ("Asia Netcom")       |
|   ("Target Company")      |    : -  Henan Province          |     (Bermuda)(3)        |
|         (PRC)(3)          |    : -  Shandong Province        -----------------------
----------------------------     : -  Liaoning Province
:                                : -  Shanghai Muncipality
:                                : -  Guangdong Province
:   Operating in:(4)
:-  Heilongjiang Province
:-  Jilin Province
:-  Neimenggu Autonomous Region
:-  Shanxi Province
```

(1)   The five PRC Shareholders, all of which are established in the PRC, are the Chinese Academy of Sciences, Information and Network Center of the State

Administration of Radio, Film and Television, China Railways Telecommunications Center, Shanghai Alliance Investment Limited, and Shandong Provincial State-owned Assets Supervision and Administration Commission.

(2) All of the ordinary shares owned by the five PRC Shareholders are registered in the name of China Netcom Group Corporation (BVI) Limited, or CNC BVI, which holds such ordinary shares in trust for each of the five PRC Shareholders. Consequently, the ownership percentage of the five PRC Shareholders in the charts above reflects the aggregate beneficial interests of these Shareholders as held through CNC BVI. The ownership percentage of CNC BVI as indicated in the charts above reflects CNC BVI's own beneficial ownership.

(3) Indicates jurisdiction of incorporation.

(4) The provincial businesses are operated under local branch offices of CNC China or the Target Company (as the case may be) and these local branch offices are not legal entities.

B. The Target Company

The Target Company is a provider of fixed-line telephone services, broadband and other Internet-related services, and business and data communications services in the Target Regions in the PRC. The Target Regions are Heilongjiang province, Jilin province, Neimenggu Autonomous Region and Shanxi province in the PRC. In each of these four provinces and autonomous region, the Target Company owns extensive local access networks and is the incumbent fixed-line operator. As at 30 June 2005, the Target Company had a total of approximately 28.9 million fixed line subscribers and 2.8 million broadband subscribers, representing a market share of approximately 90.2% and 90.7% respectively in the Target Regions. Further operational information on the Target Company is set out in Appendix I to the Circular.

We summarize below the historical (i) revenues, (ii) operating profit, and (iii) profit / (loss) of the Target Company for each of the three years ended December 31, 2002, 2003 and 2004, and the interim period ended 30 June 2005, which were extracted from the audited financial statements of the Target Company as set out in Appendix II to the Circular.

Summary historical financials

	Year ended December 31,		
	2002	2003	2004
	(RMB million)		
Revenues	16,232	17,700	18,616
Operating profit	930	1,061	2,103
Profit / (loss) for the year	98	205	(6,531)

As at 30 June 2005, the total assets and owner's equity of the Target Company were RMB47,929 million (equivalent to approximately HK$45,988 million) and RMB8,131 million (equivalent to approximately HK$7,802 million), respectively. Further financial information on the Target Company is set out in Appendix II to the Circular. As stated in the "Letter from the Chairman", the management of the Company and the Target Company believe that, on the bases and the assumptions set out in Appendix V and in the absence of unforeseen circumstances, the forecast of the Target Company's combined profit after taxation and minority interests on a reported basis, for the year ending 31 December 2005 under HKFRS is unlikely to be less than RMB2,150 million (equivalent to approximately HK$2,063 million) on a recurring basis (excluding an estimated upfront connection fee of approximately RMB735 million (equivalent to approximately HK$705 million)), it is unlikely to be less than RMB1,415 million (equivalent to approximately HK$1,358 million). As stated in the letter from the Company's Financial Advisers set out in Appendix V, the Company's Financial Advisers are of the opinion that, based on the assumptions made by the management of the Company and the Target Company, respectively, and on the basis of the accounting policies and calculations reviewed by PricewaterhouseCoopers, the profit forecast of the Target Company has been made after due and careful enquiry. Further details of the profit forecast are set out in Appendix V to the Circular.

C. Rationale for the Acquisition

As stated in the "Letter from the Chairman" in the Circular, the Acquisition represents a new and important opportunity for the Company to (i) increase coverage and achieve further growth (ii) improve the Group's service capabilities, and (iii) capture operating synergy and improve management efficiency so as to benefit further from the sustained growth of the telecommunications industry in the PRC. As stated in the "Letter from the Chairman", the Acquisition is in the interest of the Company and its Shareholders. Further details of the reasons for, and the benefits of the Acquisition are set out in the "Letter from the Chairman" in the Circular.

D. Basis of the Consideration

As noted in the "Letter from the Chairman", the Acquisition was negotiated and entered into on an arm's length basis and on normal commercial terms. We understand that the purchase price of RMB12,800 million (equivalent to approximately HK$12,282 million) was determined based on various factors, including the quality of the assets being acquired, their growth prospects, earnings potential, competitive advantages in their respective markets, the prospective profit contributions by the Target Company to the Group and as well as by reference to other financial and operational factors.

As stated in the "Letter from the Chairman", the purchase price payable by the Company for the entire equity interests in the Target Company and the other terms of the Acquisition are fair and reasonable. In particular, the terms of the deferred consideration are more favourable than the usual terms of a commercial bank loan of a similar size and term.

E. Financing of the Acquisition

Under the Acquisition Agreement, the purchase price for the Acquisition of RMB12,800 million (equivalent to approximately HK$12,282 million) will be satisfied by the payment of an initial cash consideration and the payment of a deferred consideration.

The initial cash consideration of RMB3,000 million (equivalent to approximately HK$2,879 million) will be satisfied on the completion date of the Acquisition. The Company intends to finance the initial consideration by using existing internal cash resources.

The deferred consideration of RMB9,800 million (equivalent to approximately HK$9,403 million) is payable in ten equal amounts at half-yearly intervals over a five year time period from the date of completion of the Acquisition. The Company will also pay interest at half-yearly intervals on the actual amount of deferred consideration remaining outstanding. Interest is accrued daily and is payable at the rate of 5.265% per annum, being 10% discount to the RMB lending rate of 5.85% per annum of commercial banks in the PRC in respect of loans with tenure of five years as published by the People's Bank of China and prevailing at 12:00 noon (Beijing time) on 8 September 2005, being two Business Days immediately preceding the date of the Acquisition Agreement. The Company intends to finance the deferred consideration by using internal cash resources and/or proceeds from future external financing.

The payment of the deferred consideration and the interest payments can be made in RMB or US dollars as agreed between CNC BVI and the Company, subject to the approvals of the relevant PRC governmental authorities. Any payment made in US dollars will be based on the Federal Reserve noon-buying rate between US dollars and RMB which is quoted as of 12:00 noon (New York City time) on the day which is two business days immediately prior to the date of payment. The Company may, from time to time, prepay all or part of the deferred consideration, at any time after completion until the fifth anniversary of the completion of the Acquisition, without penalty. It is noted in the "Letter from the Chairman" that the terms of the deferred consideration are more favourable than the usual terms of a commercial bank loan of a similar size and term.

In considering the suitability of the financing arrangement for the Acquisition, we have considered the following factors:

o The deferred payment mechanism provides a 5 year payment period for the deferred consideration and an early payment option without penalty, thereby ensuring the Company considerable funding flexibility;

o The deferred payment facility provides financing at more favourable rates than financing via debt or bank loans at present market rates;

o The deferred payment mechanism utilises the considerable cash resources of the Company and effectively utilises available resources of the Combined Group;

o The Company has confirmed that (a) it has sufficient internal cash resources, which as at 30 June 2005 was approximately RMB9,229 million (equivalent to HK$8,855 million) and external financing resources to fund the cash payment of the initial consideration and the deferred consideration, and (b) it has sufficient internal and external financing resources for its ongoing operations and capital expenditure requirements.

F. Valuation of the Target Company

We have analyzed the purchase price of the Acquisition using three valuation methodologies: (i) the discounted cash flow ("DCF") analysis, (ii) the comparable company trading analysis, and (iii) the comparable transaction analysis.

i. Discounted cash flow analysis

We have used the DCF analysis as the primary valuation methodology as in our view it explicitly accounts for the future financial and operating performance of the Target Company. The methodology takes into consideration the current and future anticipated change in the market and regulatory environment in which the Target Company operates in, as well as its long-term business plan and strategy, its cost structure, capital expenditure requirements and cost of capital.

Our DCF analysis reflects the business plans and financial projections of the Target Company and other relevant information provided by the Target Company and the Company, as well as our discussions with the Target Company and its representatives. We have reviewed the key assumptions and operating data of the Target Company in the context of the overall conditions of the market in which the Target Company operates. We have made relevant adjustments to certain assumptions to reasonably reflect our views of the future performance of the Target Company.

The purchase price of the Acquisition of RMB12,800 million (equivalent to approximately HK$12,282 million) is within our DCF valuation range.

ii. Comparable company trading analysis

We have carried out a comparable company trading analysis using trading multiples commonly used by investors as a valuation tool in the telecommunications industry, in particular price/earnings ("P/E") ratio. We have considered in our analysis, but have not relied on, the enterprise value/EBITDA ratio, another commonly used valuation metric, as the prospective EBITDA information for the Target Company for the year ending 31 December 2005 is not disclosed in the Circular.

We have derived trading multiples using both reporting financials (including both recurring and non-recurring items) as well as recurring financials. The difference between the two sets of the financials represents the amortization income in relation to previously received upfront connection fees. Since the Target Company does not expect to receive such fees in the future, this income is considered non-recurring.

As of the Acquisition Agreement date and using the reporting financials, the purchase price of RMB12,800 million (equivalent to approximately HK$12,282 million) for the Acquisition implies a 2005E P/E ratio of approximately 6.0 times based on the forecast net profit of the Target Company of approximately RMB2,150 million (equivalent to approximately HK$2,063 million) for the year 2005, as forecasted and stated by the Company in the "Letter from the Chairman".

As of the Acquisition Agreement date and using the recurring financials, the purchase price of RMB12,800 million (equivalent to approximately US$12,282 million) for the Acquisition implies a 2005E P/E ratio of approximately 9.0 times based on the forecast net profit (less amortization income of upfront connection fee) of the Target Company of approximately RMB1,415 million (equivalent to approximately HK$1,358 million), estimated as the forecasted reporting net profit of RMB2,150 million (equivalent to approximately HK$2,063 million) minus the estimated amortization income of upfront connection fee of approximately RMB735 million (equivalent to approximately HK$705 million) for the year 2005, as forecasted and stated by the Company and comforted by PricewaterhouseCoopers in Appendix V.

The Company, in our view, represents the most comparable company to the Target Company based on their similar business focus and product offerings, similar operating geographies (i.e. Northern China) and similar market position. China Telecom Corporation Limited ("China Telecom") is also generally regarded as a comparable company to the Company due to its similar business focus in mainland China, although it is considerably larger and operates in the Southern and Western region of mainland China.

Based on the 20-trading day average share price up to 12 September 2005 and using the reporting financials, the Target Company's 2005E P/E multiple implied by the purchase price represents a 28.8% discount and a 33.4% discount to the Company's and China Telecom's corresponding estimated multiples, respectively. Based on the 20-trading day average share price up to 12 September 2005 and using the recurring financials, the Target Company's 2005E P/E multiple implied by the purchase price represents a 17.1% discount and a 20.7% discount to the Company's and China Telecom's corresponding estimated multiples, respectively.

Reported

	financial basis 2005E P/E(3)
Target Company	6.0x
Based on 12 September 2005 Closing Price(1)	
The Company	8.5x
China Telecom	8.7x
(Discount/Premium) to the Company	(30.3%)
(Discount/Premium) to China Telecom	(31.6%)
Based on 20-Trading Day Average Closing Price(2)	
The Company	8.4x
China Telecom	8.9x
(Discount/Premium) to the Company	(28.8%)
(Discount/Premium) to China Telecom	(33.4%)

(1) Closing share price of HK$13.40 and HK$2.85 for the Company and China Telecom as of 12 September 2005.

(2) 20-trading day average share price of HK$13.12 and HK$2.93 for the Company and China Telecom up to 12 September 2005.

(3) Forecasted net incomes for the Company and China Telecom are based on CSFB Research estimates.

We have also compared the implied valuation multiples of the Acquisition to the trading multiples of selected comparable companies, which includes overseas listed Chinese wireless companies and selected telecommunications companies in the Asia-Pacific region. These comparable companies display certain common characteristics with the Target Company, though to a lesser degree than the resemblance between the Company and China Telecom to the Target Company. The implied valuation multiples of the Acquisition are reasonable when compared to the trading multiples of the above groups of comparable companies.

iii. Comparable transaction analysis

Comparable transaction analysis should be viewed in the context of factors that include market dynamics, competitive differences and significance of stake acquired. The following are the recent comparable transactions in the China telecommunication industry:

Fixed-line Sector

o China Telecom's acquisition of telecommunications assets in 10 provinces from China Telecommunications Corporation ("China Telecom Corporation Limited Acquisitioni") announced in April 2004 ("China Telecom Acquisition 1"),

o China Telecom's acquisition of telecommunications assets in 6 provinces from China Telecommunications Corporation ("China Telecom Corporation Limited Acquisition") announced in October 2003 ("China Telecom Acquisition 2"),

Mobile Sector(1)

o China Mobile (Hong Kong) Limited's acquisition of mobile assets in 10 provinces from China Mobile Group ("China Mobile Acquisition 1") announced in April 2004, o China Mobile (Hong Kong) Limited's acquisition of mobile assets in 8 provinces from China Mobile Group ("China Mobile Acquisition 2") announced in May 2002,

o China Unicom Limited's acquisition of mobile assets in 9 provinces from China Unicom (BVI) Limited ("China Unicom Acquisition 1") announced in November 2003,

o China Unicom Limited's acquisition of mobile assets in 9 provinces from China Unicom (BVI) Limited ("China Unicom Acquisition 2") announced in November 2002.

(1) Not directly comparable sector but used as a secondary benchmark in our analysis

	Reported financial basis P/E(1)
1. Target Company	6.0x
2. China Telecom Acquisition 1	5.8x
3. China Telecom Acquisition 2	7.2x
4. China Mobile Acquisition 1	9.7x
5. China Mobile Acquisition 2	12.7x
6. China Unicom Acquisition 1	12.8x
7. China Unicom Acquisition 2	10.4x
(Discount/Premium) of (1) to (2)	2.0%
(Discount/Premium) of (1) to (3)	(17.8%)
(Discount/Premium) of (1) to (4)	(38.6%)
(Discount/Premium) of (1) to (5)	(53.0%)
(Discount/Premium) of (1) to (6)	(53.4%)
(Discount/Premium) of (1) to (7)	(42.9%)

(1) Calculation based on forward-looking earnings, as disclosed in the respective shareholder circulars issued in relation to the referred transactions.

The 2005E P/E ratio implied by the purchase price of the Acquisition is consistent with the multiples implied by the China Telecom Acquisition 1. The 2005E P/E ratio implied by the purchase price of the Acquisition and based on the recurring financials represents a 21.3% discount to that of the China Telecom Acquisition 2, a 6.7% discount to that of the China Mobile Acquisition 1, a 28.6% discount to that of the China Mobile Acquisition 2, a 29.2% discount to that of the China Unicom Acquisition 1 and a 13.2% discount to that of the China Unicom Acquisition 2. The implied valuation multiples of the Acquisition are reasonable when compared to the implied multiples of the abovementioned comparable transactions.

G. Conditions of the Acquisition

As stated in the Circular, the completion of the Acquisition is conditional upon the fulfilment or waiver (where available) of the following conditions, among others, on or before 31 December 2005 or such other date as the Company, CNC BVI and China Netcom Group may agree:

o The passing of resolutions by the Independent Shareholders approving the Acquisition and the Non-exempt Continuing Connected Transactions;

o There having been no material adverse change to the financial condition, business operations, or prospects of the Target Company; and

o The receipt of various approvals and registrations from the relevant PRC regulatory authorities.

Certain PRC regulatory approvals have been obtained.

H. Pro forma financial effects to the Company

We have conducted various analyses on the potential financial effects of the Acquisition on the Company, which were extracted from the unaudited financial information of the Company and the unaudited pro forma financial information of the Combined Group as set out in Appendices III and IV to the Circular.

Summary Income Statement Items

	For the six mon June 30, 2 Group Historical (RMB million
Revenues	33,724
Operating profit	9,767
Profit for the year	6,358

Summary Balance Sheet Items

	As of June 30 Group Historical (RMB million
Cash and cash equivalent(2)	9,229
Total debt	48,968
Shareholders' equity	61,484
Total capitalization(3)	127,176
Total debt / Shareholders' equity	79.6%
Total debt / Total capitalization	38.5%

(1) Assumes acquisition price of RMB12.8 billion and initial consideration of RMB3.0 billion.

(2) Includes short-term investments.

(3) Includes deferred revenue

Earnings

The pro forma net income of the Combined Group for the six months ended 30 June

2005, would be approximately RMB7,386 million, which is approximately 16.2% higher than the actual net income of the Group for the same period.

Gearing

The pro forma total debt of the Combined Group would be approximately RMB82,443 million as at 30 June 2005, representing an increase of approximately 68.4% from the actual total debt of approximately RMB48,968 million of the Group. The pro forma net debt (total debt less cash and cash equivalents and short-term investments) would increase to approximately RMB75,748 million as at 30 June 2005, as a net result of financing the initial consideration with the existing cash resources of the Group, increasing the Group's total debt by the deferred consideration and taking on the net indebtedness of the Target Companies. The pro forma gearing of the Combined Operating Group, defined as total debt divided by shareholders' equity, would increase from approximately 79.6% to approximately 134.1% as at 30 June 2005. As also noted in the above table, the total debt/total capitalization ratio would increase from approximately 38.5% to approximately 50.1%. The increase in the total debt/shareholders' equity ratio and total debt/total capitalisation ratio is the result of the deferred consideration and the assumption of the Target Company's debt. The pro forma gearing ratios remain within the range of gearing levels of certain telecommunication companies which we have considered for comparison purposes.

2. Continuing Connected Transaction

In October 2004, CNC China, a wholly-owned subsidiary of the Company, entered into certain agreements with China Netcom Group to regulate certain ongoing transactions between CNC China and China Netcom Group and its subsidiaries and Associates. These transactions are continuing connected transactions of the Company under the Hong Kong Listing Rules.

As a result of the Acquisition, similar ongoing transactions will be conducted between the Target Company on the one hand and China Netcom Group and its subsidiaries and Associates (other than the Combined Group) on the other. These transactions are continuing connected transactions of the Company under the Hong Kong Listing Rules. In order to facilitate the management of all continuing connected transactions of the Company in China post the Acquisition, the Target Company, CNC China and China Netcom Group have entered into certain connected transactions agreements to regulate the continuing connected transactions between China Netcom Group and its subsidiaries or Associates (other than the Combined Group) on the one hand and the Combined Group on the other, in respect of the Combined Group's operations in the 12 provinces, municipalities and autonomous region in China. These agreements replace the existing connected transaction agreements between CNC China and China Netcom Group if and when the Acquisition completes. These agreements are:

i. Property Leasing Agreement

ii. Property Sub-leasing Agreement

iii. Master Sharing Agreement

iv. Ancillary Telecommunications Services Agreement

v. Support Services Agreement

vi. Telecommunications Facilities Leasing Agreement

vii. Engineering and Information Technology Services Agreement

viii. Materials Procurement Agreement

ix. Domestic Interconnection Settlement Agreement

x. International Long Distance Voice Services Settlement Agreement

For agreements (i) to (vi) above, the proposed annual cap for each of the agreements will be less than the 2.5% threshold under Rule 14A.34 of the Hong Kong Listing Rules. Accordingly, these transactions will be exempt from the Independent Shareholders' approval requirements under the Hong Kong Listing Rules, but such transactions will still be subject to the reporting and announcement requirements set out in Rules 14A.45 to 14A.47 of the Hong Kong Listing Rules.

For agreements (vii) to (viii) above, the proposed annual cap for each of the agreements will exceed the 2.5% threshold under Rule 14A.34 of the Hong Kong Listing Rules. Accordingly, such transactions will constitute Non-Exempt Continuing Connected Transactions under Rule 14A.35 of the Hong Kong Listing Rules and will be subject to the reporting and announcement requirements set out in Rules 14A.45 to 14A.47 of the Hong Kong Listing Rules and the Independent Shareholders' approval requirements under Rule 14A.48 of the Hong Kong Listing Rules.

For agreements (ix) to (x) above, no caps are proposed. Under Rule 14A.35(2) of the Hong Kong Listing Rules, in respect of a continuing connected transaction, which is not fully exempted, a cap must be set. We understand from the Company that a waiver from strict compliance with Rule 14A.35(2) of the Hong Kong Listing Rules has been obtained. Such transactions will be subject to the reporting and announcement requirements set out in Rule 14A.45 to 14A.47 of the Hong Kong Listing Rules. The transactions contemplated under agreements (ix) to (x) above are also subject to Independent Shareholders' approval requirements.

We set out below a summary of each of the Non-exempt Continuing Connected Transactions. We have not reviewed the terms of the other Continuing Connected Transaction Agreements which are not the Non-exempt Continuing Connected Transactions (the descriptions of which are found in the "Letter from the Chairman") and make no comments on them.

Domestic Interconnection Settlement Agreement

The Target Company, CNC China and China Netcom Group entered into the Domestic Interconnection Settlement Agreement on 12 September 2005. This agreement replaces the existing Interconnection Settlement Agreement between CNC China and China Netcom Group, which covers both domestic and international long distance settlement.

Pursuant to the Domestic Interconnection Settlement Agreement, the parties agreed to interconnect the network of China Netcom Group on the one hand and that of CNC China and the Target Company (together with CNC China, the "Combined Operating Group") on the other and settle the charges received in respect of domestic long distance voice services within their respective service regions. The terms in the new Domestic Interconnection Settlement Agreement are generally the same as the existing Interconnection Settlement Agreement, apart from the settlement period that has changed from monthly to quarterly to simplify the settlement procedure.

For domestic long distance voice services between China Netcom Group and the Combined Operating Group, the telephone operator in the location of the calling party makes a settlement payment to the telephone operator in the location of the called party at the rate of RMB0.06 per minute (in case where the call terminates within the network of either China Netcom Group or the Combined Operating Group) or RMB0.09 per minute (in case where the call terminates outside the network of either China Netcom Group or the Combined Operating Group). The rates are set with reference to the relevant standards and tariffs promulgated by the MII and will be adjusted accordingly from time to time.

The Domestic Interconnection Settlement Agreement takes effect from the date of completion of the Acquisition and is valid until 31 December 2007. If the Combined Operating Group notifies China Netcom Group at least three months prior to the expiration of the agreement of its intention to renew the agreement, the agreement can be renewed with the same terms for further periods of three years.

We believe that it is reasonable for no cap to be proposed in respect of the settlement of domestic long distance voice services for the following reasons:

(1) The Company will not be able to control the number of calls coming into its network as well as the number of calls going out into China Netcom Group's network. Any attempt to control that will potentially limit the serivces provided to its customers.

(2) Any cap will potentially limit the growth of its long distance voice services in China and ability to provide the same kind of services as its competitors in China.

(3) The settlement rates in respect of long distance voice services are determined with reference to the relevant standard tariff or policies promulgated by the relevant regulatory authorities in China, which are subject to change from time to time, and the Company is not in a position to set the settlement rates at its discretion.

(4) The treatment of imposing no cap is consistent with similar interconnection agreements in the telecommunication industry in China.

International Long Distance Voice Services Settlement Agreement

CNC China and China Netcom Group entered into the International Long Distance Voice Services Settlement Agreement on 12 September 2005. This agreement replaces the existing Interconnection Settlement Agreement between CNC China and China Netcom Group, which covers both domestic and international long distance settlement.

As a result of the restructuring prior to the initial public offering of the Company, CNC China has been authorized to conduct the international long distance settlement on behalf of China Netcom Group and the Company with overseas telecommunications operators, and therefore any outbound international calls originated or inbound international calls terminated in the China Netcom Group coverage area would need to involve the Company.

For outbound international calls, China Netcom Group reimburses CNC China for any amount it has paid to overseas telecommunications operators. The revenues received by China Netcom Group less the amount paid to overseas telecommunications operators are shared between China Netcom Group and CNC China in proportion to the estimated costs incurred by China Netcom Group and the Combined Operating Group in connection with the provision of outbound international long distance voice services.

For inbound international calls, the revenues received by CNC China from overseas telecommunications operators less the amount paid to China Netcom Group at the rate of RMB0.06 per minute or RMB0.09 per minute depending on whether the call terminates within or outside the network of either China Netcom Group or the Combined Operating Group, are shared between China Netcom Group and CNC China in proportion to the estimated costs incurred by China Netcom Group and the Combined Operating Group in connection with the provision of inbound international long distance voice services. The rates mentioned above are set with reference to the relevant standards and tariffs promulgated by the MII and will be adjusted accordingly from time to time.

The International Long Distance Voice Services Settlement Agreement takes effect from the date of completion of the Acquisition and is valid until 31 December 2007. If CNC China notifies China Netcom Group at least three months prior to the expiration of the agreement of its intention to renew the agreement, the agreement can be renewed with the same terms for further periods of three years.

We believe that it is reasonable for no cap to be proposed in respect of the settlement of international long distance voice services for the same reasons as for the Domestic Interconnection Settlement Agreement.

Engineering and Information Technology Services Agreement

The Target Company, CNC China and China Netcom Group entered into the Engineering and Information Technology Services Agreement on 12 September 2005 to govern the arrangements with respect to the provision of certain engineering and information technology-related services by China Netcom Group to the Company and its subsidiaries. This agreement replaces the existing Engineering and Information Technology Services Agreement between CNC China and China Netcom Group dated 8 October 2004 if and when the Acquisition completes. The terms in the new Engineering and Information Technology Services Agreement are the same as the existing Engineering and Information Technology Services Agreement.

The charges payable for the services under the agreement are determined with reference to market rates. In addition, where the value of any single item of engineering design or supervision-related service exceeds RMB0.5 million, or where the value of any single item of engineering construction-related service exceeds RMB2 million, the award of the project will be subject to a tender process, which involving at least three parties, in accordance with the relevant PRC laws. The Combined Operating Group shall give no priority to China Netcom Group in the selection process, and shall have the right to choose an independent third party as service provider. However, in the case where comparable terms are tendered, China Netcom Group would be chosen.

The Engineering and Information Technology Services Agreement takes effect from the date of completion of the Acquisition and is valid until 31 December 2007. If the Combined Operating Group notifies China Netcom Group at least three months prior to the expiration of the agreement of its intention to renew the agreement, the agreement can be renewed with the same terms for further periods of three years.

As stated in the "Letter from the Chairman", the Company proposes to set an annual cap of RMB4,400 million under this agreement. The annual cap is determined based on the approved cap obtained by the Company at its IPO in October 2004 for the existing Engineering and Information Technology Services Agreement between CNC China and China Netcom Group and the historical service charges paid by the Target Company to China Netcom Group. We have benchmarked the growth rate assumed by the Company in arriving at the annual cap against our estimated growth rate for the Target Company and we believe that the proposed annual cap is reasonable.

We have discussed with the Company the bases for setting the proposed annual cap. The Company has given consideration to certain factors including the potential growth of the Target Company, the development potential of the Target Regions, the focus of Jilin Province and Heilongjiang Province as the targeted development area in the North-East region by the Chinese Government and the lack of independent third party engineering and IT service providers in the Target Regions that can provide comparable high quality services at competitive rates.

Materials Procurement Agreement

The Target Company, CNC China and China Netcom Group entered into the Materials Procurement Agreement 12 September 2005 under which China Netcom Group may act as (i) the agent for the procurement of imported and domestic telecommunications and other domestic non-telecommunication equipment, (iii) seller of certain products, including cables, modems and yellow pages telephone directories, and (ii) provider of related storage and transportation services. The new Materials Procurement Agreement replaces the existing Materials Procurement Agreement between CNC China and China Netcom Group if and when the Acquisition completes.

Commission for the domestic materials procurement services under (i) above shall not exceed the maximum rate of 3% of the contract value. Commission for imported materials procurement services under (i) above shall not exceed the maximum rate of 1% of the contract value. The purchase price for services under (ii) above is determined with reference to the following pricing principles and limits in accordance to the relevant PRC law: (a) the government fixed price; (b) where there is no government fixed price but a government guidance price exists, the government guidance price; (c) where there is neither a government fixed price nor a government guidance price, the market price, i.e. price determined by business operators at their own discretion in a competitive market; (d) where none of the above is applicable, the price to be agreed between the relevant parties and determined on a cost-plus basis. Commission charges for services under (iii) above are determined with reference to market rates.

The Materials Procurement Agreement takes effect from the date of completion of the Acquisition and is valid until 31 December 2007. If the Combined Operating Group notifies China Netcom Group at least three months prior to the expiration of the agreement of its intention to renew the agreement, the agreement can be renewed with the same terms for further periods of three years.

As stated in the "Letter from the Chairman", the Company proposes to set an annual cap of RMB2,000 million under this agreement. Based on our discussion with the Company, the annual cap is determined based on the approved cap obtained by the Company at its IPO in October 2004 for the existing Materials Procurement Agreement between CNC China and China Netcom Group and the historical service charges paid by the Target Company to China Netcom Group, giving consideration to the potential growth of the Target Company, and the development potential of the Target Regions. We have benchmarked the growth rate assumed by the Company in arriving at the annual cap against our estimated growth rate for the Target Company and we believe that the proposed annual cap is reasonable.

For the Materials Procurement Agreement, no historical comparable figures are available. Prior to the Company's listing restructuring in 2004, China Netcom Group mainly acted as the principal, where it purchased and then resold equipments to the Combined Operating Group, rather than the agent earning commissions.

SUMMARY

After considering all of the principal factors and reasons listed above, we draw your attention to the following key factors in arriving at our opinion:

(a) The Company's view that the Acquisition will enhance the Company's market position, strengths and competitiveness, improve its growth prospects and financial position, and enable it to improve its managerial and operating efficiency;

(b) The Company's representation that the Acquisition was conducted on an arm's length basis;

(c) The purchase price of the Acquisition: (i) is within the range of the equity values implied by our DCF analysis, (ii) implies a reasonable multiple compared to the relevant trading multiples of the Company and other comparable companies, and (iii) implies a reasonable multiple compared to the multiples implied by recent comparable telecommunication transactions in China;

(d) The Board is of the opinion that the transactions contemplated under the Non-exempt Continuing Connected Transactions have been entered into, and will be carried out, in the ordinary and usual course of business of the Combined Operating Group and on normal terms and conditions;

(e) The charges under the Non-exempt Continuing Connected Transactions were determined based on the standards or tariffs promulgated by the relevant Chinese regulatory authorities, or by reference to market rates, or are based on reasonable costs or on a reasonable costs-plus basis as negotiated on an arm's length basis between the relevant parties. Furthermore, the material terms and conditions of the Non-exempt Continuing Connected Transactions are consistent with to the terms and conditions of the corresponding existing Non-exempt Continuing Connected Transactions;

(f) As required by the Listing Rules, the Company has to comply with the rules in relation to annual review of continuing connected transactions set out in Rule 14A.37 to Rule 14A.41 of the Hong Kong Listing Rules, and that, upon any variation or renewal of the Non-exempt Continuing Connected Transactions, the Company shall comply in full with all applicable requirements set out in Chapter 14A of the Hong Kong Listing Rules;

(g) The Company possesses the right to terminate the Acquisition Agreement if, among other events, a material adverse change takes place at any time after signing of the Acquisition Agreement and before the completion of the Acquisition. The Acquisition Agreement also includes warranties in favour of the Company and provisions providing for liability for breach of the warranties.

OPINION

Based on the above, we consider that the terms of the Acquisition are on normal commercial terms, and that the terms of the Non-exempt Continuing Connected Transactions are on normal commercial terms and are conducted in the ordinary and usual course of business. Furthermore, we consider that the terms of the Acquisition and the Non-exempt Continuing Connected Transactions to be fair and reasonable from a financial perspective, so far as the Independent Shareholders are concerned, and are in the interests of the Company and its Shareholders as a whole.

Accordingly, we advise the Independent Board Committee and the Independent Shareholders that the Independent Shareholders should vote in favour of the Acquisition and the Non-exempt Continuing Connected Transactions, which terms are set out in the "Letter from the Chairman".

This letter is provided to the Independent Board Committee and the Independent Shareholders of the Company in connection with and for the purposes of their evaluation of the Acquisition and the transactions contemplated under the Non-exempt Continuing Connected Transactions. The opinion contained in this letter is intended to provide only one of the bases on which the Independent Board Committee may make their recommendation to the Independent Shareholders on how to vote, and on which the Independent Shareholders may decide how to vote, in respect of the Acquisition and the Non-exempt Continuing Connected Transactions. This letter may not be disclosed, referred to, or communicated (in whole or in part) to any third party for any purpose whatsoever except with our prior written approval. This letter may be reproduced in full in the Circular but may not otherwise be disclosed publicly in any manner without our prior written approval.

Yours faithfully,
For and on behalf of
Credit Suisse First Boston (Hong Kong) Limited
Ravi Lambah
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APPENDIX I FURTHER INFORMATION ON THE TARGET COMPANY

MARKET ENVIRONMENT OF THE TARGET COMPANY

The Target Regions include Heilongjiang Province, Jilin Province, Neimenggu Autonomous Region and Shanxi Province of the PRC, which accounted for approximately 10.3% of the total GDP of China in 2004, with a growth rate of GDP of approximately 13.8% from 2003 to 2004. The fixed-line telephone penetration rate in the Target Regions reached approximately 24.9% as of 31 December 2004. The fixed-line telephone penetration rate in the Target Regions is relatively low compared to that of the Group's existing service regions. The Company believes this presents growth potential for the Target Company.

The map below indicates the Target Regions and the existing services regions of the Group in China. The accompanying table sets out selected demographic and market information related to the Target Regions and the whole of China for the year ended or as of 31 December 2004, unless otherwise indicated.

[GRAPHIC OMITTED]

	Target Regions
Population (in millions)	122
GDP per capita (RMB)	11,446
2003-2004 growth rate of GDP (%)	13.8
Fixed-line subscribers (including PHS subscribers) (in millions)	30.5
Fixed-line telephone penetration rate (%)	24.9
Broadband subscribers (in millions)	2.6

Sources: National Bureau of Statistics of China, the MII and provincial telecommunications administrations.

OVERVIEW OF THE TARGET COMPANY

The Target Company is the dominant provider of fixed-line telephone services, broadband and other Internet-related services, and business and data communications services in the Target Regions.

The principal services of the Target Company consist of:

o fixed-line telephone services (including its PHS service), including:

- local, domestic long distance and international long distance services;

- value-added services, including caller identification, PHS short messaging service, telephone information service and "Personalised Ring" service; and

- interconnection services provided to other domestic telecommunications operators;

o broadband and other Internet-related services, including broadband access such as Digital Subscriber Line ("DSL") and Local Area Network ("LAN"), and dial-up Internet access and other services; and

o business and data communications services, including DDN, frame relay, ATM, IP-VPN and leased line services.

The following table illustrates a breakdown of the revenue of the Target Company for each of the years ended 31 December 2002, 2003 and 2004 and for the six-month periods ended 30 June 2004 and 2005.

	For the year ended 31 December						For the six months ended		
	2002		2003		2004		2004		
	Amount	Percentage of revenue	Amount	Percentage of revenue	Amount	Percentage of revenue	Amount	Percentage of revenue	Amoun
	(RMB in millions, except percentage data)								
Fixed-line telephone services(1): Local:									
Local usage fees	5,867	36.1	6,118	34.6	6,197	33.3	3,155	33.9	3,18
Monthly fees	3,482	21.5	3,896	22.0	4,221	22.7	2,122	22.8	2,10
Upfront installation fees	203	1.3	223	1.3	230	1.2	118	1.3	11
Subtotal	9,552	58.9	10,237	57.9	10,648	57.2	5,395	58.0	5,41
Domestic long distance(2)	2,524	15.5	2,554	14.4	2,453	13.2	1,247	13.4	1,21
International long distance(2)(3)	134	0.8	133	0.8	113	0.6	57	0.6	5
Value-added services	277	1.7	579	3.3	847	4.5	396	4.3	54
Interconnection fees from domestic carriers	864	5.3	1,183	6.7	1,582	8.5	765	8.2	87
Upfront connection fees(4)	1,280	7.8	1,157	6.4	968	5.2	512	5.5	39
Subtotal	14,631	90.0	15,843	89.5	16,611	89.2	8,372	90.0	8,49
Broadband and other Internet-related services									
Broadband	279	1.7	663	3.7	1,034	5.6	478	5.1	73

services (including broadband access such as DSL and LAN services)									
Other Internet-related services	214	1.4	176	1.1	114	0.6	67	0.7	4
Subtotal	493	3.1	839	4.8	1,148	6.2	545	5.8	77
Business and data communications services:									
Managed data	324	2.0	338	1.9	303	1.6	155	1.7	14
Leased line	609	3.8	374	2.1	270	1.5	132	1.4	16
Subtotal	933	5.8	712	4.0	573	3.1	287	3.1	31
Other services	175	1.1	306	1.7	284	1.5	111	1.1	12
Total	16,232	100.0	17,700	100.0	18,616	100.0	9,315	100.0	9,71

(1) Includes revenue from the Target Company's PHS services.

(2) Includes revenue from the Target Company's IP voice long distance services.

(3) Includes revenue from long distance calls to Hong Kong, Macau and Taiwan.

(4) In July 2001, the upfront connection fees charged on basic telephone access services were eliminated by the MII.The following table illustrates the key operating data of the Target Company for each of the years ended or as of 31 December 2002, 2003, 2004 and for the six months ended or as of 30 June 2005.

	For the year ended 31 December or as of 31 December			F e
	2002	2003	2004	
Fixed-line subscribers (in thousands)	19,205	24,459	27,696	
Including: PHS subscribers (in thousands)	841	4,373	7,051	
Market share of fixed-line telephone services (%)(1)	96.5	94.5	90.8	
Total usage of local telephone services (inclusive of Internet dial-up usage) (in million pulses)	60,333	61,898	59,074	
Total usage of local telephone services (exclusive of Internet dial-up usage) (in million pulses)	51,241	54,596	55,883	
Domestic long distance calls (in million minutes)	5,375.0	5,972.3	6,411.4	
International long distance calls(2) (in million minutes)	33.4	38.1	35.3	

Caller identification penetration rate (%)(3)	41.7	59.9	66.8
PHS short messages (in millions)	-	63.0	716.7
Telephone information service (in million minutes)	142	243	480
Broadband subscribers (in thousands)	127.1	811.0	2,274.4
Market share of broadband services (%)(1)	100	97.1	87.9

(1) Refers to market share in Target Regions only. The market share of fixed-line telephone services is calculated by dividing the number of the Target Company's fixed-line subscribers as of 31 December 2002, 2003 and 2004 and 30 June 2005 by the total number of fixed-line subscribers in the Target Regions as of such dates, as measured by the provincial telecommunications administrations. The market share of broadband services is calculated by dividing the number of the Target Company's total broadband subscribers as of 31 December 2002, 2003 and 2004 and 30 June 2005 by the aggregate number of broadband subscribers in the Target Regions as of such dates, as measured by the provincial telecommunications administrations (other than the number of broadband subscribers in Shanxi Province as of 31 December 2003, and the number of broadband subscribers in Shanxi Province as of 31 December 2003 was estimated by the Target Company).

(2) Including calls to Hong Kong, Macau and Taiwan.

(3) Calculated by dividing the number of the Target Company's caller identification service users by the total number of fixed-line subscribers of the Target Company.

THE SERVICES OF THE TARGET COMPANY

Fixed-line telephone services (including PHS)

The Target Company is the dominant provider of fixed-line telephone services in the Target Regions, with a market share of approximately 90.2% as of 30 June 2005, based on the number of fixed-line subscribers.

The Target Company's fixed-line telephone services consist of local telephone, domestic long distance, international long distance, value-added and interconnection services. The number of the Target Company's fixed-line subscribers in the Target Regions has increased from approximately 19.21 million as of the end of 2002 to approximately 28.86 million as of 30 June 2005. Fixed-line telephone services represent the Target Company's principal business activity. The Target Company expects that its fixed-line telephone services will continue to provide a steady revenue stream.

The fixed-line penetration rate in the Target Regions increased from approximately 16.3% as of the end of 2002 to approximately 24.9% as of 31 December 2004, due to the overall economic growth and growing demand for telecommunications services. Nevertheless, such fixed-line penetration rate is relatively low compared to that of the Company's existing service regions and other developed countries, which provides an opportunity for future growth.

In 2000, the Target Company began to selectively build wireless local access networks based on PHS technology to offer PHS services as a cost-effective alternative to mobile services. Its PHS services have been introduced in most cities in the Target Regions and were designed to provide its subscribers that require mobility within an area with the same area code with a more cost-effective tariff plan than traditional mobile services and access to value-added data services. The Target Company believes that its PHS services have contributed to the growth in its customer base, overall call volumes and revenues, and have also mitigated the substitution effect of mobile services.

The number of its PHS subscribers has grown rapidly since this service was introduced. As of 30 June 2005, the Target Company had approximately 7.99 million PHS subscribers, compared to approximately 0.84 million at the end of 2002.

The Target Company also operates a network of approximately 1.6 million public telephones located in the Target Regions as of 30 June 2005 which provides local, domestic long distance and international long distance call services, and some of which also provide Internet services. An important contributing factor to the demand for public telephones services is China's large and growing migrant population.

The Target Company is seeking to stimulate continued growth in fixed-line usage through the introduction of value-added services, such as caller identification, PHS short messaging service, telephone information services and "Personalised Ring" service.

The following table summarises key information regarding the Target Company's local telephone services in the Target Regions as of 31 December 2002, 2003 and 2004 and as of 30 June 2005:

	As of 31 December		
	2002	2003	2004
	(in thousands, except percentag		
Fixed-line subscribers(1)(2)			
Residential	15,456	16,423	16,523
Business	1,922	2,480	2,621
PHS	841	4,373	7,051
Public telephones	987	1,183	1,502
Total	19,205	24,459	27,696
Market share (%)(3)	96.5	94.5	90.8

(1) Fixed-line subscribers consist of all access lines in service as well as PHS subscribers. The Target Company calculates PHS subscribers based on number of active telephone numbers for its PHS services. The Target Company increases its total number of fixed-line subscribers as soon as practicable after activation of the service. The Target Company removes a fixed-line subscriber from the total number of fixed-line subscribers as soon as practicable after the fixed-line subscriber deactivates the service voluntarily or three months after the date on which the fixed-line subscriber's bill becomes overdue. Prepaid and postpaid telephone card customers are not counted toward the Target Company's fixed-line subscribers.

(2) Including PHS subscribers.

(3) Calculated by dividing the number of the Target Company's fixed-line subscribers as of 31 December 2002, 2003 and 2004 and 30 June 2005 by total number of fixed-line subscribers in the Target Regions as of such dates, as measured by the provincial telecommunications administrations.Local telephone services

The local telephone services of the Target Company have grown steadily in recent years and continue to represent the largest portion of its fixed-line telephone services in terms of revenues.

The following table sets forth information regarding usage of the Target Company's local telephone services provided in the Target Regions for each of the years ended 31 December 2002, 2003 and 2004 and for the six months ended 30 June 2005:

	For the year ended 31 December		
	2002	2003	2004
Total usage of local telephone services (inclusive of Internet dial-up usage) (in million pulses)(1)	60,333	61,898	59,074
Total usage of local telephone services (exclusive of Internet dial-up usage) (in million pulses)(1)	51,241	54,596	55,883

(1) Pulses are the billing units for calculating local telephone usage fees. The usage of the Target Company's Internet dial-up service has declined in the last few years due to migration to broadband services. However, if the declining Internet dial-up usage is excluded, the usage of the Target Company's local telephone services increased in the three years ended 31 December 2004 due to a variety of factors, including strong economic growth in its markets, an increase in the number of fixed-line subscribers, more focused sales and marketing efforts and new services and features.

Domestic long distance services

The Target Company offers long distance services through its traditional networks as well as VoIP long distance services. The Target Company is the leading provider of domestic long distance services in the Target Regions with approximately 39.9% market share of all fixed-line and mobile operators for the six months ended 30 June 2005. Its market share has been declining in recent years as a result of increasing competition and the Target Company has taken various steps to stabilise its market share in domestic long distance services.

The Target Company's VoIP domestic long distance services in the Target Regions as a percentage of its total domestic long distance services in terms of usage increased from approximately 34.7% as of 31 December 2002 to approximately 44.9% as of 30 June 2005, primarily due to the increased usage of its lower-priced VoIP long distance services compared to stable usage levels for its long distance services using its traditional networks over this period. Furthermore, the Target Company's "IP Direct" service allows customers direct access to its VoIP network by dialing a 5-digit access code from any fixed-line telephone terminal without having to purchase prepaid phone cards, which resulted in an increasing usage of VoIP service in recent years.

The following table shows the total minutes of domestic long distance calls carried through the Target Company's long distance network and the market share of its domestic long distance services for each of the years ended 31 December 2002, 2003 and 2004 and for the six months ended 30 June 2005:

For the year ended 31 December

	2002	2003	2004
Domestic long distance calls (in millions)(1)			
Traditional	3,510.6	3,100.7	3,397.8
VoIP	1,864.4	2,871.6	3,013.6
Total	5,375.0	5,972.3	6,411.4
Market share (%)(2)	45.6	41.9	39.6

(1) Includes calls originated by prepaid phone cards users and IP subscribers that are carried over the Target Company's long distance networks.

(2) Calculated by dividing the Target Company's domestic long distance usage in the Target Regions for the years ended 31 December 2002, 2003 and 2004 and the six months ended 30 June 2005 by the aggregate domestic long distance usage of all fixed-line and mobile operators in the Target Regions for each of such period, as measured by the provincial telecommunications administrations (other than the traditional usage for Shanxi Province, and the traditional domestic long distance usage of all fixed-line and mobile operators in Shanxi Province for each of such period was estimated by the Target Company).

The increase in minutes of usage in the Target Company's domestic long distance services in recent years is mainly due to economic development, increased cross-regional business activities, growth in the Target Company's customer base and new service offerings. The increase in competition may, however, negatively affect the future growth rate of its domestic long distance services.

International long distance services

The Target Company is the leading provider of international long distance services in the Target Regions, with a total usage of approximately 17.22 million minutes and an approximately 43.2% market share for the overall international long distance service in the Target Regions for the six months ended 30 June 2005. The overall downward trend in its market share in recent years is attributable to increased competition although for the year ended 31 December 2003, due to the substantial increase in VoIP international long distance services usage, the Target Company's market share in that year has increased over the previous year.

The Target Company also offers VoIP international long distance services in the Target Regions. From the end of 2002 to 30 June 2005, VoIP international long distance services as a percentage of the Target Company's total international long distance services in terms of usage increased from approximately 40.2% to approximately 44.1%, as price-sensitive customers increasingly elected to use lower-priced VoIP international long distance services.

The following table sets forth certain information related to the usage and market share of the Target Company's international long distance services for each of the years ended 31 December 2002, 2003 and 2004 and for the six months ended 30 June 2005.

For the year ended 31 December

	2002	2003	2004
International long distance calls (in millions)(1)			
Traditional	(20.0)	(19.6)	(19.6)
VoIP	(13.4)	(18.5)	(15.7)
Total	(33.4)	(38.1)	(35.3)
Market share (%)(2)	50.3	54.8	45.5

(1) Includes calls originated by prepaid phone cards users and IP subscribers that are carried over the Target Company's long distance networks and include calls to Hong Kong, Macau and Taiwan.

(2) Calculated by dividing the Target Company's international long distance usage in the Target Regions for the years ended 31 December 2002, 2003 and 2004 and the six months ended 30 June 2005 by the aggregate international long distance usage of all fixed-line and mobile operators in the Target Regions for each of such period, as measured by the provincial telecommunications administrations (other than Shanxi Province and the international long distance usage of all fixed-line and mobile operators in Shanxi Province for each of such period was estimated by the Target Company).

Value-added services

In addition to basic telephone services, the Target Company offers a range of value-added services, including caller identification, PHS short messaging service, telephone information service, "Personalised Ring", teleconferencing, video conferencing and voice mail, etc. Its value-added services increase total usage on its network and average revenue per fixed-line subscriber, thus contributing to its revenues. For the three years ended 31 December 2002, 2003 and 2004 and for the six months ended 30 June 2005, value-added services contributed approximately RMB277 million, RMB579 million, RMB847 million and RMB540 million, respectively to the total revenue of the Target Company. For the same periods, value-added services contributed to approximately 1.7%, 3.3%, 4.5% and 5.6%, respectively of the total revenue of the Target Company.

The value-added services primarily utilise the Target Company's existing network and equipment, and marketing and sales channels. Therefore, the Target Company has incurred limited additional costs in developing and promoting its value-added services. By substantially increasing the traffic and utilisation of the network, the value-added services have become an important growth component of the average revenue per subscriber, thus making substantial contribution to the growth of the Target Company's total revenue and profit. Furthermore, the value-added services improve customer satisfaction, which allows the Target Company to defend its market leading position even under pressure of intensifying competition and mobile substitution.

Value-added services are still in a relatively early stage of development in China, and the Target Company believes that there is significant growth potential in this area.

The following table illustrates the key operating data of the Target Company's value-added services for each of the years ended or as of 31 December 2002, 2003 and 2004 and for the six months ended or as of 30 June 2005.

	For the year ended 31 December or as of 31 December		
	2002	2003	2004
Caller identification service penetration rate (%)(1)	41.7	59.9	66.8
PHS short messages (in millions)(2)	-	63.0	716.7
Telephone information service (in million minutes)	142	243	480
"Personalised Ring" service subscribers (in thousands)(3)	-	-	290

(1) Calculated by dividing the number of the Target Company's caller identification service users by the total number of fixed-line subscribers of the Target Company.

(2) The Target Company's PHS short messaging service was introduced in 2003.

(3) The "Personalised Ring" service was launched in 2004.

Caller identification service

The penetration rate of the Target Company's caller identification service in the Target Regions has increased in the last few years due to the Target Company's devoted efforts to promote such service. As of 31 December 2002, 2003, 2004 and 30 June 2005, the penetration rate of the Target Company's caller identification service in the Target Regions was approximately 41.7%, 59.9%, 66.8% and 69.5%, respectively.

PHS short messaging

The Target Company's PHS short messaging service was introduced in 2003. For each of the years ended 31 December 2003 and 2004 and for the six months ended 30 June 2005, the volume of the Target Company's PHS short messaging service was approximately 63.0 million, 716.7 million and 822.2 million messages, respectively.

In December 2004, the arrangements on interconnection of short messages with China Telecom, China Mobile and China Unicom were finalised, which enabled the Target Company's PHS subscribers to send short messages to the subscribers of the networks of the aforesaid operators and vice versa, and such arrangements accelerated the growth of the Target Company's PHS short messaging service.

Telephone information service

The Target Company's telephone information services allow users to access information at its standard telephone usage rates plus information usage fees. The Target Company also cooperates with other content and application service providers so as to enable other specialised telephone information and application services, such as telephone banking and telephone stock trading services. For each of the years ended 31 December 2002, 2003, 2004 and for the six months ended 30 June 2005, the total usage of the Target Company's telephone information service were approximately 142 million minutes, 243 million minutes, 480 million minutes and 262 million minutes, respectively. The Target Company intends to further expand the scope and usage of these services and develop flexible revenue sharing arrangements with content and application service providers.

"Personalised Ring" service

The Target Company also actively promotes the "Personalised Ring" service, which was launched in the Target Regions at the end of 2004, and has rapidly acquired approximately 1.22 million subscribers as of 30 June 2005.

Interconnection

The Target Company earns interconnection fees for terminating or transmitting calls that originate from other domestic operators' networks and pays interconnection fees to other operators in respect of calls originating from its networks that are terminated on their networks. The Target Company earns and pays such fees in respect of local and domestic and international long distance calls and Internet service.

All interconnection and settlement arrangements among domestic operators in China are governed by the Telecommunications Regulations and the rules on interconnection arrangements and settlement promulgated by the MII.

Broadband and other Internet-related services

The Target Company is the leading provider of broadband and other Internet-related services in the Target Regions. Broadband services represent one of its fastest growing businesses. This growth has been driven by the increasing affordability and rising use of personal computers and other Internet access devices and the proliferation of content and applications, such as online games and video-on-demand.

The following table sets forth selected information regarding the Target Company's broadband, dial-up and dedicated Internet access services for each of the years ended or as of 31 December 2002, 2003 and 2004 and for the six months ended or as of 30 June 2005.

	For the year ended or as of 31 December		
	2002	2003	2004
Broadband services:(1)			
DSL subscribers (in thousands)	93.1	718.9	1,529.2
LAN subscribers and subscribers of other services (in thousands)	34.0	92.1	745.2
Total (in thousands)	127.1	811.0	2,274.4
Market share (%)(2)	100	97.1	87.9
Dial-up and dedicated Internet access services:			
Dial-up online usage (in million minutes)	8,104.9	7,184.6	3,081.2
Dedicated Internet access lines in service	2,750	1,900	565

(1) DSL subscribers are calculated based on the number of active accounts. LAN subscribers consist of end-users and dedicated line users. LAN end-users

are calculated based on the number of ports subscribed for. The number of LAN dedicated line users equals total monthly fees paid by such users divided by a set monthly revenue per user. The current set monthly revenue per user is RMB90. The Target Company considers an account active or a service subscribed for as soon as practicable after activations of the applicable service. A subscriber is removed from the total number of subscribers as soon as practicable after that subscriber deactivates the service voluntarily or three months after the date on which that subscriber's bill becomes overdue.

(2) Calculated by dividing the number of the Target Company's broadband subscribers as of 31 December 2002, 2003 and 2004 and 30 June 2005 by the aggregate number of broadband subscribers in the Target Regions as of such dates, as measured by the provincial telecommunications administrations (other than the number of broadband subscribers in Shanxi Province as of 31 December 2003, and the number of broadband subscribers in Shanxi Province as of 31 December 2003 was estimated by the Target Company).

Broadband services

The Target Company is leveraging its extensive fixed-line network, large customer base, experienced sales force and established brand to achieve a leading position in the fast growing market for broadband services in China. As of 30 June 2005, the Target Company had approximately 2.78 million broadband subscribers and a market share of approximately 90.7% in the Target Regions, having averaged net additional subscribers of approximately 84 thousand per month during the six months ended 30 June 2005.

The Target Company has taken various initiatives to tailor its products and services to meet the evolving broadband needs of its customers. In order to increase broadband penetration rate in the Target Regions, the Target Company has introduced a series of products with different access speeds and developed tiered broadband usage package with different monthly payment plans to cater for customers with different affordability and needs. In addition, in order to further increase its revenue from broadband services, the Target Company has developed and promoted broadband products and solutions that are suited to various small and medium-sized enterprises. As a result, the proportion of corporate customers and their revenue contribution to the broadband services have been raised. The Target Company has also launched more products with high bandwidth access and has established Internet cafe chains, thereby retaining high-usage customers. Furthermore, the Target Company is actively working with content providers, Internet service providers and equipment manufacturers to facilitate the introduction of new content, value-added services, applications and devices that will enrich the online experience of its customers so as to increase demand for and migration to broadband services and also average revenue per unit.

DSL services

The Target Company promotes DSL services as the primary broadband service means for residential customers and small and medium-sized enterprise customers in the Target Regions. In the Target Regions, where the Target Company is the dominant fixed-line operator, the number of subscribers to its DSL services has grown steadily in recent years, with approximately 1.88 million DSL subscribers as of 30 June 2005, compared with approximately 93 thousand subscribers as of the end of 2002. As of 30 June 2005, the Target Company's DSL subscribers accounted for approximately 67.6% of its total number of broadband subscribers.

LAN services

In addition to DSL technology, the Target Company also uses Ethernet technology-based LANs, to provide its customers with broadband services. The Target Company has selectively rolled out LANs in high density residential and office buildings in the Target Regions, where customers demand a high bandwidth. As of 30 June 2005, the Target Company had approximately 0.9 million subscribers of its LAN services, representing approximately 32.4% of its total broadband subscribers.

Other Internet-related services

The Target Company is also one of the largest providers of dial-up Internet access services in the Target Regions in terms of number of subscribers. It also offers communications-intensive business customers Internet access through dedicated lines in the Target Regions. As of 30 June 2005, the Target Company had a total of 377 dedicated Internet access subscribers. The Target Company bundles this service with voice and data services to provide integrated communications solutions to its business customers.

The Target Company also operates Internet data centers, which provide co-location and website hosting services to business customers that lease servers, routers and other network components for Internet-related solutions. These services are used primarily by business customers seeking to outsource the infrastructure needed to utilise the Internet in a cost effective way.

Business and data communications services

The Target Company is the leading provider of business and data communications services in the Target Regions. Managed data services represent a growing area in China's telecommunications industry. The Target Company bundles the data communications services together with fixed-line telephone services and broadband services to attract communications-intensive business customers. The Target Company is responding to increasing market demand in this area by leveraging its network platforms for data transmission and by offering a broad portfolio of services and customised solutions.

The Target Company offers managed data products, such as DDN, frame relay, ATM and IP-VPN, and leased line products, including domestic and international leased circuits. Its customers for these services include government entities, large financial institutions and other domestic and multinational businesses, ISPs and other telecommunications operators. The Target Company focuses on diversifying its business and data communications services and products and providing quality customer service to its large corporate and carrier customers.

Managed data services

The Target Company provides a variety of managed data services to its business customers, including DDN, frame relay, ATM and IP-VPN services. The Target Company anticipates that demand for data communications services will be fuelled by growth in the emerging services segment, which includes e-commerce, broadband content, network applications and IP-VPN services. The Target Company's DDN services provide high quality and reliable transmission at speeds ranging from 9.6kbps to 2Mbps to meet the increasing demand for low- to medium-speed transmission capacity from business customers and government agencies. The Target Company also offers advanced high-speed data communications services based on frame relay and ATM technologies to major business customers, including multinational corporations, government agencies and financial institutions. These services enable flexible and cost-effective use of bandwidth resources and many of the Target Company's customers are increasingly using ATM services to form VPNs to link their local area networks in different locations.

The following table sets forth selected information regarding the managed data services of the Target Company as of 31 December 2002, 2003 and 2004 and as of 30 June 2005.

	As of 31 December		
	2002	2003	2004
Number of ports			
DDN	42,591	44,083	43,760
Frame relay	670	696	689
ATM	82	151	777
Leased bandwidth			
DDN (x64kbps)	176,998	185,767	190,503
Frame relay (x128kbps)	800	855	855
ATM (x2Mbps)	4,096	7,473	16,678

Leased line services

The Target Company is a major provider of dedicated leased line services to businesses, government agencies and other telecommunications operators in the Target Regions. The Target Company leases network elements, including digital circuits, digital trunk lines and optical fibers, to business and government customers as well as other telecommunications operators.

As of 30 June 2005, the Target Company leased circuits totalling 12,543 (x2Mbps) in bandwidth to its customers, and an increasing percentage of its leased circuits are of higher capacity. The following table sets forth the respective amounts of bandwidth of the leased line services of the Target Company provided to its business customers and carrier customers as of 31 December 2002, 2003 and 2004 and as of 30 June 2005.

	As of 31 December		
	2002	2003	2004
Bandwidth of leased circuits (x2Mbps)			
Business customers	2,694	3,983	7,006
Carrier customers	9,192	6,456	4,211
Total	11,886	10,439	11,217

Due to the increased demand for data services, the number of business customers increased steadily in recent years. On the other hand, as more and more carrier customers built their own network and generally reduced the circuits leased with the Target Company, the bandwidth of circuits leased by carrier customers decreased through the periods indicated above.

TARIFFS

The Target Company and the Group are subject to the same regulatory framework with respect to the tariffs of the various services offered by the Target Company. Accordingly, the tariff structures and rates charged by the Target Company for its various services are similar to those of the Group. For some of the newly introduced services, such as PHS short messaging service, the tariff has been set by the Company with the necessary tariff details filed with the MII. For the six months ended 30 June 2005, the tariff for PHS short messaging service ranges from RMB0.08 to RMB0.15 per message.

MARKETING, SALES, DISTRIBUTION AND CUSTOMER SERVICES

Marketing, sales, distribution and customer services initiatives

The Target Company has implemented initiatives for each of its market segments, consisting of residential, small and medium-sized enterprise and large business customers. The Target Company conducts sales primarily through its service representatives and account managers, direct and third-party sales outlets, service hotline, and its website.

The Target Company's service representatives cover particular areas and provide consulting, upfront installation and trouble-shooting services to its residential and small and medium-sized enterprise customers. Its account managers, in addition to those services provided by service representatives, also provide technical support, billing and collection services to its small and medium-sized enterprise and large customers. Its service representatives and account managers are evaluated based on quality of customer service provided, number of new customers generated and revenue growth.

The Target Company also conducts sales through its own sales outlets and the sales outlets of third parties. Its partnership with third-party distributors enables the Target Company to more effectively market to a broader customer base, increase market penetration and identify potential markets, while reducing its operating expenses. As of 30 June 2005, the Target Company had 26,049 sales and marketing employees in the Target Regions. The Target Company also had 3,388 direct sales and customer service outlets and 34,291 authorised third-party agents in the Target Regions as of 30 June 2005.

In recent years, the Target Company has also substantially increased the amount of residential marketing activities conducted both on its "10060" hotline and through its website. "10060" is the nationwide telephone number for customer service centers across China, providing comprehensive customer service for all service offerings, including service inquiry, billing inquiry, recharge and customer complaints.

In addition, for its high-end residential and small and medium-sized enterprise customers, the Target Company provides tailored services through "Gold Club" memberships. "Gold Club" members enjoy discounts on its and its partners' products, as well as rewards programs.

The Target Company provides customised services and comprehensive solution packages to large business customers, including international customers. For its small and medium-sized enterprise customers, the Target Company provides additional customised solutions for each industry.

The Target Company markets to its enterprise customers through advertising and trade shows, online advertising, industry and regional events, sponsored activities as well as through its partners, including its suppliers.

Trademarks

The Target Company markets its services under the "CNC" brand name and logo, which are registered trademarks in China owned by its ultimate parent company, China Netcom Group. Upon completion of the Acquisition, the Target Company has the right to use these trademarks on a royalty-free basis until 2014, which is automatically renewable at the option of the Target Company.

Billing services and credit control

The Target Company bills its residential customers on a monthly basis and payments are usually due within a month of the last date of the billing period. The Target Company provides a range of payment choices for the convenience of its customers, including direct-debit service, which automatically deducts the monthly payment from the subscriber's designated bank account. The Target Company also provides specially tailored billing and collection services to its large business customers to help them more effectively plan and monitor their telecommunications needs.

The Target Company charges a late payment fee on subscriber accounts with payments that are not settled by the monthly due date. The Target Company generally deactivates services for subscribers whose accounts are more than 30 days overdue. These subscribers whose services have been deactivated must pay all overdue amounts, including applicable late payment fees, to reactivate their services. The Target Company will terminate a subscriber's service and will remove him or her from the subscriber list if his or her account is overdue for more than three months. The Target Company has implemented subscriber registration procedures, including credit and background checking for PHS customers to strengthen credit control. The Target Company also actively promotes its prepaid telephone services as a means of controlling bad debts.

NETWORK INFRASTRUCTURE

The network which the Target Company operates consists of transport networks, service networks and support and information systems. The service networks, which support the Target Company's basic and value-added telecommunications services, consist of its local access networks, including PHS networks, fixed-line telephone switch networks, Internet and data service networks and intelligent networks. The support and information systems include Operation Support System ("OSS") and Business Support System ("BSS") to support the reliable and effective operation of the Target Company's networks. In addition, the Target Company is building an information technology network and Management Support System ("MSS") which is designed to ensure the speed and accuracy of its internal information flow.

Transport networks

The Target Company operates an advanced, high-speed, large capacity, secure and reliable fiber-optic transport network throughout the Target Regions. The inter-provincial fiber-optic cables in the Target Regions, which are owned by China Netcom Group, and operated by the Target Company, are integrated with the Target Company's own intra-provincial transport network. This fiber-optic network is supplemented by satellite transmissions and microwave links. The fiber-optic transport network that the Target Company operates allows it to more easily manage networks with enhanced reliability. In addition, the Target Company offers a series of advanced protection technologies to customers with varying service level requirements.

Service networks

Local access networks

The Target Company has extensive local access network coverage in the Target Regions. Its local access network covers most cities, counties and villages in the Target Regions. With its comprehensive local access networks, the Target Company is able to provide customised solutions to its customers.

The Target Company continues to upgrade its existing copper line local access networks using DSL technology. The Target Company has selectively connected additional large office buildings and business centers with broadband services using fibre optic cables.

Fixed-line telephone switch networks

A substantial portion of the Target Company's fixed-line telephone networks has been built in the last decade. All of its switches are digital. The network consists of 45 local switch networks and a long distance switch network. As of 30 June 2005, the total capacity of local switches reached approximately 35.11 million lines, and the capacity of long distance switches reached approximately 14,437 (x2Mbps) in bandwidth. The Target Company adopts advanced technology to ensure network reliability and to improve the utilisation rate of its network.

Internet and data service networks

The Target Company has developed large capacity, high quality and reliable Internet and data networks in the Target Regions. Its Internet networks primarily rely on switch routers with high bandwidths. They are structured with two layers, the backbone network layer and the application layer. Its backbone networks are meshed to achieve maximum reliability and stability. A majority of the main routes in this layer has transmission capacity at 10Gbps, or at 2.5Gbps. As of 30 June 2005, the Target Company also had a backbone IP network with a total bandwidth of 46,609 (x2Mbps). In addition, this network also allows the Target Company to provide services such as IP-VPN, Internet data center, e-commerce and video-on-demand services. The Target Company's data network system includes a DDN network and a frame relay and ATM network. These networks cover all cities and counties in the Target Regions. In particular, the Target Company's ATM network allows the Target Company to provide various access services, flexible broadband management capability and quality end-to-end services.

Support and information systems

The Target Company's OSS provides support for the operational management and control of its service networks, as well as resource management. It enhances the overall management of the Target Company's networks and helps ensure effective troubleshooting, efficient utilisation of network resources and smooth operation of networks. The Target Company's BSS principally consists of operation management, billing, customer service and other systems. It provides comprehensive and integrated support for various aspects of the Target Company's business, such as customer relationship management and tiered service for its large business customers.

RESEARCH AND DEVELOPMENT

The Target Company's research and development requirements are primarily fulfilled by China Netcom Group in return for a service fee that is negotiated on a case-by-case basis. These research and development activities are focused primarily on operational planning and development of value-added services.

COMPETITION

The Target Company competes with other telecommunications providers in virtually all aspects of its business, including fixed-line telephone services, broadband and other Internet-related services and business and data communications services. The Target Company's principal competitors in China are telecommunications carriers wholly or majority-owned by the PRC government, including three fixed-line service providers and two licensed mobile service providers. Since the Target Company controls most of the local access network, including "last mile" access network in the Target Regions, it has experienced limited competition to date in the provision of local telephone services. However, competition may increase in the future as other licensed operators develop their own networks, including through the use of alternative technologies.

EMPLOYEES

The following table sets forth information regarding employees of the Target Company as of 30 June 2005:

	As of 30 Number of Employees
Management, finance and administrative	7,361
Sales and marketing	26,049
Operations and maintenance	14,646
Others(1)	2,580
Total	50,636

(1) Includes research and development employees.

CAPITAL EXPENDITURE

The following table sets forth the Target Company's actual and planned total capital expenditure requirements for the periods indicated:

	E
2002	
2003	
2004	
2005 (Planned)	
2006 (Planned)	

The Target Company will continue to focus on controlling its capital expenditures and improving its network efficiency. It is expected that the planned capital expenditures for the years 2005 and 2006 will mainly relate to further rollout of broadband services, local access networks and transport and switching networks.

The capital expenditure estimates above are subject to uncertainty and actual capital expenditures in future periods may differ significantly from these estimates. In addition, the Target Company may enter into new telecommunications businesses in the future, which may require additional capital expenditures.

DISCUSSION ON THE PERFORMANCE OF THE TARGET GROUP

The Target Company, capitalising on its comprehensive local networks, is the dominant provider of fixed-line telephone services, broadband and other Internet-related services, and business and data communications services in the Target Regions. In addition to basic telephone services, the Target Company offers a range of value-added services. PHS services, broadband services and value-added services are at a stage of rapid development in China, and the Target Company believes that there is significant growth potential in this area.

The audited financial statements of the Target Group for the three years ended 31 December 2004 and for the six months ended 30 June 2005 are set out in Appendix II to this circular.

The amount of cash and bank deposits held by the Target Group as at 31 December 2002, 2003 and 2004 and as at 30 June 2005 amounted to RMB1,097 million, RMB1,114 million, RMB580 million and RMB466 million, respectively. All balances as at 31 December 2002, 2003 and 2004 and 30 June 2005 are denominated in Renminbi and kept in the PRC. The Target Group's source of funds is mainly derived from its operating activities in the PRC.

As at 31 December 2002, 2003 and 2004, the Target Group carried outstanding loans in the amount of RMB26,870 million, RMB27,313 million and RMB24,191 million, respectively. As at those dates, short-term bank loans of the Target Group were in the amount of RMB10,219 million, RMB15,774 million and RMB15,543 million, respectively and long-term bank loans and other loans of the Target Group were in the amount of RMB16,651 million, RMB11,539 million and RMB8,648 million, respectively. As at 30 June 2005, the Target Group carried outstanding loans in the amount of RMB23,675 million, of which RMB16,978 million are short-term bank loans and RMB6,697 million are long-term bank loans and other loans.

All the short-term bank loans are unsecured as at 31 December 2002, 2003 and 2004 and as at 30 June 2005. As at 31 December 2002, 2003 and 2004 and as at 30 June 2005, the Target Group's long-term bank loans of RMB287 million, RMB273 million, RMB260 million and RMB253 million, respectively were secured by corporate guarantees granted by China Netcom Group. In addition, as at 31 December 2002, long-term bank loans of RMB8 million were secured by corporate guarantees granted by third parties. The interest rates of the majority of the Target Group's bank loans were floating. As at 31 December 2002, 2003 and 2004 and as at 30 June 2005, the Target Group's banking facilities amounted to RMB34,818 million, RMB34,568 million, RMB33,409 million and RMB33,206 million, respectively.

As at 31 December 2002, 2003 and 2004 and as at 30 June 2005, the Target Group's total debt to capitalisation ratio (dividing total debt of the Target Group by the total of debt, owners' equity and balance of deferred revenue of the Target Group) were 66.3%, 63.9%, 63.6% and 66.5%, respectively. The Target Group's loans are denominated in Renminbi, US dollars, Japanese Yen and Euro. The Target Group did not employ any financial instrument to hedge its loans.

As at 30 June 2005, the Target Group had not given guarantees and there was no charge on its assets. As at the same date, the Target Group had no contingent liabilities.

The Target Group's assets are denominated in Renminbi and there is no foreign currency investment.

As of 30 June 2005, the Target Company had 50,636 employees, of which 7,361 are management, finance and administrative staff, 26,049 are sales and marketing staff, 14,646 are operations and maintenance staff and 2,580 are other staff, including staff responsible for research and development. Employee remuneration amounted to RMB1,759 million for the six months ended 30 June 2005. The Target Group adopted a remuneration mechanism with a market-oriented and performance-based approach. The Target Group has not adopted any employee share option scheme. Upon completion of the Acquisition, the employees of the Combined Group will be covered under the existing share option scheme of the Company.

The Target Group's actual capital expenditure for the years 2002, 2003 and 2004 were RMB8,372 million, RMB7,922 million and RMB7,017 million, respectively and its planned capital expenditure for the years 2005 and 2006 are RMB6,500 million and RMB6,300 million, respectively. The planned capital expenditures will mainly relate to further rollout of broadband services, local access networks and transport and switching networks. It is expected that the capital expenditures will be funded using internal cash resources and/or proceeds from future external financing of the Combined Group

APPENDIX II ACCOUNTANTS' REPORT OF THE TARGET Group

The following is a text of a report, prepared for the purpose of inclusion in this circular, received from the independent reporting accountants, PricewaterhouseCoopers, Certified Public Accountants, Hong Kong. As described in the section headed "General Information" in Appendix VI, a copy of the following accountants' report is available for inspection.

[PRICEWATERHOUSECOOPERS GRAPHIC OMITTED]

| PricewaterhouseCoopers
| 22/F, Prince's Building
| Central, Hong Kong

23 September 2005

The Directors
China Netcom Group Corporation (Hong Kong) Limited

Dear Sirs,

We set out below our report on the combined financial information relating to China Netcom Group New Horizon Communications Corporation (BVI) Limited (the "Target BVI Company") and its subsidiary (hereinafter collectively referred to as the "Target Group") for each of the years ended 31 December 2002, 2003 and 2004 and the six months ended 30 June 2004 and 2005 (the "Relevant Periods") for inclusion in the circular of China Netcom Group Corporation (Hong Kong) Limited (the "Company") dated 23 September 2005 (the "Circular") in relation to the proposed acquisition of the entire financial interest of the Target BVI Company by the Company.

The Target BVI Company is currently owned by China Netcom Communications Group Corporation ("China Netcom Group"), the Company's ultimate holding company which is a state-owned telecommunication operator established in the People's Republic of China (the "PRC") under the supervision and regulation of the Ministry of Information Industry ("MII"). The Target BVI Company was incorporated in the British Virgin Islands ("BVI") on 27 July 2005 as a limited liability company under the British Virgin Islands International Business Companies Act of 1984. The Target BVI Company has one subsidiary, namely China Netcom Group New Horizon Communications Corporation Limited (the "Target Company"), which was established in the PRC on 9 August 2005 as a limited liability company. The purpose of the Target BVI Company and its subsidiary is to hold and operate the fixed line telecommunications businesses of four provinces / autonomous regions in the PRC, namely Shanxi Province, Jilin Province, Heilongjiang Province and Inner Mongolia Autonomous Region (collectively referred to as the "Target Regions") which were transferred to the Target Group by China Netcom Group pursuant to a group reorganisation as described in Note 1 of Section II below.

The Target BVI Company and its subsidiary have adopted 31 December as their financial year end.

No audited financial statements have been prepared for the Target BVI Company and the Target Company since their respective date of incorporation / establishment as they were incorporated / established subsequent to 30 June 2005 and have not been involved in any significant business transactions since incorporation / establishment other than the Reorganisation referred to herein.

For the purpose of the Reorganisation, the directors of the Target BVI Company have prepared the combined financial statements of the fixed line telecommunications businesses of the Target Regions for the Relevant Periods in accordance with the relevant accounting principles and financial regulations applicable to PRC companies (the "PRC GAAP Accounts"). Except for the six months ended 30 June 2004 and 2005, the PRC GAAP Accounts were audited by PricewaterhouseCoopers Zhong Tian CPAs Limited Company [GRAPHIC OMITTED][GRAPHIC OMITTED].

For the purpose of this report, the directors of the Company have prepared the combined financial statements for the Relevant Periods as set out in Sections I to III ("Financial Information") in accordance with Hong Kong Financial Reporting Standards ("HKFRS") issued by the Hong Kong Institute of Certified Public Accountants ("HKICPA"), based on the PRC GAAP Accounts, and on the basis set out in Note 2 of Section II below, after making adjustments as are appropriate. In preparing the Financial Information, it is fundamental that appropriate accounting policies are selected and applied consistently. For the purpose of this report, we have carried out independent audit procedures on the Financial Information in accordance with Statements of Auditing Standards issued by HKICPA, and have examined the Financial Information and carried out such additional procedures as are necessary in accordance with the Auditing Guideline "Prospectuses and the Reporting Accountant" issued by HKICPA.

The directors of the Company are responsible for the preparation of the Financial Information which is required to give a true and fair view. It is our responsibility to form an independent opinion, based on our examination, on the Financial Information and to report our opinion.

In our opinion, the Financial Information, for the purpose of this report, and prepared on the basis set out in Note 2 of Section II below, gives a true and fair view of the combined state of affairs of the Target Group as at 31 December 2002, 2003 and 2004 and 30 June 2005, and of the Target Group's combined results and cash flows for the Relevant Periods.

(I) FINANCIAL INFORMATION
(All amounts in RMB million unless otherwise stated)

The following are the combined income statements of the Target Group for the Relevant Periods prepared on the basis set out in Note 2 of Section II below, after making adjustments as are appropriate.

COMBINED INCOME STATEMENTS

	Note	Years ended 31 December 2002	2003	2004	Six months Jun 2004
Revenues	6	16,232	17,700	18,616	9,315
Operating expenses					
Depreciation and amortisation		(5,988)	(6,317)	(6,426)	(3,196)
Networks, operations and support		(4,087)	(3,118)	(2,426)	(960)
Staff costs	10	(2,602)	(3,398)	(3,891)	(1,892)
Selling, general and administrative expenses		(2,245)	(3,269)	(3,311)	(1,736)
Other operating expenses		(380)	(537)	(459)	(225)
Total operating expenses		(15,302)	(16,639)	(16,513)	(8,009)
Operating profit before interest income and deficit on revaluation of property, plant and equipment		930	1,061	2,103	1,306
Interest income		28	16	11	5
Deficit on revaluation of property, plant and equipment	16(c)	-	-	(11,318)	-
Profit/(loss) from operations	7	958	1,077	(9,204)	1,311
Finance costs	8	(1,283)	(1,270)	(998)	(500)
Profit/(loss) before taxation		(325)	(193)	(10,202)	811
Taxation	9	423	398	3,671	(102)
Profit/(loss) for the year/period		98	205	(6,531)	709

COMBINED BALANCE SHEETS

The following are the combined balance sheets of the Target Group as at 31 December 2002, 2003 and 2004 and 30 June 2005, prepared on the basis set out in Note 2 of Section II below, after making adjustments as are appropriate.

	Note	As at 31 December 2002	2003	2004
Assets				
Current assets				
Cash and bank deposits	11	1,097	1,114	580
Accounts receivable	12	1,121	1,175	1,486
Inventories and consumables	13	291	209	302
Prepayments and other receivables	14	739	582	436
Due from ultimate holding company and fellow subsidiaries	23	141	94	714
Total current assets		3,389	3,174	3,518
Non-current assets				
Lease prepayments for land	15	466	450	480
Property, plant and equipment	16	44,588	47,719	42,110
Construction in progress	17	3,518	2,354	2,995

Intangible assets	18	58	91	66
Deferred costs	19	668	672	654
Deferred tax assets	26	1,663	2,076	1,410
Other non-current assets		14	11	9
Total non-current assets		50,975	53,373	47,724
Total assets		54,364	56,547	51,242
Liabilities and equity				
Current liabilities				
Accounts payable	20	5,632	5,409	6,472
Accruals and other payables	21	1,639	1,267	1,513
Short-term bank loans	22(a)	10,219	15,774	15,543
Current portion of long-term bank and other loans	22(b)	5,727	3,676	4,457
Due to ultimate holding company and fellow subsidiaries	23	1,231	1,448	1,836
Current portion of deferred revenues	24	2,140	2,170	2,223
Current portion of provisions	25	1,495	1,550	1,531
Taxation payable		105	185	165
Total current liabilities		28,188	31,479	33,740
Net current liabilities		(24,799)	(28,305)	(30,222)
Total assets less current liabilities		26,176	25,068	17,502
Non-current liabilities				
Long-term bank and other loans	22(b)	10,924	7,863	4,191
Deferred revenues	24	3,963	2,981	2,171
Provisions	25	1,181	1,153	1,431
Deferred tax liabilities	26	2,497	2,759	255
Other non-current liabilities		57	29	24
Total non-current liabilities		18,622	14,785	8,072
Total liabilities		46,810	46,264	41,812
Owner's equity		7,554	10,283	9,430
Total liabilities and equity		54,364	56,547	51,242

COMBINED STATEMENTS OF CHANGES IN EQUITY

The following are the combined statements of change in equity of the Target Group for the Relevant Periods, prepared on the basis set out in Note 2 of Section II below, after making adjustments as are appropriate.

	Revaluation reserve	Other reserve	Capital/retained earnings
Balance as at 1 January 2002	-	-	7,921
Profit for the year	-	-	98
Net distributions to owners	-	-	(155
Movement of deferred tax recognised in equity (Note 26(i))	-	-	(310

Balance as at 31 December 2002	-	-	7,554
Balance as at 1 January 2003	-	-	7,554
Profit for the year	-	-	205
Net contributions from owners	-	-	2,777
Movement of deferred tax recognised in equity (Note 26(i))	-	-	(253)
Balance as at 31 December 2003	-	-	10,283
Balance as at 1 January 2004	-	-	10,283
Loss for the year	-	-	(6,531
Net contributions from owners	-	-	3,794
Movement of deferred tax recognised in equity (Note 26(i))	-	-	(704
Revaluation surplus (Note 16)	3,863	-	-
Revaluation tax credit (Note 26(ii))	(1,275)	-	-
Balance as at 31 December 2004	2,588	-	6,842
Balance as at 1 January 2005	2,588	-	6,842
Profit for the period	-	-	1,330
Net contributions from owners	-	-	68
Distributions to owners	-	-	(930
Movement of deferred tax recognised in equity (Note 26 (ii),(iii))	1,097	843	(2,174
Transfer to retained earnings	(360)	(13)	373
Net assets distributed to owners in accordance with the reorganisation (Note 2)	-	-	(1,533
Balance as at 30 June 2005	3,325	830	3,976

COMBINED STATEMENTS OF CASH FLOWS

The following are the combined cash flow statements of the Target Group for the Relevant Periods, prepared on the basis set out in Note 2 of Section II below, after making adjustments as are appropriate.

		Years ended 31 December			Six months Jun
	Note	2002	2003	2004	2004
Cash flows from operating activities					
Net cash inflows generated from operations	27(a)	7,302	6,720	7,728	4,424
Interest received		28	16	11	5
Interest paid		(1,246)	(1,151)	(956)	(509)
Net cash inflow from operating activities		6,084	5,585	6,783	3,920
Cash flows from investing activities					
Purchase of property, plant and		(8,372)	(7,922)	(7,017)	(3,022)

equipment and construction in progress					
Sales of property, plant and equipment		-	21	30	17
Net decrease/(increase) in time deposits with maturity over three months		75	27	(8)	7
Net cash outflow from investing activities		(8,297)	(7,874)	(6,995)	(2,998)
Cash flows from financing activities					
New bank loans and other loans		14,490	16,973	14,470	11,026
Repayment of bank loans		(12,816)	(17,378)	(18,233)	(15,392)
Capital element of finance lease payments		(41)	(39)	(361)	(187)
Net contributions received from/(distributions to) owners		(155)	2,777	3,794	3,177
Net cash inflow/(outflow) from financing activities		1,478	2,333	(330)	(1,376)
Increase/(decrease) in cash and cash equivalents		(735)	44	(542)	(454)
Cash and cash equivalents at beginning of year/period		1,781	1,046	1,090	1,090
Cash and cash equivalents at end of year/period	11	1,046	1,090	548	636

(II) NOTES TO THE FINANCIAL STATEMENTS

1. The Target Group, its Reorganisation and Principal Activities

(a) Background of the Target Group

The Target BVI Company was incorporated in the BVI on 27 July 2005 as a limited liability company under the British Virgin Islands International Business Companies Act of 1984. Through China Netcom Group New Horizon Communications Corporation Limited, its wholly owned subsidiary established in the PRC, the Target BVI Company holds the assets and liabilities of the fixed line telecommunications business in the Target Regions. These assets and liabilities were injected from China Netcom Group as set out in note (b) below.

(b) Reorganisation of the Target Group

In anticipation of the proposed acquisition of the Target BVI Company by the Company from China Netcom Group (the "Proposed Acquisition"), the Target BVI Company and its subsidiary underwent a reorganisation as follows (the "Reorganisation"):

(a) The net assets of the fixed line telecommunications operations of the Target Regions, excluding certain assets and liabilities retained by China Netcom Group as set out in (c) below, valued at RMB 9,466 million as of 31 December 2004 based on an independent valuation, were injected into China Netcom Group New Horizon Communication Corporation Limited, the Target Company on 9 August 2005;

(b) The entire interests in the Target Company were transferred to the Target BVI Company, an investment holding company incorporated in the BVI and indirectly held by China Netcom Group through China Netcom Group (BVI) Company Limited, on 1 September 2005 for a consideration of RMB 9,466 million by way of equity injection;

(c) China Netcom Group retained the inter-provincial optic fibers, certain land and buildings, long term investments and certain minor current assets and liabilities of the fixed line telecommunications business of the Target Regions after the Reorganisation.

(c) Principal activities

After the Reorganisation, the Target Group is the dominant provider of fixed line telephone services, broadband services, other Internet-related services, and business and data communications services in the Target Regions.

The Target Group's operations are subject to the supervision of and regulation by the PRC Government. The MII, pursuant to the authority delegated by the PRC's State Council, is responsible for formulating the telecommunications industry policies and regulations (the "Telecommunications Regulations").

Under the Telecommunications Regulations, all telecommunications operators in the PRC must obtain a telecommunications service operating license from the MII or from the provincial telecommunications administrations. Providers of value-added services within a single province are required to obtain licenses from provincial telecommunications administrations. Providers of basic telecommunications services and providers of value-added services in two or more provinces, autonomous regions and municipalities are required to obtain licenses from the MII. In accordance with the approval of the MII, the Target Company, as an indirect subsidiary of China Netcom Group, has the right to operate the Target Group's telecommunications business in the Target Regions under the authorisation of China Netcom Group, which holds the license required for operating the Target Group's telecommunications businesses in the PRC.

Following the Reorganisation, China Netcom Group continues to be the holder of the licenses for operating a telecommunications network in China, but has, with the consent of the MII, granted the Target Group the right to operate under its licenses, the assets described above and the related businesses.

2. Basis of presentation

As a result of the segregation and separate management of the assets and liabilities retained by China Netcom Group upon Reorganisation beginning 30 June 2005, such assets and liabilities have been reflected as a distribution to owner in the combined statement of owners' equity as at 30 June 2005.

Immediately before and after the Reorganisation, the Target Group and the assets and liabilities of the Target Regions are wholly owned by China Netcom Group. Accordingly, the Reorganisation was regarded as a group restructuring and accounted for under merger accounting, as permitted by the Hong Kong Statement of Standard Accounting Practice 27 ("SSAP 27") "Accounting for group reconstructions", and the assets and liabilities injected into the Target Group by China Netcom Group under Note 1 (a) and (b) above have been stated at historical amounts. The combined Financial Information presents the combined results and financial position of the Target Group as if the fixed line telecommunications businesses were injected into the Target Group from China Netcom Group at the beginning of the earliest periods presented.

The assets and liabilities as at 30 June 2005 retained by China Netcom Group were as follows:

Current assets
Lease prepayments for land (Note 15)
Property, plant and equipment, net (Note 16)
Construction in progress (Note 17)
Other non-current assets
Current liabilities
Non-current liabilities

Net amount

3. Summary of significant accounting policies

The principal accounting policies applied in the preparation of the Financial Information are set out below. These policies have been consistently applied to all the years/periods presented, unless otherwise stated.

3.1 Basis of preparation

The Financial Information has been prepared in accordance with Hong Kong Financial Reporting Standards (HKFRS). The Financial Information has been prepared under the historical cost convention, as modified by the revaluation of certain fixed assets which are carried at fair value.

The preparation of Financial Information in conformity with HKFRS requires the use of certain critical accounting estimates. It also requires management to exercise its judgement in the process of applying the Target BVI Company's accounting policies. The areas involving a higher degree of judgement or complexity, or areas where assumptions and estimates are significant to the Financial Information, are disclosed in Note 5.

A significant percentage of the Target Group's funding requirements is achieved through short term borrowings. Consequently, the balance sheet indicates a significant working capital deficit. In the past, a substantial portion of the Target Group's short term borrowings have been rolled over upon maturity. Based on the Target Group's history of obtaining finance, its relationships with its bankers and its operating performance, the directors of the Target Group consider that the Target Group will continue to be able to roll over such short term financing, or will be able to obtain sufficient alternative sources of financing to enable it to operate and meet its liabilities as and when they fall due.

This is the first set of HKFRS financial statements of the Target Group. No audited stand-alone financial statements have been prepared for the Target BVI Company or the Target Company since their respective dates of incorporation / establishment as they were incorporated or established since 30 June 2005 and have not been involved in any significant transactions since incorporation / establishment other than the Reorganisation.

3.2 Basis of Combination

As set out in Note 2 above, the Reorganisation involving the injection of businesses from China Netcom Group into the Target Group was accounted for using merger accounting in accordance with SSAP No.27 issued by the HKICPA. The results and financial position of businesses combined under the Reorganisation were included in the Financial Information as if the businesses were acquired at the beginning of the earliest periods presented.

Subsidiaries are those entities in which the Target BVI Company, directly or indirectly, controls the composition of the board of directors, controls more than half the voting power or holds more than half of the issued share capital.

3.3. Segment reporting

A business segment is a group of assets and operations engaged in providing products or services that are subject to risks and returns that are different from those of other business segments. A geographical segment is engaged in providing products or services within a particular economic environment that are subject to risks and returns that are different from those of segments operating in other economic environments. Currently, the Target Group has one business segment, the provision of fixed line telecommunication services. The Target Group's assets and operation are all located in the PRC. Accordingly, no business and geographical segment information is presented.

3.4 Foreign currency translation

(a)

Functional and presentation currency

Items included in the financial statements of each of the Target Group's entities are measured using the currency of the primary economic environment in which the entity operates ("the functional currency") which is Renminbi.

(b)

Transactions and balances

Foreign currency transactions are translated into the functional currency using the exchange rates prevailing at the dates of the transactions. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation at year-end exchange rates of monetary assets and liabilities denominated in foreign currencies are recognised in the income statement.

3.5. Property, plant and equipment

(a)

Construction in progress

Construction in progress represents buildings, telecommunications networks plant, transmission and switching equipment under construction and pending installation, and is stated at cost less impairment losses. Cost comprises direct costs of construction including borrowing costs attributable to the construction during the period of construction. When the asset being constructed becomes available for use, the construction in progress is transferred to the appropriate category of property, plant and equipment.

(b)

Other property, plant and equipment

All other property, plant and equipment are initially stated at historical cost less depreciation and impairment losses. Historical cost includes expenditure that is directly attributable to the acquisition of the items.

Subsequent costs are included in the asset's carrying amount or recognised as a separate asset, as appropriate, only when it is probable that future economic benefits associated with the item will flow to the Target Group and the cost of the item can be measured reliably. All other repairs and maintenance are expensed in the income statement during the financial period in which they are incurred.

Buildings subsequent to initial recognition are stated at cost less accumulated impairment losses and depreciated over their expected useful lives.

(c)

Revaluation

Subsequent to the revaluation carried out as at 31 December 2004, which was based on depreciated replacement costs (Note 16), property, plant and equipment other than buildings are carried at their revalued amounts, being the fair values at the date of revaluation, less subsequent accumulated depreciation and impairment losses. When an item of property, plant and equipment is revalued, any accumulated depreciation at the date of the revaluation is restated proportionately together with the change in the gross carrying amount of the asset so that the carrying amount of the asset after revaluation equals its revalued amount.

Increases in the carrying amount arising on revaluation are credited to the valuation reserve in shareholders' equity. Decreases that offset previous increases of the same asset are charged against revaluation reserve directly in equity; all other decreases are expensed in the income statement. Any subsequent increases are credited to operating profit up to the amount previously debited. Each year the difference between depreciation based on the revalued carrying amount of the asset expensed in the income statement and depreciation based on the asset's original cost is transferred from revaluation reserve to retained earnings.

(d)

Depreciation

Depreciation of property, plant and equipment is calculated using the straight-line method to allocate cost or revalued amounts less accumulated impairment loss to their residual values over their estimated useful lives, as follows:

- Buildings	8-30 years
- Telecommunication network and equipment	5-10 years
- Furniture, fixtures, motor vehicles and other equipments	5-10 years

The assets' residual values and useful lives are reviewed, and adjusted if appropriate, at each balance sheet date.

(e)

Gain or loss on sale of property, plant and equipment

The gain or loss on disposal of property, plant and equipment is the difference between the net sales proceeds and the carrying amount of the relevant asset, and is recognised in the income statement, except where the property, plant and equipment is carried at valuation, the relevant portion of the revaluation reserve realised in respect of previous valuations is transferred to retained earnings and is shown as a movement in reserves.

(f)

Impairment

An asset's carrying amount is written down immediately to its recoverable amount if the asset's carrying amount is greater than its estimated recoverable amount (Note 3.7).

3.6 Intangible assets

(a)

Purchased software

Acquired computer software licences are capitalised on the basis of the costs incurred to acquire and bring to use the specific software. These costs are amortised using the straight-line method over their estimated useful lives ranging from three to five years.

(b)

Sponsorship fee

Sponsorship fee to the 2008 Olympic Games is capitalised and amortised using the straight-line method over its beneficial period of four years.

3.7. Impairment of assets

Assets that have an indefinite useful life are not subject to amortisation, which are at least tested annually for impairment and are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. Assets that are subject to amortisation are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. An impairment loss is recognised for the amount by which the asset's carrying amount exceeds its recoverable amount. The recoverable amount is the higher of an asset's fair value less costs to sell and value in use. For the purposes of assessing impairment, assets are grouped at the lowest levels for which there are separately identifiable cash flows (cash-generating units).

3.8 Inventories and consumables

Inventories comprise mainly spare parts and telephone handsets and are stated at the lower of cost and net realisable value after provision for obsolescence. Cost is determined using the first-in, first-out (FIFO) method. Net realisable value is the estimated selling price in the ordinary course of business, less applicable variable selling expenses.

3.9 Accounts and other receivables

Accounts and other receivables are recognised initially at fair value and subsequently measured at amortised cost using the effective interest method, less provision for impairment. A provision for impairment of accounts and other receivables is established when there is objective evidence that the Target Group will not be able to collect all amounts due according to the original terms of receivables. The amount of the provision is the difference between the asset's carrying amount and the present value of estimated future cash flows, discounted at the effective interest rate. The amount of the provision is recognised in the income statement.

3.10 Cash and cash equivalents

Cash and cash equivalents include cash in hand, deposits held at call with banks and time deposits with original maturities of three months or less which are carried at cost.

3.11 Borrowings

Borrowings are recognised initially at fair value, net of transaction costs incurred. Transaction costs are incremental costs that are directly attributable to the acquisition, issue or disposal of a financial asset or financial liability, including fees and commissions paid to agents, advisers, brokers and dealers, levies by regulatory agencies and securities exchanges, and transfer taxes and duties. Borrowings are subsequently stated at amortised cost; any difference between the proceeds (net of transaction costs) and the redemption value is recognised in the income statement over the period of the borrowings using the effective interest method.

Borrowings are classified as current liabilities unless the Target Group has an unconditional right to defer settlement of the liability for at least 12 months after the balance sheet date.

3.12 Deferred income tax

Deferred income tax is provided in full, using the liability method, on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in Financial Information. However, if the deferred income tax arises from the initial recognition of an asset or liability in a transaction other than a business combination that at the time of the transaction affects neither accounting nor taxable profit or loss, it is not accounted for. Deferred income tax is determined using tax rates (and laws) that have been enacted or substantially enacted by the balance sheet date and are expected to apply when the related deferred income tax asset is realised or the deferred income tax liability is settled.

Deferred income tax assets are recognised to the extent that it is probable that future taxable profit will be available against which the temporary differences can be utilised.

3.13 Employee benefits

(a)

Pension obligations

As stipulated by the regulations of the PRC, the Target Group participates in basic defined contribution pension plans organised by their respective Municipal Governments under which they are governed. The Target Group is required to make contributions to the retirement plans at rates of 20% of the salaries, bonuses and certain allowances of the employees. Employees are entitled to retirement benefits equal to a fixed proportion of their salary at their normal retirement age. The Target Group has no other material obligations for post-retirement benefits beyond these payments as they fall due. Payments made under these plans are expensed as incurred.

(b)

Early retirement benefits

Early retirement benefits are recognised as expenses when the Target Group reaches agreement with the relevant employees for early retirement.

(c)

Employee housing benefits

One-off cash housing subsidies paid to employees are charged to the income statement in the year in which it is determined that the payment of such subsidies is probable and the amounts can be reasonably estimated (see Note 25(a)).

Full-time employees of the Target Group participate in various government-sponsored housing funds. The Target Group contributes on a monthly basis to these funds based on certain percentages of the salaries of the employees. The Target Group's liability in respect of these funds is limited to the contributions payable in each period. Contributions to these housing funds are expensed as incurred.

3.14 Provisions

Provisions are recognised when the Target Group has a present legal or constructive obligation as a result of past events; it is more likely than not that an outflow of resources will be required to settle the obligation; and the amount has been reliably estimated. Provisions are not recognised for future operating losses.

Where there are a number of similar obligations, the likelihood that an outflow will be required in settlement is determined by considering the class of obligations as a whole. A provision is recognised even if the likelihood of an outflow with respect to any one item included in the same class of obligations may be small.

3.15 Revenue recognition

(a) The Target Group's revenues are recognised as follow:

o Revenues derived from local, domestic long distance ("DLD) and international long distance ("ILD) telephone usage, which vary depending on the day, the time of day, the distance and duration of the call and the tariffs, are recognised when the services are provided to customers.

o Monthly telephone service fees are recognised in the period during which the telephone services are provided to customers.

o Upfront connection and installation fees received are deferred and recognised over the expected customer relationship period of 10 years. With effect from 1 July 2001, no further upfront fees for connection were charged to customers.

o Revenues from the sale of prepaid calling cards are deferred and recognised as the cards are consumed by customers.

o Revenues from PHS bundled service contracts are recognised as local, DLD, or ILD service fees according to the type of usage and on a systematic basis to match the shorter of the pattern of usage of the PHS services by customers and the minimum non-cancellable contract period. PHS bundled service contracts comprise the provision of PHS services and handsets to customers, under which customers either prepay a certain amount of service fee or commit to spend a minimum monthly service fee for a designated period in order to receive a free handset (see Note 3.19(b)) for the policy on cost of the handset.

o Revenues from value-added communication services such as call waiting, call diverting and caller number display are recognised when the services are provided to customers.

o Revenues from the provision of broadband and other Internet-related services and managed data services are recognised when the services are provided to customers.

o Interconnection fees from domestic and foreign telecommunications operators are recognised when the services are rendered as measured by the minutes of traffic processed.

o Lease income from the leasing of lines and customer-end equipment is recognised over the term of the lease. Lease income from other domestic telecommunications operators and business customers for the usage of the Target Group's fixed line telecommunications networks is measured by the number of lines leased and the agreed upon rate per line leased. The lease arrangements are primarily determined on a year to year basis.

(b)

Interest income

Interest income is recognised on a time proportion basis, taking into account the principal amounts outstanding and the interest rates applicable.

3.16 Interest expenses

Interest expenses that are attributable to the acquisition, construction or production of an asset that necessarily takes a substantial period of time to get ready for its intended use or sale are capitalised as part of the cost of that asset.

All other interest expenses are charged to the income statement in the year/period in which they are incurred.

3.17 Interconnection charges@#

#@Interconnection charges represent amounts incurred for the use of other telecommuncations operators' network for facilitating the completion of calls that originate from the Target Group's fixed line telecommuncations networks. Interconnection charges are recognised on an accruals basis. For interconnection charges with domestic operators, they are accrued based on actual amounts, while those with overseas operators are accrued based on the Target Group's estimates.

3.18 Leases (as the lessee)

(a)

Operating lease

Leases in which a significant portion of the risks and rewards of ownership are retained by the lessor are classified as operating leases. Payments made under operating leases (net of any incentives received from the lessor) are expensed in the income statement on a straight-line basis over the period of the lease.

(b)

Finance lease

Leases of assets where the Target Group has substantially all the risks and rewards of ownership are classified as finance leases. Finance leases are capitalised upon commencement of the lease at the lower of the fair value of the leased assets and the present value of the minimum lease payments. Each lease payment is allocated between the liability and finance charges so as to achieve a constant rate on the finance balance outstanding. The corresponding rental obligations, net of finance charges, are included in current and non-current borrowings. The interest element of the finance cost is recognised in the income statement over the lease period so as to produce a constant periodic rate of interest on the remaining balance of the liability for each period.

3.19 Deferred costs

(a)

Deferred installation costs

The direct incremental costs associated with the installation of fixed line services are deferred and amortised to the income statement over the expected customer relationship period of 10 years except when the direct incremental costs exceed the corresponding upfront installation fees. In such cases, the excess of the direct incremental costs over the installation fees are recorded immediately as expenses in the income statement.

(b)

Customer acquisition costs

The cost of handsets given to customers under bundled service contracts are deferred as customer acquisition costs, to the extent recoverable, and amortised to the income statement on a systematic basis to match with the pattern of the customer service income over the contract period.

3.20 Contingent liabilities

A contingent liability is a possible obligation that arises from past events and whose existence will only be confirmed by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the Target Group. It can also be a present obligation arising from past events that is not recognised because it is not probable that outflow of economic resources will be required or the amount of obligation cannot be measured reliably.

A contingent liability is not recognised but is disclosed in the notes to the Financial Information. When a change in the probability of an outflow occurs so that the outflow is probable, the contingent liability will then be recognised as a provision.

A contingent asset is a possible asset that arises from past events and whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain events not wholly within the control of the Target Group.

4. Financial risk management

4.1 Financial risk factors

The Target Group's activities expose it to a variety of financial risks: market risks including currency risk and fair value interest rate risk, credit risk, liquidity risk and cash flow interest-rate risk.

(a)

Foreign exchange risk

The Target Group has foreign currency denominated bank loans, the details of which are disclosed in note 22 of the Financial Information.

(b)

Credit risk

The carrying amount of accounts receivable included in the balance sheet represents the Target Group's exposure to credit risk in relation to its financial assets. The Target Group's receivables are unsecured to the extent they are not covered by security deposits. The Target Group believes that adequate provision for uncollectible accounts receivable has been made.

(c)

Liquidity risk

A significant percentage of the Target Group's funding requirements is achieved through short term borrowings, and the balance sheet indicates a significant working capital deficit. Please refer to note 3.1 for further information.

(d)

Cash flow and fair value interest rate risk

The Target Group is exposed to changes in interest rates due to its long-term debt obligations. The Target Group enters into debt obligations to support general corporate purposes including capital expenditures, and working capital needs. Borrowings at variable rates expose the Target Group to cash flow interest rate risk. Borrowings issued at fixed rates expose the Target Group to fair value interest rate risk. The bank loans issued at variable rates and fixed rates are disclosed in note 22 of the Financial Information.

4.2 Fair value estimation

The nominal value less estimated credit adjustments of receivables and payables are assumed to approximate their fair values. The fair value of financial liabilities for disclosure purposes is estimated by discounting the future contractual cash flows at the current market interest rate that is available to the Target Group for similar financial instruments.

5. Critical accounting estimates and judgements

Estimates and judgements are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances.

The Target Group makes estimates and assumptions concerning the future. The resulting accounting estimates will, by definition, seldom equal the related actual results. The estimates and assumptions that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year are discussed below:

(a)

Depreciation of property, plant and equipment

The property, plant and equipment of the Target Group are depreciated at rates sufficient to write off their costs or revalued amounts less accumulated impairment losses and estimated residual values over their estimated useful lives on a straight-line basis. The Target Group reviewed the useful lives periodically to ensure that the method and rates of deprecation are consistent with the expected pattern of economic benefits from property, plant and equipment. The Target Group estimates the useful lives of the property, plant and equipment based on the historical experience with similar assets, taking into account anticipated technological changes. The depreciation expenses in the future periods will change if there are significant changes from previous estimates.

(b)

Revaluation of property, plant and equipment

Property, plant and equipment of the Target Group are revalued as of 31 December 2004 on a depreciated replacement cost basis. Apart from lease prepayments for land and buildings, which are carried at cost, other property, plant and equipment are carried at the revalued amounts, being the fair value at the date of revaluation, less subsequent accumulated depreciation and impairment losses. Revaluations are performed at intervals of not more than three years by independent valuers and, in each of the intervening years, valuations are undertaken by executives of the Target Group. If the revalued amounts differ significantly from the carrying amounts of the property, plant and equipment in the future, the carrying amounts will be adjusted to the revalued amounts. This will have an impact on the Target Group's future results, since any subsequent decreases in valuation are set off first against increases on earlier valuations in respect of the same item and thereafter are charged as an expense to the income statement and any subsequent increases are credited as income to the income statement up to the amount previously charged. In addition, the depreciation expense in future periods will change as the carrying amounts of such property, plant and equipment change as a result of the revaluation.

(c)

Impairment of non-current assets

At each balance sheet date, the Target Group considers both internal and external sources of information to assess whether there is any indication that non-current assets, including property, plant and equipment, are impaired. If any such indication exists, the recoverable amount of the assets is estimated and an impairment loss is recognised to reduce the carrying amount of the asset to its recoverable amount. Estimated recoverable amounts are determined based on estimated discounted future cash flows of the cash-generating unit at the lowest level to which the asset belongs. The recoverable amount is the higher of value in use or net selling price. Such impairment losses are recognised in the income statement, except where the asset is carried at valuation and the impairment loss does not exceed the revaluation surplus for that same asset, in which case the impairment loss is treated as a revaluation decrease and charged to the revaluation reserve. Accordingly, there will be an impact to the future results if there is a significant change in the recoverable amounts of the non-current assets

(d)

Revenue recognition for upfront connection and installation fees

The Target Group defers the recognition of upfront customer connection and installation fees and amortises them over the expected customer relationship period of 10 years. The related direct incremental installation costs are deferred and amortised over the same expected customer relationship period of 10 years, except that when the direct incremental costs exceed the corresponding installation fees, if any, the excess amounts are immediately written off as expenses to the income statement. The Target Group estimates the expected customer relationship period based on the historical customer retention experience and after factoring in the expected level of future competition, the risk of technological or functional obsolescence to the Target

Group's services, technological innovation, and the expected changes in the regulatory and social environment. If the Target Group's estimate of the expected customer relationship period changes as a result of increased competition, changes in telecommunications technology or other factors, the amount and timing of recognition of the deferred revenues may change for future periods.

(e)

Recognition of revenues and costs under PHS bundled service contracts

The Target Group provides PHS services, which is an extension of the local wireline telecommunications service, to customers. Promotional packages comprise the bundled provision of PHS services and handsets to customers, under which customers either prepay a certain amount of service fee or commit to spend a minimum monthly service fee for a designated period of time in order to receive a free handset. The total revenues received or receivable are recognised as deferred revenue. The cost of handsets provided to customers is treated as deferred customer acqusition costs, to the extent that they are recoverable through profits made from future services fees. Such deferred revenue and deferred costs are amortised to the income statement on a systematic basis to match the shorter of the pattern of usage of the related service and the minimum non-cancellable contract period. If the pattern of the usage of the PHS services by the customers changes in the future, the amortisation period of the revenues and costs will change accordingly, which will have an impact on future results.

(f)

Provison for doubtful debts

The Target Group maintains an allowance for doubtful debts for estimated losses resulting from the inability of its customers to make the required payments. The Target Group makes its estimates based on the aging of its accounts receivable balances, customer creditworthiness, and historical write-off experience. If the financial condition of its customers were to deteriorate, actual write-offs might be higher than expected, and the Target Group would be required to revise the basis of making the allowance and its future results would be affected.

(g)

Estimation of fair value

The Target Group estimates the fair value of its financial liabilities for disclosure purposes by discounting its future contractual cash flows at the estimated current market interest rate that is available to the Target Group for similar financial instruments. The future disclosed values will change if there are changes in the estimated market interest rate.

6 Revenues

Revenues represent the turnover of the Target Group and are derived from the provision of fixed line telecommunications and related services in PRC, net of the PRC business taxes and government levies. The Target Group's revenues by business nature can be summarised as follows:

	Years ended 31 December	Six months Ju

	2002	2003	2004	2004
Revenues				
Local usage fees	5,867	6,118	6,197	3,155
Monthly telephone service	3,482	3,896	4,221	2,122
Upfront installation fees	203	223	230	118
DLD usage fees	2,524	2,554	2,453	1,247
ILD usage fees	134	133	113	57
Value-added services	277	579	847	396
Interconnection fees	864	1,183	1,582	765
Upfront connection fees	1,280	1,157	968	512
Broadband service	279	663	1,034	478
Other internet-related service	214	176	114	67
Managed data service	324	338	303	155
Leased line income	609	374	270	132
Other services	175	306	284	111
Total	16,232	17,700	18,616	9,315

7 Profit/(loss) from operations

Profit/(loss) from operations is stated after charging and crediting the following:

	Years ended 31 December			Six months Ju
	2002	2003	2004	2004
Charging:				
Depreciation (Note 16):				
- Owned property, plant and equipment	5,942	6,188	6,169	3,074
- Leased property, plant and equipment	22	97	215	100
Amortisation of intangible assets (Note 18)	14	20	30	16
Amortisation of lease prepayments for land (Note 15)	10	12	12	6
Auditors' remuneration	5	3	15	2
Write off/loss on disposal of property, plant and equipment (industry in networks, operations and support expenses)	1,520	535	67	29
Impairment charge on property, plant and equipment (Note 16)	-	131	-	-
Impairment charge on lease prepayments for land (Note 15)	-	18	-	-
PHS subscribers acquisition cost	37	931	1,108	656
Cost of PHS handsets	34	54	51	13
Operating leases:				
- Land and buildings	17	18	27	9
- Network and machinery	96	89	83	37
Interconnection charges	139	139	235	95
Bad debt expense	492	407	353	316
Foreign exchange losses	31	96	35	-
Crediting:				
Gain on disposal of property, plant and equipment (included in networks operations and support expenses)	-	-	-	-

Foreign exchange gains	-	-	-	11

8 Finance costs

	Years ended 31 December			Si
	2002	2003	2004	
Interest expenses on				
- Bank and other loans wholly repayable within five years	1,397	1,273	1,058	
- Bank and other loans wholly repayable after five years	27	49	26	
	1,424	1,322	1,084	
Less: Interest expenses capitalised in construction in progress	(178)	(158)	(127)	
	1,246	1,164	957	
Exchange loss/(gain), net	31	96	35	
Bank charges	6	10	6	
	1,283	1,270	998	

Interest expenses were capitalised in construction in progress using the following annual interest rates 5.38% -5.64% 4.76% -6.77% 4.15% -4.86% 3.90%

9 Taxation

	Years ended 31 December			Six m
	2002	2003	2004	2
PRC enterprise income tax ("EIT")	18	6	146	1
Deferred taxation (Note 26)	(441)	(404)	(3,817)	(
Taxation charge/(credit)	(423)	(398)	(3,671)	1

The provision for EIT is calculated based on the statutory income tax rate of 33% on the assessable profit of the Target Group as determined in accordance with the relevant income tax rules and regulations in the PRC.

The reconciliation between the Target Group's actual tax charge/(credit) and the amount which is calculated based on the weighted average statutory tax rate is as follows:

		Years ended at 31 December			Six months
	Note	2002	2003	2004	2004

Profit/(loss) before taxation		(325)	(193)	(10,202)	811
Statutory tax rate		33%	33%	33%	33%
Tax calculated at the statutory tax rate		(107)	(64)	(3,367)	268
Non-taxable income	(i)	(422)	(381)	(319)	(169)
Expenses not deductible for tax purposes		106	59	17	11
Others		-	(12)	(2)	(8)
Tax charge/(credit)		(423)	(398)	(3,671)	102

Note:

(i) Non-taxable income comprises primarily upfront connection fees charged to customers and amortised over the customer relationship period.

10 Staff costs

	Years ended 31 December			Six mont
	2002	2003	2004	2004
Contributions to pensions	246	261	368	220
Early retirement benefits (Note 25)	132	204	487	156
Wages, salaries and welfare	2,224	2,933	3,036	1,516
Total	2,602	3,398	3,891	1,892

11 Cash and bank deposits

	As at 31 December		
	2002	2003	2004
Cash and cash equivalents	1,046	1,090	548
Time deposits with original maturities over three months	51	24	32
Total cash and bank deposits	1,097	1,114	580

The effective interest rate on time deposits with original maturities over three months is 0.72%. (2004: 0.72%; 2003: 0.72%; 2002: 1.42%).

All balances at 31 December 2002, 2003 and 2004 and 30 June 2005 are Renminbi denominated and kept in the PRC. The conversion of Renminbi denominated balances into foreign currencies and the remittance of bank balances and cash out of the PRC are subject to the rules and regulations of foreign exchange control promulgated by the PRC government.

12 Accounts receivable

Amounts due from the provision of fixed line telecommunications services to residential customers are due within 30 days from the date of billing. Residential customers who have accounts overdue by more than 90 days will in normal circumstances have their services disconnected. Accounts receivable from other telecommunications operators and customers are due between 30 to 90 days from the billing date.

The ageing analysis of accounts receivable based on the billing date is as follows:

	As at 31 December			As at 30 June
	2002	2003	2004	2005
0-30 days	935	870	1,024	1,201
31-90 days	157	248	261	371
Over 90 days	221	181	557	821
Total	1,313	1,299	1,842	2,393
Less: Allowance for doubtful debts	(192)	(124)	(356)	(534)
Net carrying amounts	1,121	1,175	1,486	1,859

The movement of allowance for doubtful debts is as follows:

	As at 31 December			As at 30 June
	2002	2003	2004	2005
Balance at beginning of year/period	(172)	(192)	(124)	(356)
Additional provisions	(271)	(313)	(392)	(178)
Less: Amounts utilised	251	381	160	-
Balance at end of year/period	(192)	(124)	(356)	(534)

The carring value of accounts receivables approximate their fair values based on cash flows discounted using a rate based on the borrowing rate of 5.22% (2004: 5.22%; 2003: 5.04%; 2002: 5.04%).

Included in accounts receivable are amounts due from other state-owned telecommunications operators amounting to RMB 299 million, RMB 413 million, RMB 489 million and RMB 607 million as at 31 December 2002, 2003 and 2004 and 30 June 2005 respectively.

13 Inventories and consumables

	As at 31 December	
	2002	2003

Consumables	259	142
Telephone handsets and other customer end products held for resale	32	67
	291	209

14 Prepayments and other receivables

	As at 31 December		
	2002	2003	2004
Prepaid expenses and deposits	74	126	91
Other receivables	665	456	345
	739	582	436

Included in the prepaid expenses is deferred customer acquisition cost of RMB 28 million (2004: RMB 59 million; 2003: RMB 69 million; 2002: RMB 1 million).

The carrying values of prepayments and other receivables approximate their fair value based on cash flows discounted using a rate based on the borrowing rate of 5.22% (2004: 5.22%; 2003: 5.04%; 2002: 5.04%).

15 Lease prepayments for land

This represents land use rights in the PRC and their net book value is analysed as follows:

	As at 31 December		
	2002	2003	2004
Held for:			
Lease of over 50 years	134	134	132
Lease of between 10 to 50 years	298	301	335
Lease of less than 10 years	34	15	13
	466	450	480

	As at 31 December		
	2002	2003	2004
Opening balance	412	466	450
Additions	64	14	42
Amortisation charge for the year/period	(10)	(12)	(12)
Distributed to owners in accordance with reorganisation on 30 June 2005 (Note 2)	-	-	-

Impairment charge for the year/period	–	(18)	–
	466	450	480

16 Property, Plant and Equipment

	Buildings	Telecommunication networks and equipment	Furniture fixtures moto vehicle and othe equipmen
Cost/valuation:			
Balance at 1 January 2002	6,648	54,041	2,876
Additions	186	1,624	410
Transferred from construction in progress (Note 17)	1,155	6,074	537
Disposals	(73)	(2,745)	(556)
Balance at 31 December 2002	7,916	58,994	3,267
Accumulated depreciation and impairment:			
Balance at 1 January 2002	(1,230)	(19,278)	(979)
Depreciation charge for the year	(245)	(5,290)	(429)
Disposals	31	1,588	243
Balance at 31 December 2002	(1,444)	(22,980)	(1,165)
Net book value at 31 December 2002	6,472	36,014	2,102

	Buildings	Telecommunication networks and equipment	Furnitur fixture mot vehicl and oth equipme
Cost/valuation:			
Balance at 1 January 2003	7,916	58,994	3,267
Additions	13	1,065	291
Transferred from construction in progress (Note 17)	1,000	7,158	575
Disposals	(68)	(1,021)	(172)
Balance at 31 December 2003	8,861	66,196	3,961
Accumulated depreciation and impairment:			
Balance at 1 January 2003	(1,444)	(22,980)	(1,165)
Impairment charge for the year	(123)	–	(8)
Depreciation charge for the year	(281)	(5,540)	(464)
Disposals	12	581	113
Balance at 31 December 2003	(1,836)	(27,939)	(1,524)
Net book value at 31 December 2003	7,025	38,257	2,437

	Buildings	Telecommunication	Furnitur

		networks and equipment	fixture mot vehicl and oth equipme
Cost/valuation:			
Balance at 1 January 2004	8,861	66,196	3,961
Additions	39	598	292
Transferred from construction in progress (Note 17)	414	6,657	327
Disposals	(16)	(137)	(102)
Increase as a result of revaluation	-	17,140	1,503
Decrease as a result of revaluation	-	(21,201)	(1,065)
Balance at 31 December 2004	9,298	69,253	4,916
Accumulated depreciation and impairment:			
Balance at 1 January 2004	(1,836)	(27,939)	(1,524)
Depreciation charge for the year	(325)	(5,586)	(473)
Disposals	5	92	61
Increase as a result of revaluation	-	(13,458)	(1,322)
Decrease as a result of revaluation	-	10,461	487
Balance at 31 December 2004	(2,156)	(36,430)	(2,771)
Net book value at 31 December 2004	7,142	32,823	2,145

	Buildings	Telecommunication networks and equipment	Furnitur fixture mot vehicl and oth equipme
Cost/valuation:			
Balance at 1 January 2005	9,298	69,253	4,916
Additions	1	100	49
Transferred from construction in progress (Note 17)	231	1,766	94
Disposals	(6)	(2)	(26)
Distributed to owners in accordance with the Reorganisation on 30 June 2005 (Note 2)	(1,759)	(1,242)	(183)
Balance at 30 June 2005	7,765	69,875	4,850
Accumulated depreciation and impairment:			
Balance at 1 January 2005	(2,156)	(36,430)	(2,771)
Depreciation charge for the period	(171)	(2,736)	(247)
Disposals	4	-	24
Distributed to owners in accordance with the Reorganisation on 30 June 2005 (Note 2)	487	743	90
Balance at 30 June 2005	(1,836)	(38,423)	(2,904)
Net book value at 30 June 2005	5,929	31,452	1,946

(a) The net book value of assets held under finance lease is as follows:

	Buildings	Telecommunication networks and equipment	Furnitur fixture moto vehicle and othe

			equipmen
31 December 2002	-	91	-
31 December 2003	-	863	33
31 December 2004	8	1,811	90
30 June 2005	7	1,711	84

The Target Group entered into finance lease arrangements with a related party for certain existing property, plant and equipment in order to obtain funding of RMB 596 million and RMB 1,150 million during the years ended 31 December 2003 and 2004 respectively. The net book value of such property, plant and equipment included above amounted to RMB 595 million, RMB 1,638 million, and RMB 1,542 million and the corresponding finance lease obligation amounted to RMB 593 million, RMB 1,338 million, RMB 1,020 million as at 31 December 2003 and 2004 and 30 June 2005, respectively (see note 22(b)(ii)).

(b) The analysis of the cost or revaluation of the assets of the Target Group is as follows:

	Buildings	Telecommunication networks and equipment	Furnitur fixture mot vehicl and oth equipme
At 31 December 2002			
Cost	7,916	58,994	3,267
Valuation	-	-	-
	7,916	58,994	3,267
At 31 December 2003			
Cost	8,861	66,196	3,961
Valuation	-	-	-
	8,861	66,196	3,961
At 31 December 2004			
Cost	9,298	-	-
Valuation	-	69,253	4,916
	9,298	69,253	4,916
At 30 June 2005			
Cost	7,765	-	-
Valuation	-	69,875	4,850
	7,765	69,875	4,850

(c) As detailed in Note 3.5(c), except for buildings, property, plant and equipment were carried at revalued amounts on 31 December 2004. As required by the PRC rules and regulations relevant to the Reorganisation, each class of property, plant and equipment and lease prepayments for land in the PRC injected into the Target Group as at 31 December 2004, was valued by Beijing China Enterprise Appraisal Co. Ltd. (the "PRC valuer"), independent valuers registered in the PRC, on a depreciated replacement cost basis. The value of such property, plant and equipment and lease prepayments for land in the PRC injected into the Group was determined at RMB 42,879 million. The property, plant and equipment retained by the ultimate holding company, which were transferred based on their carrying values upon the Reorganisation, were valued by the Directors at an amount of RMB 1,944 million as at 31 December 2004. The impact of the revaluation was a net deficit on revaluation of the property, plant and equipment, other than buildings, totalling RMB 7,455 million. Following the revaluation of property, plant and equipment, the revalued amount of such assets will serve as the tax base for such assets in future years (see Note 26(ii)).

The lease prepayments for land (Note 15) and buildings were also revalued and the result was a net surplus of RMB 2,553 million. Such revaluation on lease prepayments for land and buildings has not been reflected in the Financial Information and only serves as the tax base for lease prepayments for land and buildings for future years (see Note 26(iii)).

The lease prepayments for land and buildings injected by China Netcom Group were valued separately by Sallmanns, independent qualified valuers in Hong Kong, as at 31 December 2004 on the basis of their open market value. The value arrived at by these valuers was consistent with that arrived at by the PRC valuer. The Target Group's lease prepayments for land and buildings are carried at their cost less accumulated depreciation and impairment losses in the Financial Information.

The respective carrying amount of the telecommunications networks and equipment and furniture, motor vehicles and other equipment would have been RMB 39,881 million and RMB 2,542 million as at 31 December 2004 and RMB 38,193 million and RMB 2,322 million as at 30 June 2005 had they been stated at cost less accumulated depreciation.

The historical carrying amounts of the Target Group's property, plant and equipment, as at 31 December 2004, and where applicable the corresponding revalued amounts of these assets are as follows:

	Historical carrying amount	Revaluation surplus	Revaluation Deficit
At 31 December 2004			
Buildings	7,142	-	-
Telecommunications networks and equipment	39,881	3,682	(10,740)
Furniture, fixtures, motor vehicles and other equipment	2,542	181	(578)
	49,565	3,863	(11,318)

The directors have carried out a review of the Target Group's property, plant and equipment and concluded that there was no impairment of property, plant and equipment as at 30 June 2005, nor was there any significant change in the value of property, plant and equipment at that date.

17 Construction in progress

	As at 31 December		
	2002	2003	2004
Balance at beginning of year/period	4,768	3,518	2,354
Additions	6,516	7,569	8,039
Transferred to property, plant and equipment (Note 16)	(7,766)	(8,733)	(7,398)
Distributed to owners in accordance with the Reorganisation on 30 June 2005 (Note 2)	-	-	-
Balance at end of year/period	3,518	2,354	2,995

18 Intangible assets

	Purchased software	Sponsorship fee Note 31 (x)
Cost:		
Balance at 1 January 2002	56	-
Additions	24	-
Balance at 31 December 2002	80	-
Accumulated amortisation:		
Balance at 1 January 2002	(8)	-
Amortisation for the year	(14)	-
Balance at 31 December 2002	(22)	-
Net book value at 31 December 2002	58	-
Cost:		
Balance at 1 January 2003	80	-
Additions	53	-
Balance at 31 December 2003	133	-
Accumulated amortisation:		
Balance at 1 January 2003	(22)	-
Amortisation for the year	(20)	-
Balance at 31 December 2003	(42)	-
Net book value at 31 December 2003	91	-
Cost:		
Balance at 1 January 2004	133	-
Additions	5	-

Balance at 31 December 2004	138	-
Accumulated amortisation:		
Balance at 1 January 2004	(42)	-
Amortisation for the year	(30)	-
Balance at 31 December 2004	(72)	-
Net book value at 31 December 2004	66	-
Cost:		
Balance at 1 January 2005	138	-
Additions	16	60
Balance at 30 June 2005	154	60
Accumulated amortisation:		
Balance at 1 January 2005	(72)	-
Amortisation for the period	(13)	(8)
Balance at 30 June 2005	(85)	(8)
Net book value at 30 June 2005	69	52

19 Deferred costs

	As at 31 December		
	2002	2003	2004
Balance at beginning of year/period			
- Installation costs	591	615	619
- Others	34	53	53
	625	668	672
Additions for the year/period			
- Installation costs	107	98	76
- Others	40	29	68
	147	127	144
Charge for the year/period			
- Installation costs	(83)	(94)	(103)
- Others	(21)	(29)	(59)
	(104)	(123)	(162)
Balance at end of year/period			
- Installation costs	615	619	592
- Others	53	53	62
	668	672	654

20 Accounts payable

	As at 31 December		
	2002	2003	2004
0-30 days	1,343	2,059	2,249
31-60 days	185	267	518
61-90 days	309	150	298
91-180 days	477	372	807
Over 180 days	3,318	2,561	2,600
	5,632	5,409	6,472

Included in accounts payable are amounts due to other state-owned telecommunications operators amounting to RMB 37 million, RMB 24 million, RMB 43 million and RMB 7 million as at 31 December 2002, 2003 and 2004 and 30 June 2005 respectively.

21 Accruals and other payables

	As at 31 December		
	2002	2003	2004
Accrued expenses	10	13	11
Other payables	1,629	1,254	1,502
	1,639	1,267	1,513

22 Bank and other loans

(a)

The short term bank loans were unsecured and comprise:

		As at 31 December		
Currency	Interest rate	2002	2003	2004
Renminbi denominated	Variable Interest rates ranging from 4.43% to 5.94% per annum	10,219	15,703	15,472

US Dollar denominated	Fixed Interest rates at 3.27% per annum	-	71	71
		10,219	15,774	15,543

The carrying values of short term bank loans approximate their fair values which are based on cash flows discounted using rates based on the borrowing rates of 3.27%-5.94% (2004: 2.59%-5.94%; 2003: 3.27%-5.94%; 2002: 3.27%-5.94%).

(b)

The Target Group's long term bank loans and other loans comprise:

		As at 31 December		
	Note	2002	2003	2004
Bank loans	(i)	16,599	10,638	7,107
Finance lease obligations	(ii)	52	901	1,541
		16,651	11,539	8,648
Less: Current portion		(5,727)	(3,676)	(4,457)
		10,924	7,863	4,191

The carrying values of the current portion of long term bank loans approximate their fair values which are based on cash flows discounted using a rate based on the borrowing rate of 5.22% (2004: 5.22%; 2003: 5.04%; 2002: 5.04%).

(i) Long term bank loans

	As at 31 December		
	2002	2003	2004
Bank Loans			
Unsecured	16,304	10,365	6,847
Secured	295	273	260
Total	16,599	10,638	7,107
Less: Current portion	(5,688)	(3,315)	(3,736)
Long-term loans	10,911	7,323	3,371

The Target Group's long term bank loans are repayable as follows:

	As at 31 December		
	2002	2003	2004
Within one year	5,688	3,315	3,736
In the second year	4,717	4,553	1,726
In the third to fifth year	5,310	1,969	944
After the fifth year	884	801	701
	16,599	10,638	7,107

The Target Group's long term bank loans comprise:

Currency 2002	Interest rate and final maturity 2003	As at 31 December 2004	2005	
Renminbi denominated	Variable interest rates ranging from 2.4% to 10.98% per annum with maturity through 1 November 2011	14,600	8,967	5,727
US Dollar denominated	Variable interest rates ranging from 0.19% to 8.3% per annum with maturity through 31 October 2039	1,242	986	671
Japanese Yen denominated	Variable interest	445	463	482

	rates ranging from 2.3% to 5.2% per annum with maturity through 18 June 2027			
Euro denominated	Variable interest rates ranging from 0.5% to 7.35% per annum with maturity through 15 March 2034	312	222	227
		16,599	10,638	7,107

As at 30 June 2005, bank loans of RMB 253 million (2004: RMB 260 million, 2003: RMB 273 million, 2002: RMB 295 million) were secured by:

(i) Corporate guarantees granted by China Netcom Group to the extent of RMB 253 million at 30 June 2005 (2004: RMB 260 million, 2003: RMB 273 million, 2002: RMB 287 million); and

(ii) Corporate guarantees granted by third parties to the extent of Nil at 30 June 2005 (2004: Nil, 2003: Nil, 2002: RMB 8 million).

(ii) Finance lease obligations

	As at 31 December		
	2002	2003	2004
Obligation under finance leases	52	901	1,541
Less: current portion	(39)	(361)	(721)
	13	540	820

The Target Group entered into finance lease arrangements with a related party for certain existing property, plant and equipment in order to obtain funding of RMB 596 million and RMB1,150 million during the years ended 31 December 2003 and 2004 respectively. The net book value of such property, plant and equipment amounted to RMB 595 million, RMB 1,638 million, and RMB 1,542 million and the corresponding finance lease obligation included above amounted to RMB 593 million, RMB 1,338 million, RMB 1,020 million as at 31 December 2003 and 2004 and 30 June 2005, respectively.

The Target Group's liabilities under finance leases are analyzed as follows:

	As at 31 December		
	2002	2003	2004
Within one year	43	375	756
In the second year	15	366	593
In the third to fifth year, inclusive	-	191	251
	58	932	1,600
Less: future finance charges on finance leases	(6)	(31)	(59)
Present value of finance lease liabilities	52	901	1,541
The present value of finance lease liabilities is as follows:			
Within one year	39	361	721
In the second year	13	354	574
In the third to fifth year, inclusive	-	186	246
	52	901	1,541

The fair values of the Target Group's long term portion of long term bank loans and other loans are as follows:

	As at 31 December		
	2002	2003	2004
Bank loans	10,179	6,785	3,136
Finance Leases	13	540	820
	10,192	7,325	3,956

The fair values are based on cash flows discounted using rates based on the borrowing rates of 0.5%-8.30% (2004:0.19%-9.20%; 2003:0.19%-8.30%; 2002: 0.19%-8.30%). 23

Amounts due from/(to) ultimate holding companies and fellow subsidiaries

		As at 31 December		
	Note	2002	2003	2004

Due from ultimate holding company	(a)	-	27	650
Due from fellow subsidiaries	(a)	141	67	64
		141	94	714
Due to ultimate holding company	(a),(b)	69	472	520
Due to fellow subsidiaries	(a)	1,162	976	1,316
		1,231	1,448	1,836

Notes:

a) These are interest free, unsecured and have no fixed terms of repayment.

b) As at 30 June 2005, amounts due to ultimate holding company amounting to RMB 436 million were waived and recognised in the Target Group's equity upon the Reorganisation.

24 Deferred revenues

	As at 31 December		
	2002	2003	2004
Balance at beginning of year/period			
- upfront connection fees	5,303	4,023	2,866
- upfront installation fees	1,234	1,308	1,310
- prepaid telephony services	645	772	975
	7,182	6,103	5,151
Additions for the year/period			
- upfront connection fees	-	-	-
- upfront installation fees	277	225	154
- prepaid telephony services	3,011	4,879	6,821
	3,288	5,104	6,975
Reductions for the year/period			
- upfront connection fees	(1,280)	(1,157)	(968)
- upfront installation fees	(203)	(223)	(230)
- prepaid telephony services	(2,884)	(4,676)	(6,534)
	(4,367)	(6,056)	(7,732)
Balance at end of year/period			
- upfront connection fees	4,023	2,866	1,898
- upfront installation fees	1,308	1,310	1,234
- prepaid telephony services	772	975	1,262
	6,103	5,151	4,394
Representing:			
- Current portion	2,140	2,170	2,223
- Non-current portion	3,963	2,981	2,171

	6,103	5,151	4,394

25 Provisions

	Early retirement benefits Note (b), 3.13(b)	One-off cash housing subsidies Note (a), (b)
At 1 January 2002	1,383	1,324
Additional provisions	132	-
Payments during the year	(159)	(4)
At 31 December 2002	1,356	1,320
Analysis of total provisions:		
Current portion	175	1,320
Non-current portion	1,181	-
	1,356	1,320
At 1 January 2003	1,356	1,320
Additional provisions	204	-
Payments during the year	(175)	(2)
At 31 December 2003	1,385	1,318
Analysis of total provisions:		
Current portion	232	1,318
Non-current portion	1,153	-
	1,385	1,318
At 1 January 2004	1,385	1,318
Additional provisions	487	-
Payments during the year	(226)	(2)
At December 2004	1,646	1,316
Analysis of total provisions:		
Current portion	215	1,316
Non-current portion	1,431	-
	1,646	1,316
At 1 January 2005	1,646	1,316
Additional provisions	2	-
Payments during the period	(82)	-
At 30 June 2005	1,566	1,316
Analysis of total provisions:		
Current portion	197	1,316

Non-current portion	1,369	-
	1,566	1,316

a) Certain staff quarters, prior to 1998, have been sold to the Target Group's employees, subject to a number of eligibility requirements, at preferential prices. In 1998, the State Council of the PRC issued a circular which stipulated that the sale of quarters to employees at preferential prices should be terminated. In 2000, the State Council issued a further circular stating that cash subsidies should be made to certain eligible employees following the withdrawal of the allocation of staff quarters. However, the specific timetable and procedures for implementation of these policies were to be determined by individual provincial or municipal governments based on the particular situation of the provinces or municipality.

Based on the relevant detailed local government regulations promulgated, certain entities within the Target Group have adopted cash housing subsidy plans. In accordance with these plans, for those eligible employees who had not been allocated with quarters or who had not been allocated with quarters up to the prescribed standards before the discounted sales of quarters were terminated, the Target Group is required to pay them one-off cash housing subsidies based on their years of service, positions and other criteria. Based on the available information, the Target Group estimates the required provision for these cash housing subsidies amounts to RMB 1,324 million, which was charged to the combined income statement in the year ended 31 December 2000 when the State Council circular in respect of cash subsidies was issued.

b) Pursuant to the Reorganisation, if the actual payments required for these provisions differ from the amount provided as of 30 June 2005, China Netcom Group will bear any additional payments required or will be paid the difference if the actual payments are lower than the amount provided.

26 Deferred taxation

	As at 31 December 2002	As at 31 December 2003	As at 31 December 2004
Deferred tax assets			
Deferred revenue and installation cost	392	385	208
Other temporary differences primarily allowance for doubtful debts	133	215	273
Provision for early retirement provision benefits	448	457	543
Disposal of property, plant and equipment	681	874	-
Property, plant and equipment depreciation	-	-	325
Unrecognised revaluation surplus	-	-	-
Others	9	145	61
Balance at end of year/period	1,663	2,076	1,410
Deferred tax liabilities			
Property, plant and equipment depreciation	(2,226)	(2,496)	-
Interest capitalisation	(195)	(227)	(245)
Others	(76)	(36)	(10)
Balance at end of year/period	(2,497)	(2,759)	(255)

	The amounts shown in the combined balance sheet include the following:		
Deferred tax assets to be recovered after more than 12 months	1,279	648	1,029
Deferred tax liabilities to be settled after more than 12 months	(2,226)	(2,496)	(204)

Movements in deferred taxes for each of the years/periods are as follows:

	Note	Balance at 31 December 2001	Recognised in income statements	Recognised in owner's equity
Deferred tax assets				
Deferred revenue and installation cost		351	41	-
Other temporary differences primarily allowance for doubtful debts		106	27	-
Provision for early retirement provision benefits		457	(9)	-
Disposal of property, plant and equipment		361	320	-
Tax loss	(i)	-	310	(310)
Others		20	(11)	-
Balance at end of year		1,295	678	(310)
Deferred tax liabilities				
Property, plant and equipment depreciation		(2,076)	(150)	-
Interest capitalisation		(150)	(45)	-
Others		(34)	(42)	-
Balance at end of year		(2,260)	(237)	-
Net balance at end of year		(965)	441	(310)

	Note	Balance at 31 December 2002	Recognised in income statements	Recognised in owner's equity
Deferred tax assets				
Deferred revenue and installation cost		392	(7)	-
Other temporary differences primarily		133	82	-

allowance for doubtful debts				
Provision for early retirement provision benefits		448	9	-
Disposal of property, plant and equipment		681	193	-
Tax loss	(i)	-	253	(253)
Others		9	136	-
Balance at end of year		1,663	666	(253)
Deferred tax liabilities				
Property, plant and equipment depreciation		(2,226)	(270)	-
Interest capitalisation		(195)	(32)	-
Others		(76)	40	-
Balance at end of year		(2,497)	(262)	-
Net balance at end of year		(834)	404	(253)

	Note	Balance at 31 December 2003	Recognised in income statements	Recognised in owner's equity
Deferred tax assets				
Deferred revenue and installation cost		385	(177)	-
Other temporary differences primarily allowance for doubtful debts		215	58	-
Provision for early retirement provision benefits		457	86	-
Disposal of property, plant and equipment		874	(874)	-
Tax loss	(i)	-	704	(704)
Property, plant and equipment depreciation		-	325	-
Others		145	(84)	-
Balance at end of year		2,076	38	(704)
Deferred tax liabilities				
Property, plant and equipment depreciation		(2,496)	3,771	(1,275)
Interest capitalisation		(227)	(18)	-
Others		(36)	26	-
Balance at end of year		(2,759)	3,779	(1,275)
Net balance at end of year		(683)	3,817	(1,979)

	Note	Balance at 31 December 2004	Recognised in income statements	Recognised in owner's equity (ii)	Recognise in owner' equit (iii
Deferred tax assets					
Deferred revenue and installation cost		208	5	(9)	-
Other temporary differences primarily					

allowance for doubtful debts	273	88	(293)	-
Provision for early retirement provision benefits	543	(17)	(498)	-
Property, plant and equipment depreciation	325	95	(420)	-
Unrecognised revaluation surplus	-	(12)	-	843
Others	61	3	(52)	-
Balance at end of period	1,410	162	(1,272)	843
Deferred tax liabilities				
Interest capitalisation	(245)	(1)	196	-
Others	(10)	10	-	-
Balance at end of year/period	(255)	9	196	-
Net balance at end of year/period	1,155	171	(1,076)	843

Notes:

(i) This represents the net tax loss carry forward of the Target Group for the year. As the tax loss was utilised by the China Netcom Group in the same year, the utilisation of the deferred tax assets was reflected as a distribution to the owner in the combined statements of changes in owner's equity.

(ii) As described in Note 16, in connection with the Reorganisation, certain of the Target Group's telecommunications networks and equipment and furniture, fixture, motor vehicles and other equipment were revalued as at 31 December 2004. Such revalued amounts will be used to determine the tax bases for these assets for future years. In addition, in connection with the Reorganisation, the tax bases of certain assets and liabilities have been adjusted to the revalued amounts incorporated as the carrying values in the balance sheet, except for the item described in Note (iii) below. As a result, the Target Group's net deferred tax assets were subsequently decreased by RMB 1,076 million comprising deferred tax assets of RMB 1,272 million and deferred tax liabilities of RMB 196 million, and this decrease was recorded as a debit to owner's equity upon the date of the Reorganisation on 30 June 2005. RMB 1,097 million, being deferred tax liabilities originated from the revaluation surplus of fixed assets recorded, was credited to revaluation reserves and the remaining RMB 2,174 million deferred tax assets were debited to retained earnings.

(iii) In addition, the Target Group's lease prepayments for land and buildings were revalued for PRC tax purposes with a net surplus of RMB 2,553 million as at 31 December 2004 to determine the tax bases for future years. However, the resulting revaluations of lease prepayments for land and buildings were not incorporated in the combined financial statements. As a result, a deferred tax asset of RMB 843 million was subsequently recorded with a corresponding increase in owner's equity upon the Reorganisation on 30 June 2005. In the opinion of the directors, it is more likely than not that the Target Group will realise the benefits of the deferred tax asset after making reference to the historical taxable income of the Target Group. The revaluation amount is transferred to retained earnings upon the corresponding realisation of the underlying deferred tax assets. The amount of transfer to retained earnings for the six months ended 30 June 2005 was RMB 13 million.

27 Combined cash flow statements

(a) Reconciliation of profit/(loss) before taxation to net cash flows generated from operations:

	Years ended 31 December			Six mont
	2002	2003	2004	2004
Profit/(loss) before taxation	(325)	(193)	(10,202)	811
Depreciation of fixed assets and amortisation of intangible assets	5,988	6,317	6,426	3,196
Increase in deferred revenues	(1,079)	(952)	(757)	(472)
Increase/(decrease) in deferred costs	(43)	(48)	18	18
Deficit on revaluation of fixed assets	-	-	11,318	-
Allowance for doubtful debts	492	407	353	316
Loss/(gain) on disposal of fixed assets	1,520	535	67	29
Interest income	(28)	(16)	(11)	(5)
Interest expense	1,246	1,164	957	508
Impairment of property, plant and equipment and lease prepayments for land	-	149	-	-
Operating profit before working capital changes	7,771	7,363	8,169	4,401
Decrease/(increase) in accounts receivable	(191)	(385)	(698)	(413)
Decrease/(increase) in inventories and consumables	133	83	(93)	(118)
Decrease/(increase) in prepayments and other receivable	744	166	(443)	104
Increase/(decrease) in accounts payable	(323)	(372)	283	(18)
Increase/(decrease) in accruals and other payables	(832)	(135)	510	468
Net cash inflow generated from operations	7,302	6,720	7,728	4,424

(b) Major non-cash transactions

The Target Group entered into finance lease arrangements in respect of newly acquired property, plant and equipment with a total capital value at the inception of the lease of Nil, RMB 899 million, RMB 1,541 million, RMB 1,152 million and RMB 12 million for the year ended 31 December 2002, 2003 and 2004 and the six months ended 30 June 2004 and 2005.

28 Contingent liabilities

The Target Group has no contingent liabilities as at 31 December 2002, 2003 and 2004 and 30 June 2005.

29 Banking facilities

As at 31 December 2002, 2003 and 2004 and 30 June 2005, the Target Group's banking facilities are as follows:

	As at 31 December			As at 30 June
	2002	2003	2004	2005
Amount utilised	26,818	26,412	22,650	22,504
Amount unutilised	8,000	8,156	10,759	10,702

Aggregate banking facilities	34,818	34,568	33,409	33,206

30 Commitments

(a) Capital commitments

	As at 31 December			As at 30 June
	2002	2003	2004	2005
Contracted but not provided for				
Lease prepayments for land and buildings	27	33	90	77
Telecommunications networks and equipment	60	94	86	227
Others	3	1	6	1
	90	128	182	305

(b) Operating lease commitments

The Target Group has future minimum lease payments under non-cancellable operating leases in respect of premises and equipment as follows:

	As at 31 December		
	2002	2003	2004
Not later than one year	7	10	11
Later than one year and not later than five years	6	17	19
Later than five years	4	5	8
	17	32	38

31 Related party transactions

Parties are considered to be related if one party has the ability, directly or indirectly, to control the party or exercise significant influence over the party in making financial and operating decisions. Parties are also considered to be related if they are subject to common control or common significant influence.

China Netcom Group, the Target Group's parent company, is a state-controlled enterprise directly controlled by the PRC government. The PRC government is the Company's ultimate controlling party. Neither China Netcom Group nor the PRC government publishes financial statements available for public use.

All state-controlled enterprises, their subsidiaries, their key management and their close family, and their employees (collectively referred as "state-owned parties") are ultimately related parties of the Target Group. The Target Group has extensive transactions including provision and receiving of services, leasing of assets and obtaining finances, with these state-owned parties in its ordinary course of business. These transactions are carried out at terms similar to those with other non-state-owned parties and have been reflected in the Financial Information.

The Target Group's operations are subject to the supervision of and regulation by the PRC Government. The Ministry of Information Industry (the "MII"), pursuant to the authority delegated by the PRC's State Council, is responsible for formulating the telecommunications industry policies and regulations for all telecommunication operators in China. As a state-owned telecommunication operator, the Target Group has extensive transactions with other state-owned telecommunication operators in its ordinary course of business. These transactions are carried out in accordance with the rules and regulations stipulated by the MII of the PRC Government and disclosed below.

The Target Group has extensive transactions with other members of the China Netcom Group. As a result of this relationship, it is possible that the terms of the transactions between the Target Group and other members of the China Netcom Group are not the same as those that would result from transactions with other related parties or wholly unrelated parties.

Management believes that meaningful information relative to related party disclosures has been adequately disclosed.

	Note	For the year ended 31 December			For the ended
		2002	2003	2004	2004
Interconnection income					
- from utlimate holding company	v)b	-	-	2	-
- from fellow subsidiaries	v)b	-	-	2	-
- from other state-owned telecommunications operators	v)b	864	1,183	1,578	765
Sub total		864	1,183	1,582	765
Interconnection charges					
- from utlimate holding company	v)b	-	-	13	-
- from fellow subsidiaries	v)b	-	-	18	-
- from other state-owned telecommunications operators	v)b	139	139	204	95
Sub total		139	139	235	95
Rental income from properties leased to fellow subsidiaries	v)a,c	-	-	1	-
Purchase of materials					
- from fellow subsidiaries	v)a,b,c	585	726	814	249
- from related company	v)a,b,c	43	63	46	7
Sub total		628	789	860	256
Receipt of engineering, project planning, design, construction and information technology services					
- from fellow subsidaries	v)a	753	910	929	235
- from related company	v)a	67	56	64	25

Sub total		820	966	993	260
Ancillary telecommunications support services	i)				
- from fellow subsidaries	v)a,b,c	-	92	66	33
- from related company	v)a,b,c	71	-	-	-
Sub total		71	92	66	33
Payment of operating lease rentals of premises					
- from fellow subsidaries	v)a,c	4	4	5	-
- from related company	v)a,c	1	-	-	-
Sub total		5	4	5	-
Support services	ii)				
- from fellow subsidaries	v)a,b,c	401	466	230	106
- from related company	v)a,b,c	11	969	1,127	134
Sub total		412	1,435	1,357	240
Leased line revenue					
- from other state-owned telecommunications operators	v)b	514	275	172	90

Notes:

(i) Represents the provision of ancillary telecommunications support services to the Target Group by fellow subsidiaries and related companies. These services include certain telecommunications pre-sale, on-sale and after-sale services, certain sales agency services, the printing and delivery of invoice services, the maintenance of certain air-conditioning, fire alarm equipment and telephone booths and other customers services.

(ii) Represents the support services provided to the Target Group by the fellow subsidiaries and the related companies. These support services include equipment leasing services, motor vehicles services, safety and security services, conference services, basic construction agency services, equipment maintenance services, employee training services, advertising services, printing services and other support services.

(iii) As at the respective balance sheet dates, the Target Group had balances and finance lease arrangements with certain related parties, which have been set out in Notes 12, 20, 22(b)(ii) and 23.

(iv) The related parties represent the investees of the unlisted fellow subsidiaries.

(v) Transactions with individual related parties before reorganisation on 30 June 2005 were priced based on one of the following three criteria:

(a) market price;

(b) prices based on government guidance; or

(c) cost plus basis.

(vi) In connection with the Reorganisation, the Target Group and China Netcom Group entered into a number of agreements effective on the completion date of the Proposed Acquisition with an initial term expiring on 31 December 2007. The terms of the principal agreements are summarised as follows:

(a) The Target Group entered into Domestic Interconnection Settlement Agreements with China Netcom Group for interconnection of domestic and international long distance telephone calls. Pursuant to the said agreements, the telephony operator terminating a telephone call made to its local networks is entitled to receive a fee prescribed by MII from the operators from which the telephone call is originated.

(b) The Target Group entered into a Property Leasing Agreement with China Netcom Group pursuant to which the Target Group leases certain properties to/from China Netcom Group. The rental charges are based on market rates or depreciation charge and maintenance charge in respect of each property, provided that such depreciation and maintenance charge shall not be higher than the market rates.

(c) The Target Group entered into a Property Sub-leasing Agreement with China Netcom Group pursuant to which the Target Group leases certain properties from China Netcom Group which are owned by independent third parties. The rental charges are based on market rates negotiated between China Netcom Group and the relevant third parties.

(d) The Target Group entered into a Master Sharing Agreement with China Netcom Group pursuant to which expenses associated with common corporate services are allocated between the Target Group and China Netcom Group based on total assets as appropriate.

(e) The Target Group entered into an Engineering and Information Technology Services Agreement with China Netcom Group pursuant to which China Netcom Group provides the Target Group with engineering and information technology-related services. The amounts charged for these services are determined by reference to market rates as reflected in prices obtained through a tender.

(f) The Target Group entered into a Materials Procurement Agreement with China Netcom Group pursuant to which China Netcom Group provides the Target Group with the procurement of equipment and materials. The amount charged for this service is based on a percentage not exceeding 3% of the contract value of the equipment and materials purchased from domestic suppliers or 1% of the contract value of the equipment and materials purchased from overseas suppliers.

(g) The Target Group entered into an Ancillary Telecommunications Services Agreement with China Netcom Group. The ancillary telecommunications services provided by China Netcom Group include certain telecommunications pre-sale, on-sale and after-sale services, sales agency services and certain customer services. Pursuant to the said agreement, China Netcom Group charges the Target Group for these services in accordance with the following terms:

o The government fixed price;

o Where there is no government fixed price but a government guidance price exists, the government guidance price;

o Where there is neither government fixed price nor a government guidance price, the market price; or

o Where none of the above is applicable, the price to be agreed between the relevant parties, and determined on a cost-plus basis.

(h) The Target Group entered into a Support Services Agreement for various support services with China Netcom Group. The support services provided by China Netcom Group include equipment leasing and maintenance services, motor vehicles services, safety and security service, basic construction agency services, research and development services, employee training services and advertising services and other support services. Pursuant to the said agreement, China Netcom Group charges the Target Group for these services in accordance with the following terms:

o The government fixed price;

o Where there is no government fixed price but a government guidance price exists, the government guidance price;

o Where there is neither government fixed price nor a government guidance price, the market price; or

o Where none of the above is applicable, the price to be agreed between the relevant parties, and determined on a cost-plus basis.

(i) The Target Group entered into a Telecommunications Facilities Leasing Agreement with China Netcom Group pursuant to which the Target Group leases the international telecommunications facilities and inter-provincial transmission optic fibres from China Netcom Group. The lease payment is based on the depreciation charge of the assets, provided that such charges shall not be higher than market rates.

(vii) In addition, pursuant to the Reorganisation, China Netcom Group has agreed to hold and maintain, for the Target Group's benefit, all licenses received from the MII in connection with the Restructured Businesses transferred to the Group. The licences maintained by China Netcom Group were granted by the MII at nil or nominal costs. To the extent that China Netcom Group incurs a cost to maintain or obtain licences in the future, the Target BVI Company has agreed reimburse China Netcom Group for any such expense.

(viii) China Netcom Group has also agreed to indemnify the Target Group in connection with any tax and deferred tax liabilities not recognised in the financial statements of the Target Group and arisen from transactions prior to the date of Reorganisation.

(ix) As at the respective balance sheet dates, China Netcom Group granted corporate gurantee to the Target Group as set out in Note 22 (b) (i).

(x) China Netcom Group, the Target Group's ultimate holding company, entered into an agreement (the "Sponsorship Agreement") with Beijing Organisation Committee ("BOCOG") which designated China Netcom Group as the exclusive fixed-line telecommunications services partner in the People's Republic of China ("PRC") to sponsor the 2008 Beijing Olympic Games. China Netcom Group allocated the sponsorship fee to its members based on the estimated future benefits derived from the Sponsorship Agreement to respective members and the Target Group have contributed a portion of the required support under the Sponsorship Agreement through providing cash to BOCOG amounting to RMB 60 million. Accordingly, an intangible asset and a payable to the ultimate holding company of the said amount have been recognised on the Target Group's balance sheet.

32 Distributable reserves

As at 30 June 2005, the Target BVI Company had not been incorporated and hence there were no reserves available for distribution as at 30 June 2005.

33 Ultimate Controlling party

The Target BVI Company's ultimate holding company is China Netcom Group which is owned and controlled by the PRC Government.

The directors regard the PRC Government as being the ultimate controlling party.

(III) SUBSEQUENT ACCOUNTS

No audited accounts of the Target BVI Company or any of its subsidiaries have been prepared in respect of any period subsequent to 31 December 2004 up to date of this report. Save as disclosed in this report, no dividend or other distribution has been declared, made or paid by the Target BVI Company or any of its subsidiaries in respect of any period subsequent to 30 June 2005.

Yours faithfully,
PricewaterhouseCoopers
Certified Public Accountants
Hong Kong

APPENDIX III FINANCIAL INFORMATION OF THE GROUP

The following audited consolidated balance sheets of the Group as at 31 December 2002, 2003 and 2004 and the audited consolidated income statements, audited consolidated statements of changes in equity and audited consolidated statements of cash flows for the years ended 31 December 2002, 2003 and 2004 are derived from the audited financial statements of the Group prepared under HKFRS. The accompanying notes to the audited consolidated financial statements for the years ended and as at 31 December 2002 and 2003 are included in the prospectus of the Company dated 4 November 2004 ("the Prospectus"). The following unaudited consolidated balance sheet of the Group as at 30 June 2005 and the unaudited consolidated income statements, unaudited consolidated statements of changes in equity and unaudited consolidated statements of cash flows for the six months ended 30 June 2005 are unaudited and are extracted from the Company's 2005 interim results announcement. The Prospectus and the Company's 2005 interim results announcement are posted on the Company's website: www.china-netcom.com.

CONSOLIDATED BALANCE SHEETS

	As at 31 December		
	2002	2003	
	RMB million	RMB million	RMB
	(Audited)		
(Audited) (Audited) (Unaudited)			
ASSETS			
Current assets			
Cash and bank deposits	6,802	6,316	1
Short-term investments	2,665	1,506	
Accounts receivable	4,775	6,343	
Inventories and consumables	1,007	1,238	

Prepayments and other receivables	1,470	1,640	
Due from holding companies and fellow subsidiaries	672	449	
Total current assets	17,391	17,492	2
Non-current assets			
Fixed assets	146,164	133,919	12
Construction in progress	17,783	15,695	
Lease prepayments for land	-	-	
Intangible assets	273	184	
Deferred costs	5,149	7,872	
Deferred tax assets	2,652	2,784	
Long-term investments	880	880	
Interests in associated companies	90	90	
Derivative assets	-	-	
Other non-current assets	535	618	
Total non-current assets	173,526	162,042	14
Total assets	190,917	179,534	16
LIABILITIES AND EQUITY			
Current liabilities			
Accounts payable	13,302	14,786	1
Accruals and other payables	3,525	4,410	
Short-term bank loans	26,371	32,217	2
Current portion of long-term bank and other loans	14,089	15,716	
Due to holding companies and fellow subsidiaries	1,035	9,002	
Current portion of deferred revenues	7,028	7,229	
Current portion of provisions	3,098	3,083	
Taxation payable	381	428	
Total current liabilities	68,829	86,871	7
Net current liabilities	(51,438)	(69,379)	(5
Total assets less current liabilities	122,088	92,663	9
Non-current liabilities			
Long-term bank and other loans	29,480	22,309	2
Due to holding companies	-	4,750	
Deferred revenues	15,781	14,604	1
Provisions	2,623	2,341	
Deferred tax liabilities	10,872	4,213	
Derivative liabilities	-	-	
Other non-current liabilities	1,115	1,067	
Total non-current liabilities	59,871	49,284	3
Total liabilities	128,700	136,155	11
Minority interests	4	3	
Financed by:			
Share capital	1,819	1,819	
Reserves	60,394	41,557	5
Owners' equity	62,213	43,376	5
Total liabilities and equity	190,917	179,534	16

CONSOLIDATED INCOME STATEMENTS

	Years ended 31 December			Six months ended 30 June
	2002	2003	2004	2005
	RMB million	RMB million	RMB million	RMB million
	(Audited)	(Audited)	(Audited)	(Unaudited)
Revenues	54,443	59,898	64,922	33,724
Operating expenses				
Depreciation and amortisation	(18,808)	(20,483)	(18,754)	(9,265)
Network, operations and support	(10,578)	(11,990)	(11,591)	(5,549)
Staff costs	(6,433)	(7,547)	(8,041)	(4,200)
Selling, general and administrative expenses	(5,682)	(7,053)	(9,566)	(4,402)
Other operating expenses	(1,521)	(1,660)	(1,534)	(541)
Operating profit before interest income, dividend income and deficit on revaluation of fixed assets	11,421	11,165	15,436	9,767
Interest income	82	79	76	87
Dividend income	78	45	17	28
Deficit on revaluation of fixed assets	–	(25,778)	–	–
Profit/(loss) from operations	11,581	(14,489)	15,529	9,882
Finance costs	(2,848)	(3,026)	(2,932)	(1,226)
Share of loss of				
– Associated companies	(1)	(1)	(1)	–
– Jointly controlled entity	–	(415)	–	–
Profit/(loss) before taxation	8,732	(17,931)	12,596	8,656
Taxation	(2,212)	6,819	(3,348)	(2,298)
Profit/(loss) after taxation	6,520	(11,112)	9,248	6,358
Minority interests	–	1	–	–
Profit/(loss) for the year/period	6,520	(11,111)	9,248	6,358
Final dividend proposed after balance sheet date	–	–	259	–
Basic earnings/(losses) per share	RMB1.19	RMB(2.02)	RMB1.64	RMB0.96
Diluted earnings/(losses) per share	RMB1.19	RMB(2.02)	RMB1.63	RMB0.96

CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY

				Audited			
	Share capital RMB million	Share premium RMB million	Capital reserve RMB million	Statutory reserve RMB million	Revaluation reserve RMB million	Other reserve RMB million	Re ea m
Balance as at 1 January 2002	1,819	34,168	–	–	–	–	
Profit for the year	–	–	–	–	–	–	
Contributions from owners	–	–	–	–	–	–	
Distributions to owners	–	–	–	–	–	–	
Balance at 31 December 2002	1,819	34,168	–	–	–	–	
Balance as at 1 January 2003	1,819	34,168	–	–	–	–	
Loss for the year	–	–	–	–	–	–	(
Distributions to owners	–	–	–	–	–	–	
Revaluation surplus	–	–	–	–	2,982	–	
Revaluation tax credit	–	–	–	–	(984)	–	
Balance at 31 December 2003	1,819	34,168	–	–	1,998	–	
Balance as at 1 January 2004	1,819	34,168	–	–	1,998	–	
Profit for the year	–	–	–	–	–	–	
Appropriation to statutory reserve	–	–	–	723	–	–	
Movement of deferred tax recognised in equity	–	–	–	–	846	2,355	
Transfer to retained earnings	–	–	–	–	(697)	(241)	
Contributions from owners	–	–	–	–	–	–	
Distributions to owners	–	–	–	–	–	–	
Net assets distributed to owners in accordance with reorganisation in	–	–	–	–	–	–	

connection to global offering						
Distribution to an owner upon assignment of loan	-	-	-	-	-	-
Transfer to capital reserve upon reorganisation in connection to global offering	-	-	265	-	-	-
Issue of shares through global offering, net of issue expenses	362	8,582	-	-	-	-
Balance as at 31 December 2004	2,181	42,750	265	723	2,147	2,114

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY
FOR THE SIX MONTHS ENDED 30 JUNE 2005

				Unaudited			
	Share capital RMB million	Share premium RMB million	Capital reserve RMB million	Statutory reserve RMB million	Revaluation reserve RMB million	Other reserve RMB million	Re ea m
Balance as at 31 December 2004, as previously reported	2,181	42,750	265	723	2,147	2,114	
Effects of adoption of new HKFRSs:							
Share-based payment	-	-	18	-	-	-	
Balance as at 31 December 2004, as restated	2,181	42,750	283	723	2,147	2,114	
Negative goodwill	-	-	-	-	-	-	
Foreign exchange contracts	-	-	-	-	-	-	
Balance as at 1	2,181	42,750	283	723	2,147	2,114	

January 2005 as restated						
Profit for the period	-	-	-	-	-	-
Share-based payment	-	-	48	-	-	-
Dividends to shareholders	-	-	-	-	-	-
Appropriation to statutory reserve	-	-	-	3,378	-	-
Transfer to retained earnings	-	-	-	-	(417)	(28)
Foreign currency translation adjustment	-	-	-	-	-	5
Balance as at 30 June 2005	2,181	42,750	331	4,101	1,730	2,091

CONSOLIDATED STATEMENTS OF CASH FLOWS

	Years ended 31 Dec	
	2002	20
	RMB million	RMB milli
	(Audited)	(Audite
Cash flows from operating activities		
Net cash inflows generated from operations	28,024	28,8
Interest received	82	
Dividends received	78	
Interest paid	(2,789)	(2,6
Profit tax paid	(1,467)	(9
Net cash inflow from operating activities	23,928	25,3
Cash flows from investing activities		
Purchase of fixed assets and construction in progress	(25,814)	(28,5
Sales of fixed assets	768	7
Sales of other investments	274	1,1
Net (increase)/decrease in time deposits with maturity over three months	(109)	
Investment in Asia Netcom	-	(5
Purchase of additional interest in Asia Netcom	-	
Purchase of other investments	(1,041)	(
Net cash outflow from investing activities	(25,922)	(27,0
Cash flow from financing activities		

New bank loans and other loans	48,495	63,0
Repayment of bank loans	(43,208)	(64,6
Capital element of finance lease payments	(88)	(1
Advance from owners	-	4,7
Contribution received from owners	507	
Payment of distribution to owners	(3,972)	(1,8
Loans to fellow subsidiaries and related parties	-	
Issues of shares through Global Offering, net of issue expenses	-	
Net cash inflow/(outflow) from financing activities	1,734	1,2
(Decrease)/increase in cash and cash equivalents	(260)	(4
Cash and cash equivalents at beginning of year/period	6,950	6,6
Cash and cash equivalents at end of year/period	6,690	6,2

CONDENSED CONSOLIDATED STATEMENT OF CASH FLOWS

	Six months ended 30 June 2005 RMB million (Unaudited)
Net cash inflow from operating activities	13,907
Net cash outflow from investing activities	(5,737)
Net cash outflow from financing activities	(9,433)
Decrease in cash and cash equivalents	(1,263)
Cash and cash equivalents at beginning of period	10,033
Cash and cash equivalents at end of period	8,770

The following consolidated balance sheets of the Group as at 31 December 2004 together with the consolidated income statements of the Group for the year ended 31 December 2004 have been restated to reflect the impact of the adoption of the new and revised HKFRS which are effective for accounting periods beginning on or after 1 January 2005.

CONSOLIDATED BALANCE SHEETS

	As at 31 ecember 2004 RMB million (Restated)	As at 30 June 2005 RMB million (Unaudited)
ASSETS		
Current assets		
Cash and bank deposits	10,053	8,790
Short-term investments	2,876	439
Accounts receivable	5,688	6,778
Inventories and consumables	941	502
Prepayments and other receivables	1,006	1,079
Due from holding companies and fellow subsidiaries	373	489
Total current assets	20,937	18,077

Non-current assets		
Property, plant and equipment	124,787	122,689
Construction in progress	7,602	9,172
Lease repayments for land	1,266	1,291
Intangible assets	316	926
Deferred costs	7,449	6,250
Deferred tax assets	2,394	2,881
Derivative assets	-	2
Other non-current assets	424	11
Total non-current assets	144,238	143,222
Total assets	165,175	161,299
LIABILITIES AND EQUITY		
Current liabilities		
Accounts payable	14,653	13,281
Accruals and other payables	3,353	3,698
Short-term bank loans	29,339	26,425
Current portion of long-term bank and other loans	7,270	4,263
Due to holding companies and fellow subsidiaries	8,244	8,469
Current portion of deferred revenues	6,653	6,196
Current portion of provisions	2,596	2,480
Taxation payable	196	2,656
Total current liabilities	72,304	67,468
Net current liabilities	(51,367)	(49,391)
Total assets less current liabilities	92,871	93,831
Non-current liabilities		
Long-term bank and other loans	21,861	18,280
Deferred revenues	11,817	10,528
Provisions	2,143	2,080
Deferred tax liabilities	1,321	1,354
Derivative liabilities	-	83
Other non-current liabilities	564	22
Total non-current liabilities	37,706	32,347
Total liabilities	110,010	99,815
Financed by:		
Share capital	2,181	2,181
Reserves	52,984	59,303
Owners' equity	55,165	61,484
Total liabilities and equity	165,175	161,299

CONSOLIDATED INCOME STATEMENTS

	For the year ended 31 December 2004 RMB million	For the s months end 30 June 20 RMB milli

	(Restated)	(Audite
Revenues	64,922	32,4
Operating expenses		
Depreciation and amortisation	(18,754)	(9,5
Network, operations and support	(11,591)	(5,1
Staff costs	(8,059)	(4,2
Selling, general and administrative expenses	(9,566)	(4,1
Other operating expenses	(1,534)	(7
Total operating expenses	(49,504)	(23,9
Operating profit before interest income dividend income	15,418	8,5
Interest income	76	
Dividend income	17	
Profit from operations	15,511	8,6
Finance costs	(2,932)	(1,6
Share of loss of associated companies	(1)	
Profit before taxation	12,578	6,9
Taxation	(3,348)	(2,1
Profit for the year/period	9,230	4,8

The details of the changes of accounting policies are set out in the Interim Announcement. The impact of the change to accounting policies on the Group's profit before taxation was as follows:

	For the six months ended 30 June 2004	For the year ended 31 December 2004
	RMB million	RMB million
HKFRS 2	-	18
Decrease in profit before taxation for the period/year	-	18

The following notes to the financial statements are extracted from the Company's 2004 annual report and should be read in conjunction with the audited consolidated financial statements included in such annual report.

1 The group, its reorganisation and principal activities

Background of the group

China Netcom Corporation (Hong Kong) Limited (the "Company") was incorporated in the Hong Kong Special Administrative Region ("Hong Kong") of the People's Republic of China ("PRC") on October 22, 1999 as a limited liability company under the Hong Kong Companies Ordinance. Prior to a reorganisation conducted for the listing of the shares of the Company (the "Reorganisation"), the Company's ultimate holding company was China Netcom (Holdings) Company Limited ("China Netcom Holdings").

China Netcom Holdings was previously owned by four state-owned enterprises and became the Company's holding company in December 2000. The Company, through its principal operating subsidiary China Netcom (Group) Limited ("CNC China"), is engaged in the provision of fixed line telecommunication services through different regional branch offices in the PRC. In March 2003, the Company along with two co-investors through Asia Netcom Corporation Limited ("Asia Netcom"), being a 51% owned jointly controlled entity of the Company at that time, acquired the Asia-Pacific submarine cable assets and related physical network assets and liabilities, from Asia Global Crossing Ltd. On December 31, 2003, the Company further purchased the remaining 49% interests in Asia Netcom held by the other co-investors and became the sole owner of Asia Netcom.

Reorganisation of the group

In anticipation of the listing of the Company's shares and American Depository Shares ("ADSs") on The Stock Exchange of Hong Kong and the New York Stock Exchange Inc. respectively (the "Global Offering"), China Netcom Holdings and China Network Communications Group Corporation (the "China Netcom Group") both being state owned enterprises under the supervision and regulation of the Ministry of Information Industry ("MII"), underwent the Reorganisation which was effective for accounting purposes on June 30, 2004 (see Note 2). Immediately after the Reorganisation, the ultimate holding company of the Company was China Netcom Group.

China Netcom Group, the Company's current ultimate holding company, was established by the State Council of the PRC in May 2002. Under a comprehensive industry restructuring plan relating to the fixed line telecommunication sector in China approved by the State Council in November 2001, the fixed line telecommunications businesses originally operated by China Telecommunication Corporation ("China Telecom Group") were split into northern and southern operations. In May 2002, China Netcom Group took over the northern part fixed line telecommunication operations in 10 provinces, municipalities and autonomous regions.

The Reorganisation undertaken in anticipation of the listing of the Company comprised the following:

(a) China Netcom Group acquired the entire interest in China Netcom Holdings from its four state owners and became the ultimate holding company of the Group;

(b) The Company's principal operating subsidiary, namely CNC China, transferred all of its assets and liabilities in the PRC telecommunications operations to China Netcom Group, and assets and liabilities of the PRC fixed line telecommunications operations previously owned by both China Netcom Group and the Company were combined in the respective provinces, municipalities and autonomous regions;

(c) After excluding certain assets and liabilities which were retained by China Netcom Group as set out in (f) (i) below, the net assets of the telecommunications operations of 8 PRC provinces and municipalities, namely Beijing Municipality, Tianjin Municipality, Hebei Province, Henan Province, Shandong Province, Liaoning Province, Shanghai Municipality and Guangdong Province (collectively referred to as the "Eight Service Regions"), which had been valued at RMB43,012 million, based on an independent valuation, were injected into the Company in consideration of approximately 5,442 million ordinary shares (21,769 million shares before share consolidation, see Note 32(b) for details) of the Company (the "Asset Injection").

(d) Certain Asia-Pacific submarine cable assets and related physical network assets and liabilities were transferred from Asia Netcom to China Netcom Group.

(e) The Company and its subsidiaries (the "Group"), immediately after the Reorganisation, contained the assets and liabilities related to: (i) fixed line telecommunication operations in the Eight Service Regions; and (ii) fixed line telecommunication operations in the Asia-Pacific region operated by Asia Netcom (collectively the "Restructured Businesses").

(f) China Netcom Group, immediately after the Reorganisation, retained or held the following assets and liabilities: (i) certain assets and liabilities of the Eight Service Regions including fixed assets, mainly inter-provincial optic fibers, investments in associated companies, long-term investments, bank balances and borrowings and those attributable to certain minor ancillary telecommunications services; (ii) all assets and liabilities of the fixed line telecommunication operations outside the Eight Service Regions; (iii) all non-core businesses representing businesses other than the principal communications services operations in the Group's northern and southern service regions and primarily include procurement of materials, equipment maintenance services, engineering, project planning and design and operations of certain social facilities and (iv) the Asia-Pacific submarine cable assets and related physical network transferred from Asia Netcom (collectively the "Retained Businesses").

The above reorganisation procedures primarily resulted in a net effect of (i) the transfer from China Netcom Group to the Company of the assets and liabilities of the telecommunications operations in the Eight Service Regions, which were previously owned by China Netcom Group prior to the Reorganisation; and (ii) the transfer from the Company to China Netcom Group of certain assets and liabilities of the telecommunications operations outside the Eight Service Regions and the Asia-Pacific submarine cable assets and related physical network, which were previously owned by the Group prior to the Reorganisation.

The shares of the Company were listed on The Stock Exchange of Hong Kong Limited on November 17, 2004 and the ADSs of the Company were listed on The New York Stock Exchange Inc. on November 16, 2004.

Principal activities

After the Reorganisation, the Group is a dominant provider of fixed line telephone services, broadband, other Internet-related services, and business and data communications services in six northern municipalities and provinces, namely Beijing Municipality, Tianjin Municipality, Hebei Province, Henan Province, Shandong Province and Liaoning Province in the PRC. The Group also provides telecommunications services to selected business and residential customers in a southern municipality and a southern province, namely Shanghai Municipality and Guangdong Province in the PRC. In addition, the Group operates a network and offers international data services throughout the Asia Pacific countries and regions.

After the Reorganisation, the Group's principal services consist of:

o fixed line telephone services (including the personal handy phone system (PHS) services), comprising:

- local, domestic long distance and international long distance services;

- value-added services, including caller identity, telephone information services; and

- interconnection services provided to other domestic telecommunications service providers including the fellow subsidiary owned by China Netcom Group operating outside the Eight Service Regions;

o broadband services and other Internet-related services;

o business and data communications services, including integrated regional data and voice communications services; and

o international services consisting of international voice services, including international inbound calls destined for the PRC or transit through the PRC or other Asia-Pacific countries and regions, and leased line, Internet access, managed data and other telecommunications services provided to business and carrier customers located outside the PRC.

The Group's PRC operations are subject to the supervision of and regulation by the PRC Government. The MII, pursuant to the authority delegated by the PRC's State Council, is responsible for formulating the telecommunications industry policies and regulations (the "Telecommunications Regulations").

Under the Telecommunications Regulations, all telecommunications operators in the PRC must obtain a telecommunications service operating license from the MII or from the provincial telecommunications administrations. Providers of value-added services within a single province are required to obtain licenses from provincial telecommunications administrations. Providers of basic telecommunications services and providers of value-added services in two or more provinces, autonomous regions and municipalities are required to obtain licenses from the MII. In accordance with the approval of the MII, CNC China, the Group's principal operating subsidiary in China, as an indirect subsidiary of China Netcom Group, has the right to operate the Group's telecommunications business in Eight Service Regions under the authorisation of China Netcom Group, which holds the license required for operating the Group's telecommunications businesses in the PRC.

Following the Reorganisation, China Netcom Group continues to be the holder of the licenses for operating a telecommunications network in China, but has, with the consent of the MII, granted CNC China the right to operate under its licenses, the assets described above and the related business. The Company is the holder of licenses that are necessary to own and operate the assets that are outside the PRC described above in such key countries and regions such as Hong Kong, Japan, Singapore and Korea.

2 Basis of presentation

The Reorganisation was effective for accounting purposes on June 30, 2004, which was the date on which the Company and China Netcom Group signed the legally binding agreements that identified (i) all specific assets and liabilities under the Asset Injection to be transferred to the Company from China Netcom Group and (ii) the specific assets and liabilities to be transferred from Asia Netcom to China Netcom Group.

China Netcom Group and China Netcom Holdings were both state-owned enterprises before and after the Reorganisation, and the acquisition of China Netcom Holdings by China Netcom Group was carried out under the directive of the State Council. Accordingly, the Reorganisation was regarded as a common control transaction and accounted for using merger accounting, as permitted by the Hong Kong Statement of Standard Accounting Practice 27 "Accounting for group reconstructions", and the assets and liabilities injected into the Company by China Netcom Group under Note 1 (c) above have been stated at historical amounts. The consolidated financial statements present the consolidated results and financial position of the Group as if China Netcom Holdings and China Netcom Group had been merged throughout the periods presented and as if the Restructured Businesses were injected into the Company from China Netcom Group at the beginning of the earliest periods presented or when such businesses were acquired by the Group or China Netcom Group, whichever is later. The consolidated financial statements do not include the results and financial position of businesses previously owned by China Netcom Group outside the Eight Service Regions which had been retained by China Netcom Group upon the Reorganisation.

Prior to the consummation of the Reorganisation, the assets and liabilities of the PRC telecommunications operations, both within and outside the Eight Service Regions of the Company held through CNC China, the Company's principal operating subsidiary, had been historically under common management and control. Therefore, the Group's consolidated income statements for the years ended December 31, 2003 and 2004 and consolidated balance sheets as at December 31, 2003 include the entire consolidated financial data of the PRC operations of CNC China up to the effective date of the Reorganisation although the assets and liabilities of operations of CNC China outside the Eight Service Regions had been transferred to China Netcom Group under the Reorganisation as set out in Note 1 above. In addition, the consolidated balance sheet as at December 31, 2003 also includes the assets and liabilities of the Eight Service Regions in the PRC which had been retained by China Netcom Group under the Reorganisation (see Note 1 (f) (i) above) and the assets and liabilities that were transferred from Asia Netcom to China Netcom Group under the Reorganisation (see Note 1 (f) (iv) above) as those assets and liabilities were part of the telecommunications operations and were not separately managed throughout the periods presented. The above assets and liabilities retained by, or transferred to, China Netcom Group but included in the financial statements as at year ended December 31, 2003 and the amounts of such assets and liabilities distributed to owners on June 30, 2004 as a result of the Reorganisation were as follows:

	June 30, 2004 RMB million	As at December 31, 2003 RMB million
Assets and liabilities:		
Current assets	1,915	2,637
Fixed assets, net		
- Land and buildings	10,169	10,276
- Telecommunications networks and equipment	6,760	7,089
- Furniture, fixtures, motor vehicles and other equipment	251	216
	17,180	17,581
Construction in progress	1,401	2,057
Interest in associated companies and long-term investments	969	970
Other non-current assets	281	396
Current liabilities	(5,830)	(7,618)
Non-current loans and other borrowings	(5,153)	(4,979)
Other non-current liabilities	(4,716)	(4,833)
Net assets	6,047	6,211

	For the six months ended June 30, and the year ended December 31, 2004 RMB million	For the year ended December 31, 2003 RMB million
Revenues	479	802

Operating expenses, mainly comprising:		
Depreciation and amortisation	(276)	(240)
Networks, operations and support	(272)	(409)
Staff costs	(64)	(65)
Selling, general and administrative	(138)	(257)
Other operating income/(expenses)	28	(71)
Finance costs	(248)	(496)
Loss for the period/year	(486)	(740)

Accounting principles and standards

The financial statements have been prepared in accordance with Hong Kong Financial Reporting Standards ("HKFRS") issued by the Hong Kong Institute of Certified Public Accountants ("HKICPA") and accounting principles generally accepted in Hong Kong. They have been prepared under the historical cost convention modified by the revaluation of certain fixed assets and the marking to fair values of certain investments as explained in the principal accounting policies below in Note 3 below, and on a going concern basis.

The HKICPA has issued a number of new and revised HKFRSs which are effective for accounting periods beginning on or after January 1, 2005. The Group has not early adopted these new and revised HKFRSs in the financial statements for the year ended December 31, 2004. The Group has commenced an assessment of the impact of these new and revised HKFRSs, but is not yet in a position to state whether these new and revised HKFRSs would have a significant impact on its results of operations and financial position.

A significant percentage of the Group's funding requirements is achieved through short term borrowings. Consequently, the balance sheet indicates a significant working capital deficit. In the past, a substantial portion of the Group's short term borrowings have been rolled over upon maturity. Based on the Group's history of obtaining finance, its relationships with its bankers and its operating performance, the directors consider that the Group will continue to be able to roll over such short term financing, or will be able to obtain sufficient alternative sources of financing to enable it to operate and meet its liabilities as and when they fall due.

3 Principal accounting policies

The principal accounting policies adopted in the financial statements are set out below:

(a) Basis of consolidation

As set out in Note 2 above, the Reorganisation involved the injection of businesses from the Group's ultimate holding company into the Group and was accounted for using merger accounting in accordance with SSAP No.27 issued by the HKICPA. The results and financial position of businesses merged under the Reorganisation were included in the consolidated financial statements as if the businesses were acquired at the beginning of the earliest periods presented or the date that such businesses were acquired by the Group or China Netcom Group whichever was later.

Acquisitions of subsidiaries from third parties are accounted for using purchase accounting. The results and financial positions of such subsidiaries acquired or disposed of during the year are included in the consolidated income statements from the effective date of acquisition or up to the effective date of disposal, as appropriate.

All significant intercompany transactions and balances within the Group are eliminated on consolidation.

Minority interests represent the interests of outside shareholders in the operating results and net assets of subsidiaries.

(b) Subsidiaries

Subsidiaries are those entities in which the Company, directly or indirectly, controls the composition of the board of directors, controls more than half the voting power, or holds more than half of the issued share capital.

In the Company's balance sheet, the investment in subsidiaries are stated at cost less provision for impairment losses. The results of subsidiaries are accounted for by the Company on the basis of dividends received and receivable.

(c) Jointly controlled entities

A jointly controlled entity is a joint venture which involves the establishment of a corporation, partnership or other entity in which each venturer has an interest. A joint venture is a contractual arrangement whereby the Group and other parties undertake an economic activity which is subject to joint control and none of the participating parties has unilateral control over the economic activity. A jointly controlled entity controls the assets of the joint venture, incurs liabilities and expenses and earns income. It may enter into contracts in its own name and raise finance for the purposes of the joint venture activity. Each venturer is entitled to a share of the results of the jointly controlled entity under the equity method of accounting.

The consolidated income statements include the Group's share of the results of jointly controlled entities under the equity method of accounting.

(d) Associated companies

An associated company is a company, not being a subsidiary or a jointly controlled entity, in which an equity interest is held for the long-term and significant influence is exercised in its management.

The consolidated income statements include the Group's share of the results of associated companies for the year, and the consolidated balance sheets include the Group's share of the net assets of the associated companies and any unamortised goodwill (net of accumulated amortisation) on acquisition.

Equity accounting is discontinued when the carrying amount of the investment in an associated company reaches zero, unless the Group has incurred obligations or guaranteed obligations in respect of the associated company.

(e) Revenue recognition

(i) The Group's revenues are recognized as follows:

o Revenues derived from local, domestic long distance ("DLD") and international long distance ("ILD") telephone usage, which vary depending on the day, the time of day, the distance and duration of the call and the tariffs, are recognised when the services are provided to customers.

o Monthly telephone service fees are recognised in the period during which the telephone services are provided to customers.

o Upfront connection and installation fees received are deferred and recognised over the expected customer relationship period of 10 years. With effect from July 1, 2001, no further upfront fees for connection were charged to customers.

o Revenues from the sale of prepaid calling cards are deferred and recognised as the cards are consumed by customers.

o Revenues from PHS bundled service contracts are recognised as local, DLD, or ILD service fees according to the type of usage and on a systematic basis to match the pattern of usage of the PHS services by customers. PHS bundled service contracts comprise the provision of PHS services and handsets to customers, under which customers either prepay a certain amount of service fee or commit to spend a minimum monthly service fee for a designated period in order to receive a free handset (see Note 3(t)(ii) for the policy on cost of the handset).

o Revenues from value-added communication services such as call waiting, call diverting and caller number display are recognised when the services are provided to customers.

o Revenues from the provision of broadband and other Internet-related services and managed data services are recognised when the services are provided to customers.

o Interconnection fees from domestic and foreign telecommunications operators are recognised when the services are rendered as measured by the minutes of traffic processed.

o Lease income from the leasing of lines and customer-end equipment is recognised over the term of the lease. Lease income from other domestic telecommunications operators and business customers for the usage of the Group's fixed line telecommunications networks is measured by the number of lines leased and the agreed upon rate per line leased. The lease arrangements are primarily determined on a year to year basis.

(ii) Interest income

Interest income is recognised on a time proportion basis, taking into account the principal amounts outstanding and the interest rates applicable.

(iii) Dividend income

Dividend income is recognised when the right to receive payment is established.

(f) Interest expenses

Interest expenses that are attributable to the acquisition, construction or production of an asset that necessarily takes a substantial period of time to get ready for its intended use or sale are capitalised as part of the cost of that asset.

All other interest expenses are charged to the consolidated income statements in the year in which they are incurred.

(g) Interconnection charges

Interconnection charges represent amounts incurred for the use of other telecommunications operators' networks for facilitating the completion of calls that originate from the Group's fixed line telecommunications networks. Interconnection charges are recognised on an accrual basis. For interconnection charges with domestic operators and the fellow subsidiaries of the Group, they are accrued based on actual amounts, while those with overseas operators are accrued based on the actual amounts, if known, or the Group's estimates.

(h) Translation of foreign currencies

Transactions in foreign currencies are translated at exchange rates ruling at the transaction dates. Monetary assets and liabilities expressed in foreign currencies at the balance sheet dates are translated at rates of exchange ruling at the balance sheet dates. Exchange differences arising in these cases are dealt with in the consolidated income statement.

The balance sheets of subsidiaries and associated companies expressed in foreign currencies are translated at the rates of exchange ruling at the balance sheet dates and the respective income statement accounts are translated at the average exchange rates for the year. Exchange differences are dealt with as a movement in reserves.

(i) Cash and cash equivalents

Cash and cash equivalents, comprising cash on hand, deposits held at call with banks and cash investments with original maturities of three months or less are carried at cost.

(j) Accounts receivable

Accounts receivable are carried at original amounts less provisions for doubtful debts. The provision for doubtful debts is recorded if there is objective evidence that the Group will not be able to collect all amounts due according to the original term of the accounts receivable.

(k) Inventories and consumables

Inventories comprise mainly telephone handsets and are stated at the lower of cost and net realisable value on a first-in, first-out basis, after provisions for obsolescence.

Consumables consist of materials and supplies used in maintaining the Group's telecommunication networks and are charged to the income statement when brought into use. Consumables are valued at cost less any provision for obsolescence.

(l) Fixed assets

(i) Construction-in-progress

Construction-in-progress represents buildings, telecommunications networks plant, transmission and switching equipment under construction and pending installation, and is stated at cost less any provision for impairment losses. Cost comprises direct costs of construction including borrowing costs attributable to the construction during the period of construction. When the asset being constructed becomes available for use, the construction-in-progress is transferred to the appropriate category of fixed assets.

(ii) Other fixed assets

Fixed assets are initially stated at cost less accumulated depreciation and accumulated impairment losses. Major costs incurred in restoring fixed assets to their normal working condition are charged to the income statement as incurred. Improvements are capitalised and depreciated over their expected useful lives.

Land and buildings, subsequent to initial recognition, are stated at cost less accumulated impairment losses and are depreciated over their expected useful lives.

Subsequent to the revaluation carried out as at December 31, 2003, which was based on depreciated replacement costs (Note 18), fixed assets other than land and buildings are carried at their revalued amounts, being the fair values at the date of revaluation, less subsequent accumulated depreciation and impairment losses. When an item of fixed asset is revalued, any accumulated depreciation at the date of the revaluation is restated proportionately together with the change in the gross carrying amount of the asset so that the carrying amount of the asset after revaluation equals its revalued amount.

(iii) Revaluations

Revaluations on fixed assets other than land and buildings will be performed at intervals of not more than three years by independent valuers; in each of the intervening years valuations will be undertaken by executives of the Group. Increases in valuation are credited to the revaluation reserve. Decreases in valuation are first set off against any revaluation surplus arising from earlier valuations in respect of the same item and thereafter are debited to operating profit. Any subsequent increases are credited to operating profit up to the amount previously debited.

(iv) Depreciation

Fixed assets are depreciated at rates sufficient to write off their costs or revalued amounts less accumulated impairment losses and estimated residual values over their estimated useful lives on a straight-line basis. The principal useful lives are as follows:

Land	over the term of the lease, being 10-50 years
Buildings	8-30 years
Telecommunications networks and equipment	5-10 years
Furniture, fixtures, motor vehicles and other equipment	5-10 years

The useful lives are reviewed periodically to ensure that the methods and rates of depreciation are consistent with the expected pattern of economic benefits from fixed assets.

(v) Gain or loss on sale of fixed assets

The gain or loss on disposal of a fixed asset is the difference between the net sales proceeds and the carrying amount of the relevant asset, and is recognised in the income statement, except where the fixed asset is carried at valuation, the relevant portion of the revaluation reserve realised in respect of previous valuations is transferred to retained earnings and is shown as a movement in reserves.

(m) Impairment of assets

At each balance sheet date, both internal and external sources of information are considered to assess whether there is any indication that assets are impaired. If any such indication exists, the recoverable amount of the asset is estimated and where relevant, an impairment loss is recognised to reduce the asset to its recoverable amount. Estimated recoverable amounts are determined based on estimated discounted future cash flows of the cash-generating unit at the lowest level to which the asset belongs. The recoverable amount is the higher of value in use or net selling price. Such impairment losses are recognised in the income statement, except where the asset is carried at valuation and the impairment loss does not exceed the revaluation surplus for that same asset, in which case the impairment loss is treated as a revaluation decrease and charged to the revaluation surplus.

(n) Assets under leases

(i) Finance leases

Leases that substantially transfer to the Group all of the risks and rewards of ownership of assets are accounted for as finance leases. Finance leases are capitalised at the inception of the lease at the lower of the fair value of the leased assets or the present value of the minimum lease payments. Each lease payment is allocated between the capital and finance charges so as to achieve a constant rate on the capital balances outstanding. The corresponding rental obligations, net of finance charges, are included in long-term liabilities. The finance charges are charged to the income statement over the lease periods. Assets held under finance leases are depreciated over the shorter of their estimated useful lives or the lease periods.

(ii) Operating leases

Leases where substantially all of the risks and rewards of ownership of the assets remain with the leasing company are accounted for as operating leases. Payments made under operating leases, net of any incentives received from the leasing company, are charged to the income statement on a straight-line basis over the lease periods.

(o) Intangible assets

(i) Goodwill

Goodwill represents the excess of the cost of an acquisition over the fair value of the Group's share of the net assets of the acquired subsidiary, jointly controlled entity or associated company, at the date of acquisition. Goodwill on acquisitions is included in intangible assets and is amortised using the straight-line method over its estimated useful life of not more than 20 years.

(ii) Negative goodwill

Negative goodwill represents the excess of the fair value of the Group's share of the net assets acquired over the cost of acquisition. Negative goodwill is presented in the same balance sheet classification as goodwill. Negative goodwill, not exceeding the fair values of the non-monetary assets acquired, is recognised in the income statement over the remaining weighted average useful life of those assets; negative goodwill in excess of the fair values of those non-monetary assets is recognised in the income statement immediately.

(iii) Purchased software

Expenditure on purchased software is capitalised and amortised using the straight-line method over the expected useful lives of the software, which vary from three to five years.

(p) Investments

(i) Long-term investments

Long-term investments comprise unlisted investment securities that are held for long term purposes. Such investments are stated at cost less any provision for impairment losses.

(ii) Short-term investments

Short-term investments comprise listed securities held for trading purposes and are carried at fair value. At each balance sheet date, the net unrealised gains or losses arising from the changes in fair value of short-term investments are recognised in the income statement. Profits or losses on disposal of short-term investments, representing the difference between the net sales proceeds and the carrying amounts, are recognised in the income statement as they arise.

(q) Provisions

Provisions are recognised when the Group has a present legal or constructive obligation as a result of past events, it is probable that an outflow of resources will be required to settle the obligation, and a reliable estimate of the amount can be made. Where the Group expects a provision to be reimbursed, the reimbursement is recognised as a separate asset but only when the reimbursement is virtually certain.

(r) Employee benefits

(i) Pension obligations

(a) As stipulated by the regulations of the PRC, the subsidiaries in the PRC participate in basic defined contribution pension plans organised by their respective municipal governments under which they are governed. The Group is required to make contributions to the retirement plans at rate of 20% of the salaries, bonuses and certain allowances of the employees. Employees in the PRC are entitled to retirement benefits equal to a fixed proportion of their salary at their normal retirement age. The Group has no other material obligation for post-retirement benefits beyond these payments as they fall due. Payments made under these plans are expensed as incurred.

(b) The Group also operates a mandatory provident fund scheme ("the MPF scheme") under the Hong Kong Mandatory Provident Fund Schemes Ordinance for employees employed under the jurisdiction of the Hong Kong Employment Ordinance. The MPF scheme is a defined contribution retirement scheme administered by independent trustees. Under the MPF scheme, the employer and its employees are each required to make contributions to the scheme at 5 per cent. of the employees' relevant income, subject to a cap of monthly relevant income of HK$20,000.

(ii) Early retirement benefits

Early retirement benefits are recognised as expenses when the Group reaches agreement with the relevant employees for early retirement.

(iii) Employee housing benefits

One-off cash housing subsidies paid to employees are charged to the consolidated income statements in the year in which it is determined that the payment of such subsidies is probable and the amounts can be reasonably estimated (see Note 30(a)).

Full-time employees of the Group participate in various government-sponsored housing funds. The Group contributes on a monthly basis to these funds based on certain percentages of the salaries of the employees. The Group's liability in respect of these funds is limited to the contributions payable in each period. Contributions to these housing funds are expensed as incurred.

(iv) Share option scheme

Share options are granted to directors and to certain employees at the directors' discretion. When the options are exercised, no change is recorded to the income statement and the proceeds received net of any transaction costs are credited to share capital (nominal value) and share premium.

(s) Deferred taxation

Deferred taxation is provided in full, using the liability method, on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the financial statements. Taxation rates enacted or substantially enacted at the balance sheet date are used to determine deferred taxation. Deferred tax assets are recognised to the extent that it is probable that future taxable profit will be available against which the temporary differences can be utilised.

(t) Deferred costs

(i) Deferred installation costs

The direct incremental costs associated with the installation of fixed line services are deferred and amortised to the income statement over the expected customer relationship period of 10 years except when the direct incremental costs exceed the corresponding upfront installation fees. In such cases, the excess of the direct incremental costs over the installation fees is recorded immediately as expenses in the income statement.

(ii) Customer acquisition costs

The cost of handsets given to customers under bundled service contracts and related commissions paid to distributors are deferred as customer acquisition costs and amortised to the income statement on a systematic basis to match with the pattern of the customer service income over the contract period.

(iii) Prepaid network capacities

Prepayments for the network capacities purchased on an indefeasible rights to use ("IRU") basis are capitalised and amortised over the corresponding lease period.

(iv) Discount on foreign currency exchange forward contracts

The unamortised portion of the discount on foreign currency exchange forward contracts (see Note(w)) is recognised as deferred cost.

(u) Contingent liabilities

A contingent liability is a possible obligation that arises from past events and whose existence will only be confirmed by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the Group. It can also be a present obligation arising from past events that is not recognised because it is not probable that an outflow of economic resources will be required or the amount of obligation cannot be measured reliably.

A contingent liability is not recognised but is disclosed in the notes to the financial statements. When a change in the probability of an outflow occurs so that the outflow is probable, the contingent liability will then be recognised as a provision.

A contingent asset is a possible asset that arises from past events and whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain events not wholly within the control of the Group.

(v) Segmental reporting

Business segments provide services that are subject to risks and returns that are different from other business segments. Geographical segments provide services within a particular economic environment that is subject to risks and returns that differ from those of components operating in other economic environments. Currently the Group has one business segment, the provision of fixed line telecommunications services. Less than 10% of the Group's assets and operations are located outside the PRC. Accordingly, no business and geographical segment information is presented.

(w) Foreign currency exchange forward contracts

A foreign currency exchange forward contract is an agreement to exchange different currencies at a specified future date and at a specified rate. A non-speculative foreign currency exchange forward contract is one which is designated and effective as a hedge of a net investment in a foreign entity, of a foreign currency asset, or of a net monetary asset or liability. All other foreign currency exchange forward contracts, or parts of foreign currency exchange forward contracts in excess of the amount hedged, are speculative. Where a foreign currency exchange forward contract is non-speculative and used as a hedge of a net monetary asset or liability, the gain or loss on the contract, being the foreign currency amount of the contract multiplied by the difference between the spot rate at the balance sheet date and the spot rate at the date of inception of the contract or at an intervening balance sheet date, is taken to the income statement. The discount or premium on the contract, being the foreign currency amount of the contract multiplied by the difference between the contracted forward rate and the spot rate at the date of inception of the contract, is amortised over the period of the contract. In the balance sheet, unamortised discounts are recorded within deferred costs and unamortised premiums are recorded within deferred revenues.

Where a foreign currency exchange forward contract is speculative, the gain or loss, being the foreign currency amount of the contract multiplied by the difference between the forward rate for the balance of the contract at the balance sheet date and either the contracted forward rate or the forward rate used at an intervening balance sheet date, is credited or charged to the income statement at each intervening balance sheet date.

(x) Earnings/(loss) per share ("EPS") and per ADS

Basic EPS is computed by dividing net profit/(loss) attributable to ordinary shareholders by the weighted average number of ordinary share outstanding during the year.

Diluted EPS is computed by dividing net profit/(loss) attributable to shareholders by the weighted average number of ordinary and dilutive ordinary equivalent shares outstanding during the year. Ordinary equivalent shares consist of ordinary shares issuable upon the exercise of outstanding stock options using the treasure stock method.

Earnings/(loss) per ADS is computed by multiplying the EPS by 20, which is the number of shares represented by each ADS.

4 Revenues

Revenues represent the turnover of the Group and are derived from the provision of fixed line telecommunications and related services, net of the PRC business taxes and government levies. The Group's revenues by nature can be summarised as follows:

	Years ended 2004 RMB million
Revenues	
Local usage fees	18,661
Monthly telephone service	13,743

Upfront installation fees	1,338
DLD usage fees	8,813
ILD usage fees	1,302
Value-added services	2,146
Interconnection fees	4,915
Upfront connection fees	3,378
Broadband and other Internet-related service	5,418
Managed data service	1,526
Leased line income	2,321
Other services	1,361
Total	64,922

The Group's revenues by geographical location of the customers can be summarised as follows:

	Years ended 2004 RMB million
Domestic telecommunications services (Being revenues generated from customers located in the PRC)	
Local usage fees	18,661
Monthly telephone service	13,743
Upfront installation fees	1,338
DLD usage fees	8,813
ILD usage fees	1,121
Value-added services	2,146
Interconnection fees	3,903
Upfront connection fees	3,378
Broadband and Internet-related service	5,058
Managed data service	1,217
Leased line income	1,825
Other services	1,076
Subtotal	62,279
International telecommunications services (Being revenues generated from customers located outside the PRC, including Hong Kong and Macau Special Administrative Regions and Taiwan)	
ILD usage fees	181
Interconnection fees	1,012
Broadband and other Internet-related service	360
Managed data service	309
Leased line income	496
Other services	285
Subtotal	2,643
Total	64,922

5 Profit/(loss) from operations

Profit/(loss) from operations is stated after charging or crediting the following:

	Years ended 2004 RMB million
Charging	
Deficit on revaluation of certain fixed assets (Note 18(c))	-
Depreciation:	
- Owned fixed assets	18,451
- Leased fixed assets	174
Loss on disposal of fixed assets (included in networks operations and support expenses)	145
Amortisation of intangible assets (Note 20)	129
Contributions to pension plans (included in staff costs)	813
Early retirement benefits (included in staff costs)	206
Cost of inventories	374
Operating leases:	
- Land and buildings	571
- Network and machinery	1,542
Interconnection charges	2,411
Bad debt expense	832
Auditors' remuneration	18
Unrealised loss on short-term investments	4
Unrealised foreign exchange losses	70
Crediting	
Realised gain on disposal of short-term investments	-
Unrealised gain on short-term investments	-

6 Finance costs

	Years ended 2004 RMB million
Interest expenses on	
- Bank and other loans wholly repayable within five years	3,127
- Bank and other loans wholly repayable after more than five years	88
	3,215
Less: Interest expenses capitalised in construction-in-progress	(421)
	2,794
Exchange loss, net	70
Bank charges	50
Amortisation of discount on foreign currency exchange forward contracts	18
	2,932
Interest expenses were capitalised in construction in progress using the following annual interest rates	3.69%-5.45%

7 Taxation

	Years ended 2004 RMB million
PRC enterprise income tax ("EIT")	2,786
Deferred taxation (Note 31)	562
Share of taxation attributable to jointly controlled entity	-
Taxation charges/(credit)	3,348

The provision for EIT is calculated based on the statutory income tax rate of 33% on the assessable profit of each of the entities now comprising the Group in the PRC as determined in accordance with the relevant income tax rules and regulations in the PRC.

Taxation on profits derived from certain subsidiaries and the jointly controlled entity outside the PRC, including Hong Kong, has been calculated on the estimated assessable profit at the rates of taxation ranging from 17.5% to 30%, prevailing in the countries in which those entities operates.

The reconciliation between the Group's actual tax charge/(credit) and the amount which is calculated based on the weighted average statutory tax rate is as follows:

	Years ended 2004 RMB million
Profit/(loss) before taxation	12,596
Weighted average statutory tax rate	33.00%
Tax calculated at the weighted average statutory tax rate	4,157
Non-taxable income (Note below)	(1,264)
Expenses not deductible for tax purposes	252
Tax losses not recognised/(utilised)	356
Others	(153)
Tax charge/(credit)	3,348

Note: Non-taxable income comprises primarily upfront connection fees charged to customers and amortised over the customer relationship period.

8 Profit/(loss) attributable to shareholders

(a) For the year ended December 31, 2004, profit attributable to shareholders included a loss of RMB41 million (2003: a profit of RMB19 million) which has been dealt with in the financial statements of the Company.

(b) One of the Company's subsidiaries (refer to Note 22) CNC China was registered as foreign investment enterprises in the PRC. In accordance with the Articles and Association of CNC China, it is required to provide for certain statutory reserves, namely, general reserve and staff bonus and welfare fund, which are appropriated from profits after tax but before dividend distribution.

CNC China is required to allocate at least 10% of their profits after tax determined under PRC GAAP to the general reserve fund until the cumulative amounts reach 50% of the registered capital. The statutory reserve can only be used, upon obtained from the relevant authority, to offset accumulated losses or increase capital.

Accordingly, CNC China appropriated approximately RMB723 million (2003: Nil) to the general reserve fund for the year ended December 31, 2004.

9 Final dividend proposed after balance sheet date

Final dividend proposed after the balance sheet date of HK$0.037 per share

The final dividend proposed after the balance sheet date has not been recognised as a dividend payable as of December 31, 2004 but will be reflected as appropriation of retained profits in the financial statements for the year ending December 31, 2005.

10 Earnings/(loss) per share

Basic earnings/(loss) per share is computed using the weighted average number of ordinary shares outstanding during the year. Diluted earnings/(loss) per share is computed using the weighted average number of ordinary shares and potential ordinary shares outstanding during the year.

The following table sets forth the computation of basic and diluted net earnings/(loss) per share:

	Years ende 2004 (in RMB mi share and p
Numerator:	
Profit/(loss) for the year	9,248
Denominator:	
Weighted average number of ordinary shares outstanding and shares used in computing basic earnings/(loss) per share	5,622,685,175
Weighted average number of potential ordinary shares:	
Diluted equivalent shares arising from convertible Preference Shares	5,140,036
Diluted equivalent shares arising from share options	2,209,241
Shares used in computing diluted earnings/(loss) per share	5,630,034,452
Basic earnings/(loss) per share	RMB 1.64
Diluted earnings/(loss) per share	RMB 1.63

The diluted loss per share for the year ended December 31, 2003 is the same as the basic loss per share as all potential ordinary shares are anti-dilutive.

All the number of shares stated above have taken into consideration the effect of the share consolidation conducted on September 7, 2004 as set out in note 32(a).

11 Staff cost including directors' remunerations

	Years ended 2004 RMB million
Wages, salaries and welfare	7,022
Contributions to pensions	813
Early retirement benefits	206
Total	8,041

12 Directors' and senior management's emoluments

(a) Directors' emoluments

The following table sets out the emoluments paid to the Company's directors during the years:

	Years ended 2004 RMB million
Fees	1
Basic salaries, housing allowances, other allowances and benefits in kind	7
Contributions to retirement schemes	-
	8

Directors' fees disclosed above include HK$312,500 (2003: Nil) paid to independent non-executive direcrtors. The number of directors whose emoluments fell within the following bands are set out as follows:

	Years ended 2004
Nil - RMB 1,060,000 (equivalent of HK$1,000,000)	12
RMB 1,060,001 - RMB 3,710,000 (equivalent of HK$3,500,000)	-
RMB 3,710,001 - RMB 4,240,000 (equivalent of HK$4,000,000)	1

(b) Five highest paid individuals

The five individuals whose emoluments were the highest for the years ended December 31, 2004 (2003: one) include three directors whose emoluments are reflected in the analysis presented above. The emoluments payable to the remaining individuals are as follows:

	Years ended 2004 RMB million
Basic salaries, housing allowances, other allowances and benefits in kind	3
Contributions to retirement schemes	-
	3

The number of the remaining individuals whose emoluments fell within the following bands is set out as follows:

	Years ended 2004
Nil - RMB 1,060,000 (equivalent of HK$1,000,000)	1
RMB1,060,001 - RMB 2,650,000 (equivalent of HK$2,500,000)	-
RMB 2,650,001- RMB 3,180,000 (equivalent of HK$3,000,000)	1

(c) None of the directors and 5 highest paid individuals received any fees, bonuses, inducements, or compensation for loss of office, or waived any emoluments during 2003 and 2004 .

13 Cash and bank deposits

	Years ended 2004 RMB million
Cash and cash equivalents	10,033
Time deposits with original maturities over three months	20
Total cash and bank deposits	10,053

Included in the cash and bank deposits as at the end of each of December 31, 2003 and 2004 are Renminbi denominated balances kept in the PRC amounting to RMB 5,631 million and RMB 1,868 million, respectively. The conversion of Renminbi denominated balances into foreign currencies and the remittance of bank balances and cash out of the PRC are subject to the rules and regulation of foreign exchange control promulgated by the PRC government.

14 Short-term investments

The Group and the Company's short-term investments comprise primarily investments in listed debt securities and investment funds.

15 Accounts receivable

Amounts due from the provision of fixed line telecommunications services to residential and business customers are due within 30 days from the date of billing. Residential and business customers who have accounts overdue by more than 90 days will have their services disconnected. Accounts receivable from other telecommunications operators and customers are due between 30 to 90 days from the billing date.

The ageing analysis of accounts receivable based on the billing date is as follows:

	As at Dec 2004 RMB million
0-30 days	4,479
31-90 days	861
Over 90 days	1,404
Total	6,744
Less: Allowance for doubtful debts	(1,056)
Net carrying amounts	5,688

The movement of allowance for doubtful debts is as follows:

	As at Dec 2004 RMB million
Balance at beginning of year	1,051
Additional provisions	852
Less: Amounts utilised	(798)
Distributed to owners in accordance with Reorganisation	(49)
Balance at end of year	1,056

16 Inventories and consumables

	As at Dec 2004 RMB million
Consumables, at cost	607
Telephone handsets and other customer end-products held for resale, at cost	334
	941

17 Prepayments and other receivables

	Group As at December 31, 2004	2003	Company As at 2004
	RMB million	RMB million	RMB million
Prepaid expenses and deposits	546	648	8
Other receivables	460	992	8
	1,006	1,640	16

18 Fixed assets

	Land and buildings	Telecommu- nications networks and equipment	Furniture, fixtures, motor vehicles and other equipment
	RMB million	RMB million	RMB million
Cost/valuation:			
Balance at January 1, 2003	27,121	190,535	7,761
Additions	393	2,381	307
Acquired through Asia Netcom (Note 35(c))	-	3,298	-
Transferred from construction in progress (Note 19)	1,892	24,062	1,286
Disposals	(408)	(5,676)	(498)
Increase as a result of revaluation	-	6,456	655
Decrease as a result of revaluation	-	(40,124)	(2,034)
Balance at December 31, 2003	28,998	180,932	7,477
Accumulated depreciation:			
Balance at January 1, 2003	(4,852)	(71,392)	(3,009)
Charge for the year	(716)	(18,520)	(1,148)
Acquired through Asia Netcom (Note 35(c))	-	(261)	-
Disposals	103	3,622	434
Increase as a result of revaluation	-	(3,693)	(436)
Decrease as a result of revaluation	-	15,696	684
Balance at December 31, 2003	(5,465)	(74,548)	(3,475)
Net book value at December 31, 2003	23,533	106,384	4,002
Cost/valuation:			
Balance at January 1, 2004	28,998	180,932	7,477
Additions	200	115	234
Transferred from construction in progress (Note 19)	1,479	24,160	1,561
Disposals	(51)	(812)	(75)
Distributed to owners in accordance with Reorganisation	(12,827)	(9,265)	(325)
Balance at December 31, 2004	17,799	195,130	8,872
Accumulated depreciation:			
Balance at January 1, 2004	(5,465)	(74,548)	(3,475)

Charge for the year	(756)	(16,791)	(1,078)
Disposals	2	591	64
Distributed to owners	2,658	2,505	74
Balance at December 31, 2004	(3,561)	(88,243)	(4,415)
Net book value at December 31, 2004	14,238	106,887	4,457

(a) The net book value of assets held under finance lease is as follows:

	Land and buildings	Telecommu- nications networks and equipment	Furniture, fixtures, motor vehicles and other equipment
	RMB million	RMB million	RMB million
At December 31, 2003	-	715	2
At December 31, 2004	-	1,763	7

During the year ended December 31, 2004, the Group entered into a finance lease arrangement with a related party with certain existing fixed assets to obtain funding of RMB1,085 million. The net book value of such fixed assets included above amounted to RMB954 million and the corresponding finance lease obligation amounted to RMB1,070 million as at December 31, 2004 (see note 27(b)(ii)).

(b) The analysis of the cost or revaluation of the assets of the Group is as follows:

	Land and buildings	Telecommu- nications networks and equipment	Furniture, fixtures, motor vehicles and other equipment
	RMB million	RMB million	RMB million
At December 31, 2003			
Cost	28,998	-	-
Valuation	-	180,932	7,477
	28,998	180,932	7,477
At December 31, 2004			
Cost	17,799	-	-
Valuation	-	195,130	8,872
	17,799	195,130	8,872

The Group's land and buildings are primarily located in the PRC and held on leases of primarily between 10 to 50 years.

(c) As detailed in Note 3 (I) (ii), except for land and buildings, fixed assets were carried at revalued amounts on December 31, 2003. As required by the PRC rules and regulations relevant to the Reorganisation, each class of fixed assets in the PRC injected into the Group as at December 31, 2003, was valued by Beijing China Enterprise Appraisal Co. Ltd. (the "PRC valuer"), independent valuers registered in the PRC, on a depreciated replacement cost basis. The value of such fixed assets in the PRC injected into the Group was determined at RMB122,456 million. The fixed assets retained by the ultimate holding company, which were transferred based on their carrying values upon the Reorganisation, were valued by the Directors at an amount of RMB17,581 million as at December 31, 2003. The impact of the revaluation was a net deficit on revaluation of the fixed assets, other than land and buildings, totalling RMB 22,796 million. Such revalued amounts serve as the tax base for such assets for future years following the revaluation (see Note 31).

The land and buildings were also revalued and the result was a net surplus of RMB 6,967 million. Such revaluation on land and buildings serves as the tax base for land and buildings for future years following the revaluation, and has not been incorporated in the consolidated financial statements (see Note 31(ii)).

The land and buildings injected by China Netcom Group were valued separately by Sallmanns, independent qualified valuers in Hong Kong, as at December 31, 2003 on the basis of their open market value. The value arrived at by these valuers was consistent with that arrived at by the PRC valuers. The Group's land and buildings are carried at their cost less accumulated depreciation and impairment losses in the consolidated financial statements.

The respective carrying amount of the telecommunications networks and equipment and furniture, fixtures, motor vehicles and other equipment would have been RMB 128,049 million and RMB 5,133 million as at December 31, 2003 and RMB 101,433 million and RMB 4,103 million as at December 31, 2004 had they been stated at cost less accumulated depreciation.

The historical carrying amounts of the Group's fixed assets, as at December 31, 2003, and where applicable the corresponding revalued amounts of these assets are as follows:

	Historical carrying amount RMB million	Revaluation surplus RMB million	Revaluation deficit RMB million	RM
At December 31, 2003				
Land and buildings	23,533	-	-	
Telecommunications networks and equipment	128,049	2,763	(24,428)	
Furniture, fixture, motor vehicles and other equipment	5,133	219	(1,350)	
	156,715	2,982	(25,778)	

The directors have carried out a review of the Group's fixed assets and concluded that there was no impairment of fixed assets as at December 31, 2004, nor was there any significant change in the value of fixed assets at that date.

At December 31, 2003 and 2004, the net book value of fixed assets pledged as security for the Group's long term bank and other loans amounted to RMB 2,668 million and RMB 22 million respectively.

19 Construction in progress

	As at Dec 2004 RMB million
Balance at beginning of year	15,695
Additions	20,979
Transferred to fixed assets (Note 18)	(27,200)
Distributed to owners in accordance with the Reorganisation on June 30, 2004	(1,401)
Balance at end of year	8,073

20 Intangible assets

	Goodwill/ (Negative goodwill) RMB million	Purchased software RMB million
Cost:		
Balance at January 1, 2003	3	660
Additions	-	191
Negative goodwill on acquisition of certain entities of Asia Global Crossing through Asia Netcom (See note below)	(296)	-
Acquisition of additional 49% interest in Asia Netcom (Note 35(c))	115	-
Balance at December 31, 2003	(178)	851
Accumulated amortisation:		
Balance at January 1, 2003	(2)	(388)
Amortisation for the year	-	(99)
Balance at December 31, 2003	(2)	(487)
Net book value at December 31, 2003	(180)	364
Cost:		
Balance at January 1, 2004	(178)	851
Additions	-	261
Balance at December 31, 2004	(178)	1,112
Accumulated amortisation:		
Balance at January 1, 2004	(2)	(487)
Amortisation for the year	14	(143)
Balance at December 31, 2004	12	(630)
Net book value at December 31, 2004	(166)	482

Note:

On March 10, 2003, Asia Netcom, the Group's 51% jointly controlled entity at that time, acquired certain entities from Asia Global Crossing (details see Note 35(c)). The unamortised negative goodwill of RMB 296 million arising from the aforementioned acquisition has been consolidated into the Group through Asia Netcom upon the acquisition of the remaining 49% interest of Asia Netcom, which became a wholly owned subsidiary of the Group on December 31, 2003.

21 Deferred costs

	As at Dec 2004 RMB million
Balance at beginning of year	
- Installation costs	4,708
- Customer acquisition costs	1,370
- Prepaid networks capacities	1,248
- Discount on foreign currency exchange forward contracts	77
- Others	469
	7,872
Additions for the year	
- Installation costs	634
- Customer acquisition costs	1,940
- Prepaid network capacity	
- additions	254
- acquired through Asia Netcom (Note 35(c))	-
- Discount on foreign currency exchange forward contracts	-
- Others	425
	3,253
Charge for the year	
- Installation costs	(1,068)
- Customer acquisition costs	(2,006)
- Prepaid network capacities	(119)
- Discount on foreign currency exchange forward contracts	(18)
- Others	(291)
	(3,502)
Distributed to owners in accordance with Reorganisation on June 30, 2004	
- Prepaid network capacity	(61)
- Others	(113)
	(174)
Balance at end of year	
- Installation costs	4,274
- Customer acquisition costs	1,304
- Prepaid network capacities	1,322
- Discount on foreign currency exchange forward contracts	59
- Others	490
	7,449

22 Investments in subsidiaries

	Com
	As at Dec
	2004
	RMB million
Investment in subsidiaries, at cost	37,509

As at December 31, 2004, the Company direct and indirect interests in the following principal subsidiaries, all of which are private companies:

Company name	Place and date of incorporation/ establishment	Issued and fully paid up/registered capital	Percentage of equity interest attributable to the Group	Principal and place operation
Directly held:				
China Netcom (Group) Company Limited (formerly know as "China Netcom Corporation Limited") (note(a))	PRC August 6, 1999	Registered capital of RMB150 million	100%	Provision networks communicat services i
China Netcom Corporation International Limited (note(b))	Bermuda October 15, 2002	12,000 ordinary shares of US$1.00 each	100%	Investment in Bermuda
Indirectly held:				
Asia Netcom Corporation Limited (note(c))	Bermuda October 15, 2002	120,000,000 ordinary shares of US$ 0.01 each	100%	Investment in Bermuda
China Netcom (Hong Kong) Operations	Hong Kong May 2, 2001	1,000 ordinary shares of US$1.00	100%	Provision netwo