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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

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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.

The Stock Exchange of Hong Kong Limited takes no responsibility for the contents of this circular, makes no representation as to its accuracy or completeness and expressly disclaims any liability whatsoever for any loss howsoever arising from or in reliance upon the whole or any part of the contents of this circular.

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 Citigroup Global Markets Goldman Sachs (Asia)
Corporation (Hong Kong) Limited Asia Limited 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:

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| | |
|-------------------------------------|--|
| "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 Acquisition |
| "ADSS" | American depository 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 generally open in Hong Kong for the transaction of normal banking business |
| "China" or "PRC" | the People's Republic of China (excluding, for the purposes of this circular, Hong Kong, Macau and Taiwan) |
| "China Mobile" | China Mobile Communications Corporation ([GRAPHIC OMITTED]), a company established under the laws of the PRC |
| "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]), a company established under the laws of the PRC |
| "China Unicom" | China United Telecommunications Corporation ([GRAPHIC OMITTED]), a company established under the laws of the PRC |
| "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 Group |
| "Companies Ordinance" | the Companies Ordinance (Chapter 32 of the Laws of Hong Kong) |
| "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 |

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| "CSFB" or "Independent Financial Adviser" | "Letter from the Chairman" 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 2005 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 thereof |
| "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 Kong Institute of Certified Public Accountants |
| "Hong Kong" | Hong Kong Special Administrative Region of the People's Republic of China |
| "Hong Kong Listing Rules" | the Rules Governing the Listing of Securities on The Stock 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 Directors formed to advise the Independent Shareholders in respect of the Acquisition and the Non-exempt Continuing Connected Transactions |
| "Independent Shareholders" | Shareholders other than China Netcom Group and its Associates |
| "Latest Practicable Date" | 8 September 2005, being the latest practicable date prior to the printing of this circular for ascertaining certain information contained herein |
| "MII" | Ministry of Information Industry of the PRC ([GRAPHIC OMITTED]) or where the context so requires, its predecessor, the Ministry of Posts and Telecommunications ([GRAPHIC OMITTED]) |
| "MOC" | the Ministry of Commerce of the PRC ([GRAPHIC OMITTED]) |
| "Non-exempt Continuing Connected Transactions" | continuing connected transactions contemplated under the Domestic Interconnection Settlement Agreement, the International Long Distance Voice Services Settlement Agreement, the Engineering and Information Technology Services Settlement Agreement and the Materials Procurement Agreement, |

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| | |
|------------------------------------|--|
| "Option(s) " | such transactions and agreements are further described in the section headed "Continuing Connected Transactions" of the "Letter from the Chairman" 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 Corporation 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 the Target BVI Company and the Target Company |
| "Target Group" | the regions in which the Target Company operates its business, being Heilongjiang Province, Jilin Province, Neimenggu Autonomous Region, and Shanxi Province of the PRC |
| "Target Regions" | |
| "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)

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

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

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

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

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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 Acquisition, 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

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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.

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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.

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| | For the year ended 31 December 2004 | | | For the six months en June 2005 | |
|--|---|---|----------------------|--|--|
| | Before Acquisition | | After Acquisition | Before Acquisition | |
| | 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) Including: Personal Handyphone System ("PHS") subscribers (in thousands) | 80,383 | 27,696 | 108,079 |
| Broadband subscribers (in thousands) | 15,073 | 7,051 | 22,124 |
| | 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

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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

| China Network |
| Communications |

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| | | |
|--------------------------------|---------------------------|--------------------------|
| Group Corporation | | |
| ("China Netcom Group") | | |
| (PRC) (3) | | |
| ----- | | |
| 100% | | |
| ----- | | |
| China Netcom Group | Five PRC Shareholders(1) | Public Shareholders(1) |
| Corporation (BVI) Limited | | |
| ("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 Municipality | |
| | : - Guangdong Province | |

Corporate structure immediately following completion of the Acquisition

| | | |
|---------------------------|--------------------------|---------------------|
| ----- | | |
| China Network | | |
| Communications | | |
| Group Corporation | | |
| ("China Netcom Group") | | |
| (PRC) (3) | | |
| ----- | | |
| 100% | | |
| ----- | | |
| China Netcom Group | Five PRC Shareholders(1) | Public Shareholders |
| Corporation (BVI) Limited | | |

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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 Municipality | | |
| : | : - Guangdong Province | | |
| : Operating in: (4) | | | |
| :- Heilongjiang Province | | | |
| :- Jilin Province | | | |
| :- Neimenggu Autonomous Region | | | |
| :- Shanxi Province | | | |

Corporate structure after completion of the Acquisition and the merger by absorp

| | | | |
|---------------------------|--------------------------|--|---------------------|
| ----- | | | |
| China Network | | | |
| Communications | | | |
| Group Corporation | | | |
| ("China Netcom Group") | | | |
| (PRC) (3) | | | |
| ----- | | | |
| 100% | | | |
| ----- | | | |
| China Netcom Group | Five PRC Shareholders(1) | | Public Shareholders |
| Corporation (BVI) Limited | | | |

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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 Municipality | | |
| : - Guangdong Province | | |
| :- 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.

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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 |
|---|------------------------|----------|----------|------------|
| | 2002 | 2003 | 2004 | June |
| | RMB | RMB | RMB | 2004 |
| | million | million | million | 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 | 2003 | 2004 |
| | RMB | RMB | RMB |
| | million | million | million |
| Assets | | | |

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| | | | |
|---|--------------|--------------|--------------|
| 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.

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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

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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

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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

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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

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(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.

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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

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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:

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(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:

- 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 a 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.

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.

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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:

- 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 a 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.

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:

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- 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 a 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.

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)

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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

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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 - 35 100 |
| Property Sub-leasing Agreement | payable by the Combined Operating Group |
| Master Sharing Agreement | 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

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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

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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

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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

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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

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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

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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.

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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

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(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

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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.

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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.

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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 Acquisition1") 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,

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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:

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- 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 months ended June 30, 2012 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, 2012 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

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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

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- 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

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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 services 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

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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.

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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;

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(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

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(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
Managing Director

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;

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- 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 | | 2005 | |
| | Amount | Percentage of revenue | Amount | Percentage of revenue | Amount | Percentage of revenue | Amount | Percentage of revenue | Amount | Percentage of revenue |
| (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 | 3,188 | 33.9 |
| Monthly fees | 3,482 | 21.5 | 3,896 | 22.0 | 4,221 | 22.7 | 2,122 | 22.8 | 2,100 | 22.8 |
| Upfront installation fees | 203 | 1.3 | 223 | 1.3 | 230 | 1.2 | 118 | 1.3 | 118 | 1.3 |
| Subtotal | 9,552 | 58.9 | 10,237 | 57.9 | 10,648 | 57.2 | 5,395 | 58.0 | 5,406 | 58.0 |
| Domestic long distance(2) | 2,524 | 15.5 | 2,554 | 14.4 | 2,453 | 13.2 | 1,247 | 13.4 | 1,210 | 13.4 |
| International long distance(2)(3) | 134 | 0.8 | 133 | 0.8 | 113 | 0.6 | 57 | 0.6 | 57 | 0.6 |
| Value-added services | 277 | 1.7 | 579 | 3.3 | 847 | 4.5 | 396 | 4.3 | 540 | 5.8 |
| Interconnection fees from domestic carriers | 864 | 5.3 | 1,183 | 6.7 | 1,582 | 8.5 | 765 | 8.2 | 870 | 9.2 |
| Upfront connection fees(4) | 1,280 | 7.8 | 1,157 | 6.4 | 968 | 5.2 | 512 | 5.5 | 390 | 4.2 |
| Subtotal | 14,631 | 90.0 | 15,843 | 89.5 | 16,611 | 89.2 | 8,372 | 90.0 | 8,496 | 90.0 |
| Broadband and other Internet-related services | | | | | | | | | | |
| Broadband | 279 | 1.7 | 663 | 3.7 | 1,034 | 5.6 | 478 | 5.1 | 730 | 7.8 |

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| | | | | | | | | | |
|---|--------|-------|--------|-------|--------|-------|-------|-------|------|
| services (including broadband access such as DSL and LAN services) | | | | | | | | | |
| Other | 214 | 1.4 | 176 | 1.1 | 114 | 0.6 | 67 | 0.7 | 4 |
| Internet-related services | | | | | | | | | |
| 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 | | |
|--|--|---------|---------|
| | 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 |

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| | | | |
|--|-------|-------|---------|
| 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.

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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 percentages) | | |
| 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

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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

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| | 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

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| | 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.

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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.

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"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

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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

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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.

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| | 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

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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.

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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

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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

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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:

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

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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

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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

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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

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| | | Years ended 31 December | | | Six months Jun 2004 |
|---|-------|-------------------------|----------|----------|---------------------------|
| | Note | 2002 | 2003 | 2004 | 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.

| | | As at 31 December | | |
|---|------|-------------------|--------|--------|
| | Note | 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 |

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| | | | | |
|---|-------|--------------|--------------|--------------|
| 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) |

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| | | | |
|---|-----------|---------|------------|
| 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 2004 |
|--|-------|-------------------------|---------|---------|---------------------------|
| | Note | 2002 | 2003 | 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) |

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| | | | | |
|--|----------|----------|----------|----------|
| 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 |
| | | | 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;

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(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

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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.

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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

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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)

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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.

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- 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 telecommunications operators' network for facilitating the completion of calls that originate from the Target Group's fixed line telecommunications 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

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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 depreciation 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

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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

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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 acquisition 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)

Provision 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

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| | 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 |
|---|-------------------------|-------|-------|------------|
| | 2002 | 2003 | 2004 | Ju 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) | - | - | - | - |

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Foreign exchange gains - - - 11

8 Finance costs

| | Years ended 31 December | | | Six months ended 31 December |
|---|-------------------------|-------|-------|------------------------------|
| | 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 months ended 31 December |
|-----------------------------------|-------------------------|-------|---------|------------------------------|
| | 2002 | 2003 | 2004 | |
| PRC enterprise income tax ("EIT") | 18 | 6 | 146 | 1 |
| Deferred taxation (Note 26) | (441) | (404) | (3,817) | (1) |
| 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:

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

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| | | | | |
|--|-----------|-------|----------|-------|
| 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

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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 |
|------------------------------------|-------------------|--------------|--------------|--------------|
| | 2002 | 2003 | 2004 | June 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 |
|--------------------------------------|-------------------|--------------|--------------|--------------|
| | 2002 | 2003 | 2004 | June 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 carrying 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 |

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| | | |
|--|-----|-----|
| 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) | - | - | - |

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| | | | |
|---------------------------------------|-----|------|-----|
| 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 |

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| | | 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 |
|-----------|--|--|
|-----------|--|--|

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| | | | equipment |
|------------------|---|-------|-----------|
| 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 | Furniture fixture mot vehicle and other 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

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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.

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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 | - |

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| | | |
|------------------------------------|------|-----|
| 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

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| | 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:

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

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| | | | | |
|-----------------------|---|--------|--------|--------|
| 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 |

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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 | 2006 |
| 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 |

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| | | | | |
|------------------|---|--------|--------|-------|
| | 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

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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

| Note | As at 31 December | | |
|------|-------------------|------|------|
| | 2002 | 2003 | 2004 |

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| | | | | |
|-----------------------------------|----------|-------|-------|-------|
| 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 |

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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 |

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| | | |
|---------------------|-------|-------|
| 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) |

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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 | - |

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| | | | | |
|---|-----|---------|-------|-------|
| 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 | | | | | |

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| | | | | |
|---|-------|------|---------|-----|
| 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:

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| | Years ended 31 December | | | Six months |
|--|-------------------------|-------|----------|------------|
| | 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 |
|-------------------|-------------------|--------|--------|-----------|
| | 2002 | 2003 | 2004 | June 2005 |
| Amount utilised | 26,818 | 26,412 | 22,650 | 22,504 |
| Amount unutilised | 8,000 | 8,156 | 10,759 | 10,702 |

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

30 Commitments

(a) Capital commitments

| | As at 31 December | | | As at 30 |
|---|-------------------|------|------|--------------|
| | 2002 | 2003 | 2004 | June 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,

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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 2004 |
|--|-----------|--------------------------------|-------|-------|--------------------|
| | | 2002 | 2003 | 2004 | |
| Interconnection income | | | | | |
| - from ultimate 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 ultimate 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 subsidiaries | v)a | 753 | 910 | 929 | 235 |
| - from related company | v)a | 67 | 56 | 64 | 25 |

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| | | | | | |
|---|----------|-----|-------|-------|-----|
| Sub total | | 820 | 966 | 993 | 260 |
| Ancillary telecommunications support services | i) | | | | |
| - from fellow subsidiaries | 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 subsidiaries | v) a,c | 4 | 4 | 5 | - |
| - from related company | v) a,c | 1 | - | - | - |
| Sub total | | 5 | 4 | 5 | - |
| Support services | ii) | | | | |
| - from fellow subsidiaries | 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.

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(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.

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(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 guarantee 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

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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 | |

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| | | | |
|--|-----------------|-----------------|------------|
| 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

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| | Years ended 31 December | | | Six months ended 30 |
|---|-------------------------|-----------------------|-----------------------|-------------------------|
| | 2002 | 2003 | 2004 | June 2005 |
| | RMB million (Audited) | RMB million (Audited) | RMB million (Audited) | RMB million (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

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| | Share capital RMB million | Share premium RMB million | Capital reserve RMB million | Audited 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 | - | - | - | - | - | - | |

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| | | | | | | |
|--|-------|--------|-----|-----|-------|-------|
| 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

| | Share capital RMB million | Share premium RMB million | Capital reserve RMB million | Unaudited 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 | |

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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 RMB million (Audited) | 2001 RMB million (Audited) |
|--|---|----------------------------------|
| Cash flows from operating activities | | |
| Net cash inflows generated from operations | 28,024 | 28,800 |
| Interest received | 82 | |
| Dividends received | 78 | |
| Interest paid | (2,789) | (2,600) |
| Profit tax paid | (1,467) | (900) |
| Net cash inflow from operating activities | 23,928 | 25,300 |
| Cash flows from investing activities | | |
| Purchase of fixed assets and construction in progress | (25,814) | (28,500) |
| Sales of fixed assets | 768 | 700 |
| Sales of other investments | 274 | 1,100 |
| Net (increase)/decrease in time deposits with maturity over three months | (109) | |
| Investment in Asia Netcom | - | (500) |
| Purchase of additional interest in Asia Netcom | - | |
| Purchase of other investments | (1,041) | |
| Net cash outflow from investing activities | (25,922) | (27,000) |
| Cash flow from financing activities | | |

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| | | |
|---|----------|-------|
| 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 December 2004 | As at 30 June 2005 |
|--|---------------------------|----------------------------|
| | RMB million (Restated) | 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 |

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

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| | (Restated) | (Audited) |
|---|------------|-----------|
| 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").

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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

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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;

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- 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 authorization 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

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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 |

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| | | |
|--|-------|-------|
| 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.

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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.

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- 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

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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

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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

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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

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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

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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

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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 |

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| | |
|--|------------|
| 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

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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% |

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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

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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 ended 2004 (in RMB million) 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 |

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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 directors. 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

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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.

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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 |

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17 Prepayments and other receivables

| | Group | As at December 31, | Company | As at |
|-------------------------------|-------------|--------------------|-------------|-------------|
| | As at | 2003 | As at | 2004 |
| | 2004 | 2003 | 2004 | 2004 |
| | RMB million | 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 | Telecommunications 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) |

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| | | | |
|-------------------------------------|---------|----------|---------|
| 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

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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

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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 |

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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 |

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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 of 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 Limited (note(d)) | Hong Kong May 2, 2001 | 1,000 ordinary shares of US\$1.00 each | 100% | Provision networks communicat services |

Notes:

(a) This company is a wholly owned foreign enterprise established in the PRC. The accounts of this company for the years ended December 31, 2003 and 2004 were audited by PricewaterhouseCoopers Zhong Tian CPAs Limited Company.

(b) This company adopted March 31 as its financial year end, which is not coterminous with the year end of the Group. No audited accounts have been prepared for this company because there are no statutory requirements to prepare accounts in its jurisdiction.

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(c) This company previously adopted March 31 as its financial year end, which was changed to December 31 during 2003. The accounts for the period from October 15, 2002 to March 31, 2003 and April 1, 2003 to December 31, 2003 were audited by PricewaterhouseCoopers.

(d) This company adopted March 31 as its financial year end, which is not coterminous with the year end of the Group. The accounts of this company for the years ended March 31, 2002 and 2003 were audited by PricewaterhouseCoopers.

23 Long-term Investments and interests in associated companies

Long-term investments and interests in associated companies were unlisted equity investments, which were transferred to China Netcom Group upon Reorganisation on June 30, 2004.

24 Foreign currency exchange forward contracts

The Group has entered into certain foreign currency exchange forward contracts with banks, which are non-speculative and used to manage the risk of certain of the Group's borrowings denominated in foreign currencies. The respective foreign currency exchange forward contract receivable and payable balances which are included in other non-current assets and other non-current liabilities are as follows:

| | As at Dec 2004 RMB million |
|------------|----------------------------------|
| Receivable | 408 |
| Payable | 533 |

25 Accounts payable

| | As at Dec 2004 RMB million |
|---------------|----------------------------------|
| 0-30 days | 6,122 |
| 31-60 days | 1,833 |
| 61-90 days | 925 |
| 91-180 days | 2,115 |
| Over 180 days | 3,658 |
| | 14,653 |

26 Accruals and other payables

| | Group | Com |
|--|--------------------|-------------|
| | As at December 31, | As at Dec |
| | 2004 | 2004 |
| | RMB million | RMB million |

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| | | | |
|------------------|-------|-------|-----|
| Accrued expenses | 1,569 | 2,949 | 140 |
| Other payables | 1,784 | 1,461 | - |
| | 3,353 | 4,410 | 140 |

27 Bank and other loans

(a) As at December 31, 2004, the short term bank loans were unsecured and comprise:

| Currency 2004 | Interest rate and final maturity 2003 | As at Dec RMB million |
|-----------------------|--|--------------------------|
| Renminbi denominated | Interest rates ranging from 4.54% to 5.02% per annum with maturity through Dec. 30, 2005 | 29,220 |
| US Dollar denominated | Interest rates ranging from 2.59% to 3.98% per annum with maturity through Nov. 29, 2005 | 119 |
| | | 29,339 |

(b) The Group's long term bank and other loans comprise:

| | Note | As at Dec 2004 RMB million |
|---------------------------|------|----------------------------------|
| Bank and other loans | (i) | 27,571 |
| Finance lease obligations | (ii) | 1,560 |
| | | 29,131 |
| Less: Current portion | | (7,270) |
| | | 21,861 |

(i) Long term bank and other loans

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| | As at Dec 2004 RMB million |
|-----------------------|----------------------------------|
| Loans | |
| Unsecured | 25,228 |
| Secured | 2,343 |
| Total | 27,571 |
| Less: Current portion | (7,060) |
| Long-term loans | 20,511 |

The Group's long term bank and other loans (excluding finance lease liabilities) were repayable as follows:

| | As at Dec 2004 RMB million |
|----------------------------|----------------------------------|
| Within one year | 7,060 |
| In the second year | 6,550 |
| In the third to fifth year | 11,196 |
| After the fifth year | 2,765 |
| | 27,571 |

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

| Currency | Interest rate and final maturity | As at Dec 2004 RMB million |
|-----------------------|---|----------------------------------|
| Bank loans | | |
| Renminbi denominated | Interest rates ranging from 4.5% to 6.1% per annum with maturity through Oct. 20, 2014 | 23,776 |
| US Dollar denominated | Interest rates ranging from 2.1% to 5.0% per annum with maturity through Dec. 31, 2040 | 2,552 |

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| | | |
|--------------------------|--|--------|
| Japanese Yen denominated | Interest rates ranging from 2.1% to 2.6% per annum with maturity through Oct. 20, 2022 | 860 |
| Euro denominated | Interest rates ranging from 2% to 5.94% per annum with maturity through Jun. 30, 2023 | 383 |
| | | 27,571 |
| Other loans | | |
| US Dollar denominated | Interest rates at 1% per month with maturity through Sep. 2006 | - |
| | | 27,571 |

As at December 31, 2004, secured loans and bank loans totalled RMB 2,343 million (2003: RMB 3,568 million) which were secured by the following:

- (i) Certain fixed assets amounting to RMB 22 million (2003: RMB 2,668 million) in respect of loans amounting to RMB 3 million (2003: RMB 16 million);
- (ii) Corporate guarantees granted by China Netcom Group to the extent of RMB 1,888 million (2003: RMB 1,047 million); and
- (iii) Corporate guarantees granted by third parties to the extent of RMB 452 million (2003: RMB 483 million).

Besides, other loans amounting to RMB 1,222 million at December 31, 2003 representing finance arrangements with certain vendors, which were secured by certain cable systems, property and contracts owned by the Group had been all transferred to China Netcom Group upon the Reorganisation on June 30, 2004.

(ii)

Finance lease obligations

| | |
|---------------------------------|----------------------------------|
| | As at Dec 2004 RMB million |
| Obligation under finance leases | 1,560 |

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| | |
|-----------------------|-------|
| Less: current portion | (210) |
| | 1,350 |

During the year ended December 31, 2004, the Group entered into a finance lease arrangement with a related party (see note 18 (a)). The lease obligation payable to the related party as at December 31, 2004 amounted to RMB 1,070 million.

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

| | As at Dec 2004 RMB million |
|--|----------------------------------|
| Within one year | 390 |
| In the second year | 662 |
| In the third to fifth year, inclusive | 580 |
| After the fifth year | - |
| | 1,632 |
| Less: future finance charges on finance leases | (72) |
| Present value of finance lease liabilities | 1,560 |

The present value of finance lease liabilities is as follows:

| | |
|---------------------------------------|-------|
| Within one year | 210 |
| In the second year | 776 |
| In the third to fifth year, inclusive | 574 |
| After the fifth year | - |
| | 1,560 |

28 Amount due from/(to) holding companies and fellow subsidiaries

| | Note | As at Dec 2004 RMB million |
|--|----------|----------------------------------|
| Current | | |
| Due from holding companies | (a) | 136 |
| Due from fellow subsidiaries | (a) | 237 |
| | | 373 |
| Profits distribution payable to ultimate holding company | (a) | (8,244) |
| Non-current | | |
| Due to holding companies | | |
| - intermediate holding company | (a), (c) | - |
| - ultimate holding company | (b), (c) | - |

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Note:

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

(b) The amount due to the ultimate holding company amounting to RMB 1,750 million as at the end of December 31, 2003 was unsecured, and carried interest at 4.6% per annum.

(c) These balances were waived and recognised into the Group's equity upon the Reorganisation. 29 Deferred revenues

| | As at Dec 2004 RMB million |
|--|----------------------------------|
| Balance at beginning of year | |
| - upfront connection fees | 10,390 |
| - upfront installation fees | 6,691 |
| - advances from network capacity sales | 2,050 |
| - prepaid telephony services | 2,702 |
| | 21,833 |
| Additions for the year | |
| - upfront connection fees | - |
| - upfront installation fees | 1,051 |
| - advances from network capacity sales | |
| - additions | 242 |
| - acquired through Asia Netcom (Note 35 (c)) | - |
| - prepaid telephony services | 11,815 |
| | 13,108 |
| Reductions for the year | |
| - upfront connection fees | (3,378) |
| - upfront installation fees | (1,338) |
| - advances from network capacity sales | (114) |
| - prepaid telephony services | (11,592) |
| | (16,422) |
| Distributed to owners in accordance with Reorganisation on June 30, 2004 | |
| - advances from network capacity sales | (5) |
| - prepaid telephony services | (44) |
| | (49) |
| Balance at end of year | |
| - upfront connection fees | 7,012 |
| - upfront installation fees | 6,404 |
| - advances from network capacity sales | 2,173 |
| - prepaid telephony services | 2,881 |
| | 18,470 |

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Representing:

| | |
|-----------------------|--------|
| - Current portion | 6,653 |
| - Non-current portion | 11,817 |
| | 18,470 |

30 Provisions

| | Early retirement benefits RMB million Note 3(r)(ii) | One-off cash housing subsidies RMB million Note (a) |
|-----------------------------------|---|---|
| At January 1, 2004 | 2,754 | 2,670 |
| Additional provisions | 206 | - |
| Payments during the year | (414) | (477) |
| At December 31, 2004 | 2,546 | 2,193 |
| Analysis of total provisions: | | |
| Current portion | 403 | 2,193 |
| Non-current portion | 2,143 | - |
| | 2,546 | 2,193 |

(a) Certain staff quarters have been sold to its 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 allocation of staff quarters. However, the specific timetable and procedures of implementation of these policies were to be determined by individual provincial or municipal government based on the particular situation of the provinces or municipality.

Based on the relevant detailed local government regulations promulgated, certain entities within the 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 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 Group estimated the required provision for these cash housing subsidies amounting to RMB 2,818 million, which was charged to the consolidated income statement in the year ended December 31, 2000 when the State Council circular in respect of cash subsidies was issued. Pursuant to the Reorganisation, if the actual payments required for these one-off housing subsidies differ from the amount provided as of June 30, 2004, 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.

31 Deferred taxation

Movements of the deferred tax and liability are as follows:

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| | Balance at December 31, 2003 RMB million | Recognised in income statement RMB million | Recognised in equity RMB million Note (i) | Recognised in equity RMB million Note (ii) | Ba RMB |
|--|---|---|--|---|-----------|
| Deferred tax assets | | | | | |
| Deferred revenue, primarily advances from customers | 559 | (46) | (513) | - | |
| Other temporary differences primarily allowance for doubtful debts | 465 | 81 | (420) | - | |
| Unrecognised revaluation surplus and deficit (note(ii)) | - | (241) | - | 2,355 | |
| Provision for early retirement provision benefits | 974 | 25 | (945) | - | |
| Disposal of fixed assets | 703 | (70) | (633) | - | |
| Others | 83 | 86 | (69) | - | |
| Balance at end of year | 2,784 | (165) | (2,580) | 2,355 | |
| Deferred tax liabilities | | | | | |
| Revenue recognition | (712) | 133 | 579 | - | |
| Fixed assets depreciation | (2,347) | (450) | 2,797 | - | |
| Deferred costs | (245) | 114 | 131 | - | |
| Interest capitalization | (832) | (142) | (270) | - | |
| Others | (77) | (52) | 52 | - | |
| Balance at end of year | (4,213) | (397) | 3,289 | - | |

The amounts shown in the consolidated balance sheet are as follows:

| | |
|--|---------|
| Deferred tax assets to be recovered after more than 12 months | 1,760 |
| Deferred tax liabilities to be settled after more than 12 months | (3,501) |

Notes:

(i) As described in Note 18, in connection with the Reorganisation, certain of the Group's telecommunications networks and equipment and furniture, fixture, motor vehicles and other equipment were revalued as at December 31, 2003. 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 (ii) below. As a result, the Group's net deferred tax liabilities were subsequently reduced by RMB709 million (comprising deferred tax assets of RMB2,580 million and deferred tax liabilities of RMB3,289 million), and this reduction was recorded as a credit to owner's equity upon the date of the Reorganisation on June 30, 2004. Among the RMB709 million net reduction of deferred tax liabilities, RMB846 million, being deferred tax liabilities originated from the revaluation surplus of fixed assets recorded, was credited to revaluation reserves and the remaining RMB137 million deferred tax assets were debited to retained earnings.

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(ii) In addition, the Group's land and buildings were revalued for PRC tax purposes with a net surplus of RMB6,967 million as at December 31, 2003 to determine the tax bases for future years. However, the resulting revaluations of land and buildings were not incorporated into the consolidated financial statements. As a result, a deferred tax asset of RMB2,355 million was subsequently recorded with a corresponding increase in owner's equity upon the Reorganisation on June 30, 2004. In the opinion of the directors, it is more likely than not the Group will realize the benefits of the deferred tax asset after making reference to the historical taxable income of the Group. The revaluation asset is being transferred to retained earnings upon the corresponding realisation of the underlying deferred tax assets. The amount of transfer from revaluation reserve to retained earnings for the year ended December 31, 2004 was RMB241 million.

32 Share capital

| | Ordinary shares of US\$0.04 | | | AUTHORISED Convertible preference shares of US\$0.04 each (note (c)) | | |
|--|-----------------------------|---------------|----------------|--|-----------|------|
| | No. of shares | US\$ | RMB million | No. of shares | US\$ | mill |
| At January 1 December 31, 2003 and December 31, 2004 | 25,000,000,000 | 1,000,000,000 | 8,277 | 7,741,782 | 309,671 | |
| | Ordinary shares of US\$0.04 | | | ISSUED Convertible preference shares of US\$0.04 each (note (c)) | | |
| | No. of shares | US\$ | RMB million | No. of shares | US\$ | mill |
| At January 1 and 31 December 2003 (note (b)) | 5,492,258,218 | 219,690,329 | 1,816 | 7,741,782 | 309,671 | |
| Conversion of convertible preference shares (note (c)) | 7,741,782 | 309,671 | 3 | (7,741,782) | (309,671) | |
| Issue of shares through Global Offering (note (d)) | 1,093,529,000 | 43,741,160 | 362 | - | - | |
| At December 31, 2004 | 6,593,529,000 | 263,741,160 | 2,181 | - | - | |

Notes:

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(a) Pursuant to an ordinary resolution dated September 1, 2004, the authorised share capital of the Company was increased to US\$1,000,000,000 by creating an additional 99,600,000,000 shares of US\$0.01 each. Pursuant to an ordinary resolution passed on September 7, 2004, every four issued and unissued shares of US\$0.01 each were consolidated into one new share of US\$0.04 each. Following the creation of 99,600,000,000 additional shares and the share consolidation, the authorised share capital of the Company is RMB8,277 million divided into 25,000,000,000 shares of US\$0.04 each, of which 5,492,258,218 shares were in issue and fully paid. The shares after the share consolidation rank par in all respects with each other. All references to the share capital of the Company in this report have been adjusted retrospectively to take into account the increase in authorised share capital and share consolidation. Besides, the increase in authorised capital is applied respectively in connection with presentation of share capital of the consolidated balance sheets as detailed in notes below.

(b) The share capital presented in the consolidated balance sheet at January 1, 2003 represents (i) the share capital of the Company, including the shares as at January 1, 2003 totalling 50,000,000 ordinary shares and (ii) shares issued for the Asset Injection arising from the Reorganisation totalling 5,442,258,218 ordinary shares described in note 1 above. The shares described in (ii) are deemed to have been issued on January 1, 2003 under the Reorganisation for mergers accounting provision of Hong Kong SSAP No.27. The difference between the nominal value of the shares described in (ii) and the value of the net assets injected into the Company under the Asset Injection, totalling approximately RMB31 billion, is reflected as share premium as at January 1, 2003.

(c) All preference shares were converted into ordinary shares of the Company on August 30, 2004.

(d) On December 8, 2004, the Company completed its Global Offering as follows:

(i) issue of an aggregate of 950,895,000 shares of US\$0.04 each at HK\$8.48 per share on The Stock Exchange of Hong Kong Limited ("HKSE") and at US\$21.82 (HK\$169.60) per ADS on the New York Stock Exchange Inc., on Nov. 17 and Nov. 16 respectively; and

(ii) issue of 142,634,000 shares of US\$0.04 each at HK\$8.48 by way of a placing among professional and institutional investors on December 8, 2004 upon the full exercise of an over-allotment option.

The listing proceeds of the aforementioned Global Offering of shares, net of share issue expenses of HK\$650 million (equivalent to RMB689 million) amounted to approximately HK\$8,438 million (equivalent to RMB8,944 million). The resulting share premium amounted to approximately HK\$8,096 million (equivalent to RMB8,582 million).

33 Share option scheme

A share option scheme was approved pursuant to a directors' resolution on September 30, 2004 ("Share Option Scheme"). Share options are granted to directors of the Company and to certain employees of the Group at the directors' discretion. Share option can be exercised at least 18 months from the later of the date of grant or the date of the listing of the shares of the Company on the Hong Kong Stock Exchange and subject to certain vesting schedules.

On October 22, 2004, 158,640,000 share options with exercise price of HK\$8.40 each were granted to certain directors of the Company and certain employees of the Group. The total number of ordinary shares that are available for issuance upon the exercise of options granted pursuant to this scheme may not exceed 10% of the total number of issued ordinary shares. The Company may, however, seek

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separate approvals from its shareholders for granting options beyond the 10% limit. The scheme will be valid and effective for a period of six years and no options may be granted pursuant to this scheme following the expiration of the scheme. Pursuant to the Company's share option plan, the Company granted 158,640,000 options to certain of its directors and employees, immediately prior to the closing of its global offering, to subscribe for its ordinary shares at the initial public offering price under the Hong Kong public offering, excluding brokerage and trading fees, and transaction and investor compensation levies. The options granted under this plan has a vesting period of 42 months from the date of listing of our shares and will expire six years from the date of grant. Details of the share options granted immediately prior to the closing of the global offering and the movement during the year are summarised as follows:

| Date of grant | Outstanding as at January 1, 2004 | Granted during the period | No. of directors and employees | NO. OF SHARE OPTIONS | | Cancelled during the period | Outsta Dec 31, |
|---------------|--|---------------------------------|---|-----------------------------------|--------------------------------|-----------------------------------|----------------------|
| | | | | Exercised during the period | Lapsed during the period | | |
| 22/10/2004 | - | 158,640,000 | 456 | - | 920,000 (a) | - | 157,72 |

(a) A director resigned during the year and the options granted to him lapsed on the date of resignation in accordance with the terms of the share option scheme.

34 Reserves - Company

| | Share premium RMB million | Capital Reserve RMB million | Retain earnin RMB milli |
|--|---------------------------------|-----------------------------------|-------------------------------|
| At January 1, 2003 | 2,771 | - | 1 |
| Profit for the year | - | - | |
| At December 31, 2003 | 2,771 | - | 1 |
| Issue of shares under Asset Injection in accordance with Reorganisation | 31,397 | 2,982 | |
| Distributions to owners in accordance with Reorganisation | - | - | (3 |
| Loss for the year | - | - | (|
| Distribution to an owner upon assignment of loan prior to the Global Offering (Note a) | - | - | (1,0 |
| Issue of shares through Global Offering (net of issue expenses) | 8,582 | - | |
| At December 31, 2004 | 42,750 | 2,982 | (1,2 |

(a) Pursuant to the promissory note (the "Note") signed by Group Wealth Finance Limited ("Group Wealth"), a fellow subsidiary owned by CNC BVI, the Company's immediate holding company, dated July 27, 2004, Group Wealth has borrowed an amount of US\$123,301,980 (RMB1,020,644,470) from Asia Netcom, and used these funds to acquire the right to receive the outstanding debt payments owed by East Asia Netcom Limited, a fellow subsidiary, from the vendors to the aggregate

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amount of approximately US\$123 million on July 29, 2004.

Subsequently, on September 30, 2004, CNC BVI instructed Group Wealth to assign the loan to the Company. Accordingly, upon such assignment, the amount receivable from Group Wealth of the said amount is effectively waived and the Company recorded such assignment as an equity distribution to CNC BVI.

35 Consolidated cash flow statements

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

| | Years ended 2004 RMB million |
|---|------------------------------------|
| Profit/(loss) before taxation | 12,596 |
| Depreciation of fixed assets and amortisation of intangible assets | 18,754 |
| Amortisation of deferred revenues | (16,422) |
| Deferred costs expensed in the income statements | 3,484 |
| Deficit on revaluation of fixed assets | - |
| Allowance for doubtful debts | 832 |
| Loss on disposal of fixed assets | 145 |
| Dividend income | (17) |
| Share of loss from associated companies and jointly controlled entities | 1 |
| Interest income | (76) |
| Interest expense | 2,794 |
| Discount on foreign currency exchange forward contracts | 18 |
| Realised (gain) on disposal of short-term investments | - |
| Unrealised loss/(gain) on short-term investments | 4 |
| Unrealised foreign exchange losses | 70 |
| | |
| Operating profit before working capital changes | 22,183 |
| Increase in accounts receivable | (312) |
| Decrease/(increase) in inventories and consumables | 201 |
| (Increase)/decrease in prepayments and other receivable | (62) |
| Increase in deferred costs and other non-current assets | (3,158) |
| Increase in accounts payable | 1,229 |
| (Decrease) in accruals and other payables | (3,483) |
| Increase in deferred revenues | 13,108 |
| | |
| Net cash inflow generated from operations | 29,706 |

(b) Major non-cash transactions

During 2004, the Group entered into finance lease arrangements in respect of newly acquired fixed assets with a total capital value at the inception of the lease of RMB409 million (2003: RMB276 million).

During 2004, the immediate holding company assigned a loan to the Company which resulted in a direct charge to the Company's equity, see note 34(a) for details.

(c) Acquisition of Asia Global Crossing through Asia Netcom The Group acquired 100% of certain entities previously controlled by Asia Global Crossing through Asia Netcom by way of two acquisitions. On March 10, 2003, the Group injected RMB507 million into Asia Netcom, a 51% owned jointly controlled entity which acquired the entire interest in certain entities, which own and operate an

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Asia-Pacific region cable network providing city-to-city connectivity, data communications and IP-based services, previously controlled by Asia Global Crossing. On December 31, 2003, the Group acquired the remaining 49% of the equity of Asia Netcom for a total cost of RMB525 million. From March 10, 2003 to December 31, 2003, Asia Netcom was accounted for as a jointly controlled entity. On December 31, 2003, Asia Netcom became a wholly owned subsidiary of the Company and was consolidated into the Group's financial statements. The net assets acquired and the net cash inflow in respect of the purchase of the remaining 49% interest in Asia Netcom, which has a group of subsidiaries, is analysed as follows:

Net assets acquired at their respective estimated fair values

Fixed assets
 Deferred costs
 Other non-current assets
 Cash and bank deposits
 Accounts receivables and other current assets
 Accounts payable and other current liabilities
 Advances from network capacity sales
 Bank and other loans

Net assets

49% of net assets
 Goodwill (note 20)

Satisfied by Cash

Cash consideration
 Cash and bank deposits acquired

Net cash inflow in respect of the purchase of subsidiaries

36 Contingent liabilities

(a) Guarantees

| | Group | | Com |
|---|----------------------------|-------------|-------------------|
| | As at December 31, 2004 | 2003 | As at Dec 2004 |
| | RMB million | RMB million | RMB million |
| Guarantees for US dollar denominated bank loans of third parties | 63 | 125 | - |

On December 8, 2000, a subsidiary of the Company entered into an agreement to provide a guarantee to a subsidiary of China Mobile for a foreign currency

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borrowing. The guarantee arose from the assumption of responsibilities by both parties as part of the legacy arrangements of their predecessor companies commonly controlled by the state government.

The guarantee obligation is limited to the outstanding loan and accrued interest amount payable by the subsidiary of China Mobile which is due to be settled by September 2005. As at December 31, 2003 and 2004, the outstanding balances of the borrowing, including interest payable, were US\$15.1 million (RMB125 million) and US\$7.6 million (RMB 63 million) respectively.

The directors are of the opinion that the possibility of the guaranteed party defaulting on the outstanding balance of the borrowing is remote, hence no provisions have been made for the guarantee.

(b) National Audit Office ("NAO") audit

During the year, the NAO has completed its audit on the ultimate holding company, China Netcom Group, including all of its business operations, assets and liabilities prior to the Reorganisation. Substantial assets and liabilities currently comprising the Group were injected by China Netcom Group in accordance with the Reorganisation. China Netcom Group has informed the directors that no significant matters have been raised to China Netcom Group by the NAO as a result of its audit. Accordingly the directors are of the opinion that there is no matter concerning the Group that qualifies for disclosure in its consolidated financial statements in relation to the NAO audit.

37 Banking facilities

As at December 31, 2003 and 2004, the Group's banking facilities are as follows:

| | Group | | Com As at Dec 2004 RMB million |
|------------------------------|---|---------------------|---|
| | As at December 31, 2004 RMB million | 2003 RMB million | |
| Amount utilised | 56,910 | 69,498 | - |
| Amount unutilised | 13,590 | 10,952 | - |
| Aggregate banking facilities | 70,500 | 80,450 | - |

38 Commitments

(a) Capital commitments

| | Group | | Com As at Dec 2004 RMB million |
|---|---|---------------------|---|
| | As at December 31, 2004 RMB million | 2003 RMB million | |
| Contracted but not provided for | | | |
| - Land and buildings | 47 | 220 | - |
| - Telecommunications networks and equipment | 986 | 1,971 | - |
| | 1,033 | 2,191 | - |

Authorised but not contracted for

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| | | | |
|---|-------|-------|---|
| - Land and buildings | 2 | 213 | - |
| - Telecommunications networks and equipment | 1,778 | 4,626 | - |
| | 1,780 | 4,839 | - |

(b) Operating lease commitments

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

| | Group | | Com |
|---|----------------------------|-------------|-------------------|
| | As at December 31, 2004 | 2003 | As at Dec 2004 |
| | RMB million | RMB million | RMB million |
| Not later than one year | 793 | 463 | - |
| Later than one year and not later than five years | 1,129 | 770 | - |
| Later than five years | 1,510 | 297 | - |
| | 3,432 | 1,530 | - |

39 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.

(a) Transaction before Reorganisation on June 30, 2004 The directors consider that the following related party transactions were carried out in the normal course of business of the Group and at terms mutually agreed between the Group and the respective related parties.

| | Note | Period from January 1, 2004 to June 30, 2004 prior to Reorganisation RMB million |
|--|------------------|--|
| Rental income from properties leased to related companies | (v) (a), (v) (c) | 2 |
| Purchase of materials | | |
| - from fellow subsidiaries | (v) (a), (v) (c) | (528) |
| - from related companies | (v) (a), (v) (c) | (670) |
| | | (1,198) |
| Receipt of engineering, project planning, design, construction and information technology services | | |
| - from fellow subsidiaries | (v) (a), (v) (b) | (321) |
| - from related companies | (v) (a), (v) (b) | (564) |

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| | | |
|---|------------------|-------|
| | | (885) |
| Ancillary telecommunications support services (iii) | | |
| - from fellow subsidiaries | (v) (a), (v) (c) | (207) |
| - from related companies | (v) (a), (v) (c) | (232) |
| | | (439) |
| Payment of operating lease rentals of premises | | |
| - from fellow subsidiaries | (v) (a), (v) (c) | (7) |
| - from related companies | (v) (a), (v) (c) | (5) |
| | | (12) |
| Support services (iv) | | |
| - from fellow subsidiaries | (v) (a), (v) (c) | (187) |
| - from related companies | (v) (a), (v) (c) | (149) |
| | | (336) |

(b) Transaction after Reorganisation on June 30, 2004

| | | |
|--|--|----------|
| | | Note |
| Interconnection fee received from ultimate holding company | | (vi) (a) |
| Interconnection fee paid to ultimate holding company | | (vi) (a) |
| Payment of operating lease rentals of premises from fellow subsidiaries | | (vi) (b) |
| Payment of operating sub-lease rentals of premises from fellow subsidiaries | | (vi) (c) |
| Common corporate services income received from ultimate holding company | | (vi) (d) |
| Common corporate services expense paid to ultimate holding company | | (vi) (d) |
| Receipt of engineering, project planning, design, construction and information technology services | | (vi) (e) |
| - from fellow subsidiaries | | |
| - from related companies | | |
| Purchase of materials | | (vi) (f) |
| - from fellow subsidiaries | | |
| - from related companies | | |

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| | |
|--|----------|
| Ancillary telecommunications support services | (vi) (g) |
| - from fellow subsidiaries | |
| - from related companies | |
| Support services | (vi) (h) |
| - from fellow subsidiaries | |
| - from related companies | |
| Payment of operating lease rentals of telecommunications facilities to fellow subsidiaries | (vi) (i) |
| Payment for purchase of long-term telecommunications capacity to ultimate holding company | (vi) (j) |
| Payment for lease of long-term telecommunications capacity to ultimate holding company | (vi) (k) |
| Management fee received from ultimate holding company | (vi) (l) |

Notes:

(i) As at the respective balance sheet dates, the Group had balances with certain related parties, which have been set out in Notes 27(b)(ii) and 28.

(ii) The related companies represent the investees of the unlisted fellow subsidiaries.

(iii) Represents the provision of ancillary telecommunications support services to the Group by the fellow subsidiaries and the 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.

(iv) Represents the support services provided to the 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.

(v) Transactions with individual related parties before reorganisation on June 30, 2004 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 Group and China Netcom Group entered into a number of agreements effective on or after July 1, 2004 with an initial term expiring on December 31, 2006. The terms of the principal agreements are summarised as follows:

(a) The Group entered into an Interconnection Settlement Agreement with China Netcom Group for interconnection of domestic and international long distance telephone calls. Pursuant to the said agreement, the telephony operator

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terminating a telephone call made to its local networks is entitled to receive a fee prescribed by MII from the operator from which the telephone call is originated.

(b) The Group entered into a Property Leasing Agreement with China Netcom Group pursuant to which the Group leases certain properties to/from China Netcom Group. The rental charges are based on either 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 Group entered into Property Sub-leasing Agreement with China Netcom Group pursuant to which the 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 Group entered into a Master Service Sharing agreement with China Netcom Group pursuant to which expenses associated with common corporate services are allocated between the Group and China Netcom Group based on revenues as appropriate.

(e) The Group entered into an Engineering and Information Technology Services Agreement with China Netcom Group pursuant to which China Netcom Group provides the 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 Group entered into a Materials Procurement Agreement with China Netcom Group pursuant to which China Netcom Group provides the 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 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 Group for these services in accordance with the following terms:

- o Government prescribed price;
- o Where there is no government prescribed price but there is a government guided price, the government guided price will apply;
- o Where there is neither government prescribed price nor a government guided price the market price will apply;
- o Where none of the above is available, the price is to be agreed between the relevant parties, which shall be based on the cost incurred in providing the services plus a reasonable profit margin.

(h) The 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 Group for these services in accordance with the following terms:

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- o Government prescribed price;
- o Where there is no government prescribed price but there is a government guided price, the government guided price will apply;
- o Where there is neither government prescribed price nor a government guided price the market price will apply;
- o Where none of the above is available, the price is to be agreed between the relevant parties, which shall be based on the cost incurred in providing the services plus a reasonable profit margin.

(i) The Group entered into a Telecommunications Facilities Leasing Agreement with China Netcom Group pursuant to which the 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.

(j) The Group entered into a Capacity Purchase Agreement with East Asia Netcom Limited ("EANL"), a wholly owned subsidiary of China Netcom Group, pursuant to which the Group receives certain amounts of long-term telecommunications capacity from China Netcom Group at market prices as set out in the Capacity Purchase Agreement.

(k) The Group entered into a Capacity Lease Agreement with EANL, pursuant to which the Group leases certain amounts of capacity of China Netcom Group's telecommunications network at market rates as set out in the Capacity Lease Agreement.

(l) The Group entered into a Management Services Agreement with EANL, pursuant to which the Group provides certain management services to China Netcom Group either on a cost reimbursement basis or on the basis of cost plus reasonable profits not exceeding the market price as set out in the Management Service Agreement.

(vii) In addition, pursuant to the Reorganisation, China Netcom Group has agreed to hold and maintain, for the 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 Company has agreed reimburse China Netcom Group for any such expense.

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

(ix) During the year, the Group entered into a finance lease arrangement with a related party (see note 18(a)).

(x) During the year, a fellow subsidiary borrowed a loan from the Group and the loan payable from the fellow subsidiary was assigned to the Group at the instruction of its immediate holding company, which resulted in a direct charge to the Company's equity, please refer to note 34(a) for details.

40 Significant subsequent events

After the balance sheet date, the directors proposed a final dividend. Further details are disclosed in note 9.

41 Ultimate holding company

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The directors regard China Netcom Group, a state-owned company established in the PRC, as being the ultimate holding company.

42 Approval of financial statements

The financial statements were approved by the Board of Directors on April 6, 2005.

APPENDIX IV FINANCIAL INFORMATION OF THE COMBINED GROUP

Unaudited Pro Forma Combined Financial Statements

1 BACKGROUND INFORMATION OF THE TARGET GROUP

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 1984. The Target BVI Company is currently owned by China Netcom Group, the Company's ultimate holding company and a state-owned enterprise established in the PRC. Through the Target Company, its wholly-owned subsidiary established in the PRC, the Target BVI Company holds 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 four provinces or autonomous regions in the PRC, namely, Shanxi Province, Jilin Province, Heilongjiang Province and Neimenggu Autonomous Region which were transferred from China Netcom Group through a reorganisation.

2 INTRODUCTION TO THE UNAUDITED PRO FORMA combined FINANCIAL INFORMATION OF THE COMBINED GROUP

The accompanying unaudited pro forma financial information of the Combined Group has been prepared to illustrate the effect of the Acquisition at a consideration of RMB12.8 billion. The consideration will be satisfied by cash in 11 instalments. The initial consideration of RMB3 billion will be satisfied on completion of the Acquisition and the deferred consideration of RMB 9.8 billion, being the difference between the total consideration and the initial consideration, is interest bearing at 5.265% per annum and is fully repayable within five years after the date of completion of the Acquisition.

The accompanying unaudited pro forma combined balance sheet of the Combined Group as at 30 June 2005 gives effect to the Acquisition as if it had been consummated on 30 June 2005.

The accompanying unaudited pro forma combined income statements for the year ended 31 December 2004 and for the six months ended 30 June 2005 of the Combined Group give effect to the Acquisition as if it had taken place on 1 January 2004 and 1 January 2005 respectively.

In connection with the Reorganisation, the lease prepayments for land and property, plant and equipment of the Target Group were revalued at RMB42,879 million as of 31 December 2004 as required by the relevant PRC rules and regulations. The Target Group expects that the revaluation of fixed assets will have a material impact on its overall results of operations as the Acquisition will be accounted for under the purchase method of accounting. Accordingly, the accompanying unaudited pro forma income statements of the Combined Group has been adjusted to give effect to the revaluation as if the Acquisition had been consummated on 1 January 2004 and on 1 January 2005 respectively.

The accompanying unaudited pro forma financial information of the Combined

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Group is prepared based upon the historical financial information of the Target Group as set out in Appendix II to this circular and the consolidated financial statements of the Group after giving effect to the pro forma adjustments described in the accompanying notes. The historical income statement of the Group for the year ended 31 December 2004 presented in the published audited financial statements 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. The restated income statement of the Group for the year ended 31 December 2004 has been presented in the Company's 2005 interim results announcement dated 12 September 2005 as supplementary financial information and Appendix III to this circular.

Narrative descriptions of the pro forma adjustments that are (i) directly attributable to the transactions; (ii) expected to have a continuing impact on the Combined Group; and (iii) factually supportable, are summarised in the accompanying notes.

The unaudited pro forma financial information of the Combined Group is based on a number of assumptions, estimates, uncertainties and currently available information, and is provided for illustrative purposes. Accordingly, as a result of the uncertain nature of the accompanying unaudited pro forma financial information of the Combined Group, it may not give a true picture of the actual financial position or results of the Combined Group's operations that would have been attained had the Acquisition actually occurred on the dates indicated herein. Further, the accompanying unaudited pro forma financial information of the Combined Group does not purport to predict the Combined Group's future financial position or results of operations.

The unaudited pro forma financial information of the Combined Group should be read in conjunction with the Accountants' Report of the Target Group as set out in Appendix II to this circular, the financial information of the Group as set out in Appendix III to this circular and other financial information included elsewhere in this circular.

3 UNAUDITED PRO FORMA COMBINED BALANCE SHEET AS AT 30 JUNE 2005

The accompanying unaudited pro forma combined balance sheet of the Combined Group as at 30 June 2005 gives effect to the Acquisition as if it had been consummated on 30 June 2005.

| | The Group Historical RMB million | Target Group Historical RMB million | Pro forma adjustments RMB million | Note |
|--|--|---|--|------|
| Assets | | | | |
| Current assets | | | | |
| Cash and bank deposits | 8,790 | 466 | (3,000) | (c) |
| Short-term investments | 439 | - | - | |
| Accounts receivable | 6,778 | 1,859 | - | |
| Inventories and consumables | 502 | 273 | - | |
| Prepayments and other receivables | 1,079 | 366 | - | |
| Due from holding companies and fellow subsidiaries | 489 | 166 | - | |
| Total current assets | 18,077 | 3,130 | (3,000) | |
| Non-current assets | | | | |
| Lease prepayments for land | 1,291 | 437 | 1,878 | (a) |

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| | | | | |
|---|----------|----------|---------|-----|
| Property, plant and equipment | 122,689 | 39,327 | 644 | (a) |
| Construction in progress | 9,172 | 3,178 | - | |
| Intangible assets | 926 | 121 | 2,978 | (b) |
| Deferred costs | 6,250 | 593 | - | |
| Deferred tax assets | 2,881 | 1,143 | (831) | (a) |
| Derivative assets | 2 | - | - | |
| Other non-current assets | 11 | - | - | |
| Total non-current assets | 143,222 | 44,799 | 4,669 | |
| Total assets | 161,299 | 47,929 | 1,669 | |
| Liabilities and equity | | | | |
| Current liabilities | | | | |
| Accounts payable | 13,281 | 6,091 | - | |
| Accruals and other payables | 3,698 | 1,319 | - | |
| Short-term bank loans | 26,425 | 16,978 | - | |
| Current portion of long-term bank and other loans | 4,263 | 3,484 | - | |
| Due to holding companies and fellow subsidiaries | 8,469 | 1,866 | 1,960 | (d) |
| Current portion of deferred revenues | 6,196 | 1,954 | - | |
| Current portion of provisions | 2,480 | 1,513 | - | |
| Taxation payable | 2,656 | 97 | - | |
| Total current liabilities | 67,468 | 33,302 | 1,960 | |
| Net current liabilities | (49,391) | (30,172) | (4,960) | |
| Total assets less current liabilities | 93,831 | 14,627 | (291) | |
| Non-current liabilities | | | | |
| Long-term bank and other loans | 18,280 | 3,213 | - | |
| Due to holding companies | - | - | 7,840 | (d) |
| Deferred revenues | 10,528 | 1,860 | - | |
| Provisions | 2,080 | 1,369 | - | |
| Deferred tax liabilities | 1,354 | 50 | - | |
| Derivative liabilities | 83 | - | - | |
| Other non-current liabilities | 22 | 4 | - | |
| Total non-current liabilities | 32,347 | 6,496 | 7,840 | |
| Total liabilities | 99,815 | 39,798 | 9,800 | |
| Financed by: | | | | |
| Share capital | 2,181 | - | - | |
| Reserves | 59,303 | 8,131 | (8,131) | (e) |
| Owner's equity | 61,484 | 8,131 | (8,131) | |
| Total liabilities and equity | 161,299 | 47,929 | 1,669 | |

Notes to the unaudited pro forma combined balance sheet of the Combined Group

A description of the unaudited pro forma adjustments is as follows.

(a) The adjustment represents the fair value adjustments of Target Group's lease prepayments for land and property, plant and equipment under the purchase method of accounting as if the Acquisition had taken place on 30 June 2005. Accordingly, the deferred tax assets previously recognised by the Target Group arising from the revaluation of lease prepayment for land and building not recognised in the financial statement would be reversed.

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(b) The adjustment represents the recognition of goodwill as a result of the Acquisition as if the Acquisition had taken place on 30 June 2005. Goodwill represents the excess of the total purchase consideration of RMB 12.8 billion and the estimated fair value of the identifiable assets and liabilities of the Target Group as at 30 June 2005.

For the purpose of preparing the unaudited combined balance sheet of the Combined Group after the completion of the Acquisition, the estimated net fair value of the identifiable assets and liabilities of the Target Group as at 30 June 2005 based on the historical cost basis modified by the revaluation of lease prepayments for land and plant, property and equipment are applied in the calculation of the estimated goodwill arising from the Acquisition. Based on the preliminary assessment made by the Directors, no intangible assets would be recognised upon Acquisition. As a formal valuation of the identifiable assets and liabilities, including the intangible assets of the Target Group, will be undertaken on completion of the Acquisition, intangible assets may be recognised and the net fair value of the identifiable assets and liabilities may be substantially different from their fair value used in the preparation of the unaudited combined balance sheet presented above, the actual goodwill arising from the Acquisition may be different from the estimated goodwill shown in this Appendix.

(c) In connection with the Acquisition, an initial cash consideration of RMB 3 billion will be paid by the Company to CNC BVI on completion of the Acquisition. The adjustment reflects the payment of the initial cash consideration as if the Acquisition had taken place on 30 June 2005.

(d) In connection with the Acquisition, a deferred consideration of RMB 9.8 billion, representing the difference between the total consideration and the initial consideration described in note (c) above, is payable by the Company to CNC BVI within five years after the date of completion of the Acquisition. The adjustment reflects the deferred consideration payable as if the Acquisition had taken place on 30 June 2005.

(e) The adjustment represents the elimination of the owners' equity of the Target Group as at 30 June 2005.

4 UNAUDITED PRO FORMA COMBINED INCOME STATEMENT FOR THE YEAR ENDED 31 DECEMBER 2004

The accompanying unaudited pro forma combined income statement for the year ended 31 December 2004 of the Combined Group gives effect to the Acquisition as if it had taken place on 1 January 2004.

| | The Group Historical Restated (e) RMB million | Target Group Historical RMB million | Pro forma adjustments RMB million | Note | Combined Group Pro forma RMB million |
|------------------------------------|---|---|--|------|--|
| Revenues | 64,922 | 18,616 | - | | 83,538 |
| Operating expenses | | | | | |
| Depreciation and amortisation | (18,754) | (6,426) | 618 | (a) | (24,562) |
| Network, operations and support | (11,591) | (2,426) | - | | (14,017) |

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| | | | | | |
|--|----------|----------|-------|-----|----------|
| Staff costs | (8,059) | (3,891) | - | | (11,950) |
| Selling, general and administrative expenses | (9,566) | (3,311) | - | | (12,877) |
| Other operating expenses | (1,534) | (459) | - | | (1,993) |
| Total operating expenses | (49,504) | (16,513) | 618 | | (65,399) |
| Operating profit before interest income, dividend income and deficit on revaluation of property, plant and equipment | 15,418 | 2,103 | 618 | | 18,139 |
| Interest income | 76 | 11 | (43) | (b) | 44 |
| Dividend income | 17 | - | - | | 17 |
| Deficit on revaluation of property, plant and equipment | - | (11,318) | - | | (11,318) |
| Profit/(loss) from operations | 15,511 | (9,204) | 575 | | 6,882 |
| Finance costs | (2,932) | (998) | (490) | (c) | (4,420) |
| Share of loss of associated companies | (1) | - | - | | (1) |
| Profit/(loss) before taxation | 12,578 | (10,202) | 85 | | 2,461 |
| Taxation | (3,348) | 3,671 | (190) | (d) | 133 |
| Profit/(loss) for the year | 9,230 | (6,531) | (105) | | 2,594 |

5 UNAUDITED PRO FORMA COMBINED INCOME STATEMENT FOR THE SIX MONTHS ENDED 30 JUNE 2005

The accompanying unaudited pro forma combined income statement for the six months ended 30 June 2005 of the Combined Group gives effect to the Acquisition as if it had taken place on 1 January 2005.

| | The Group Historical RMB million | Target Group Historical RMB million | Pro forma adjustments RMB million | Note |
|---|---|--|--|------|
| Revenues | 33,724 | 9,712 | - | |
| Operating expenses | | | | |
| Depreciation and amortisation | (9,265) | (3,184) | (44) | (a) |
| Network, operations and support | (5,549) | (992) | - | |
| Staff costs | (4,200) | (1,759) | - | |
| Selling, general and administrative expenses | (4,402) | (1,369) | - | |
| Other operating expenses | (541) | (129) | - | |
| Total operating expenses | (23,957) | (7,433) | (44) | |
| Operating profit before interest income and dividend income | 9,767 | 2,279 | (44) | |
| Interest income | 87 | 3 | (22) | (b) |
| Dividend income | 28 | - | - | |

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| | | | | |
|------------------------|---------|-------|-------|-----|
| Profit from operations | 9,882 | 2,282 | (66) | |
| Finance costs | (1,226) | (501) | (258) | (c) |
| Profit before taxation | 8,656 | 1,781 | (324) | |
| Taxation | (2,298) | (451) | 22 | (d) |
| Profit for the period | 6,358 | 1,330 | (302) | |

Notes to the unaudited pro forma combined income statements of the Combined Group

A description of the unaudited pro forma adjustments is as follows.

(a) For the unaudited pro forma combined income statement for the year ended 31 December 2004, the adjustment represents the reduction in depreciation and amortisation resulting from the fair value adjustments on the lease prepayments for land and property, plant and equipment of the Target Group under the purchase method of accounting as if the Acquisition had taken place on 1 January 2004.

For the unaudited pro forma combined income statement for the period ended 30 June 2005, the adjustment represents the increase in depreciation and amortisation resulting from the fair value adjustments on the lease prepayments for land and property, plant and equipment of the Target Group under the purchase method of accounting as if the Acquisition had taken place on 1 January 2005.

(b) The adjustment reflects the reduction in interest income for the initial cash consideration described in note (c) in Section 3 above to be taken from the internal resources of the Group as if the Acquisition had taken place on 1 January 2004 and 1 January 2005.

(c) The adjustment represents the interest expenses charged on the deferred consideration described in note (d) in Section 3 above at 5.265% per annum as if the Acquisition had taken place on 1 January 2004 and 1 January 2005. The interest expense is not deductible for taxation purposes.

(d) The adjustment represents the tax effect of the pro forma adjustment described above.

(e) The historical income statement of the Group for the year ended 31 December 2004 presented in the published audited financial statements 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. The restated income statement of the Group for the year ended 31 December 2004 has been presented in the Company's 2005 interim results announcement dated 12 September 2005 as supplementary financial information and Appendix III to this circular.

6 REPORT ON THE UNAUDITED PRO FORMA FINANCIAL INFORMATION OF THE COMBINED GROUP

The following is the text of a report, prepared for the sole purpose of inclusion in this circular, received from the independent reporting accountants, PricewaterhouseCoopers, Certified Public Accountants, Hong Kong.

[PRICEWATERHOUSECOOPERS LETTERHEAD GRAPHIC OMITTED]

23 September 2005

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The Directors
China Netcom Group Corporation (Hong Kong) Limited

Dear Sirs,

We report on the unaudited pro forma financial information of the Combined Group (as defined below) set out in Appendix IV to the circular of China Netcom Group Corporation (Hong Kong) Limited (the "Company", and together with its existing subsidiaries the "Group") dated 23 September 2005 (the "Circular") in connection with the proposed acquisition of China Netcom Group New Horizon Communications Corporation (BVI) Limited and its subsidiary China Netcom Group New Horizon Communications Corporation Limited (collectively the "Target Group", and together with the Group the "Combined Group"). The unaudited pro forma financial information has been prepared by the directors of the Company, for illustrative purposes only, to provide information about how the proposed acquisition of the Target Group resulting in the formation of the Combined Group might have affected the income statements of the Group for the year ended 31 December 2004 and the six months ended 30 June 2005 and the balance sheet as of 30 June 2005.

RESPONSIBILITIES

It is the responsibility of the directors of the Company to prepare the unaudited pro forma financial information in accordance with Rule 4.29 of the Rules Governing the Listing of Securities on the Stock Exchange of Hong Kong Limited ("the Hong Kong Listing Rules").

It is our responsibility to form an opinion, as required by Rule 4.29 of the Hong Kong Listing Rules, on the unaudited pro forma financial information and to report our opinion to you. We do not accept any responsibility for any reports previously given by us on any financial information used in the compilation of the unaudited pro forma financial information beyond that owed to those to whom those reports were addressed by us at the dates of their issue.

BASIS OF OPINION

We conducted our work with reference to the Statements of Investment Circular Reporting Standards and Bulletin 1998/8 "Reporting on pro forma financial information pursuant to the Listing Rules" issued by the Auditing Practices Board in the United Kingdom, where applicable. Our work, which involved no independent examination of any of the underlying financial information, consisted primarily of comparing the unadjusted financial information with the source documents, considering the evidence supporting the adjustments and discussing the unaudited pro forma financial information with the directors of the Company.

Our work does not constitute an audit or review in accordance with Statements of Auditing Standards issued by the Hong Kong Institute of Certified Public Accountants, and accordingly, we do not express any such assurance on the unaudited pro forma financial information.

The unaudited pro forma financial information has been prepared on the bases set out in Appendix IV to the Circular for illustrative purposes only and, because of its nature, it may not be indicative of the financial position of the Combined Group at any future date and the results of the Combined Group for any future periods.

OPINION

In our opinion:

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(a) the unaudited pro forma financial information has been properly compiled by the directors of the Company on the basis stated;

(b) such basis is consistent with the accounting policies of the Group; and

(c) the adjustments are appropriate for the purposes of the unaudited pro forma financial information as disclosed pursuant to Rule 4.29 of the Hong Kong Listing Rules.

Yours faithfully
PricewaterhouseCoopers
Certified Public Accountants
Hong Kong

7 INDEBTEDNESS

Borrowings

At the close of business on 31 July 2005, being the latest practicable date for the purpose of this indebtedness statement, the Combined Group had the following outstanding borrowings:

Short-term debts

| | Interest rate and final maturity | RMB million |
|-----------------------|---|-------------|
| Short-term bank loans | | |
| Renminbi denominated | Interest rates ranging from 4.70% to 5.02% per annum with maturity through 15 July 2006 | 42,015 |
| US dollar denominated | Interest rates ranging from 3.58% to 4.70% per annum with maturity through 29 November 2005 | 219 |

| | | |
|---|--|-------|
| Current portion of long-term bank loans and finance lease obligations | | 7,490 |
|---|--|-------|

49,724

Long-term debts

| | Interest rate and final maturity | RMB million |
|--|--|-------------|
|--|--|-------------|

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| | | |
|---|--|---------|
| Long-term bank loans Renminbi denominated | Interest rates ranging from 0.50% to 10.08% per annum with maturity through 1 November 2011 | 20,071 |
| US dollar denominated | Interest rates ranging from 0.50% to 8.00% per annum with maturity through 31 December 2039 | 1,737 |
| Japanese Yen denominated | Interest rates ranging from 2.12% to 2.60% per annum with maturity through 18 June 2027 | 895 |
| Euro denominated | Interest rates ranging from 0.50% to 7.35% per annum with maturity through 15 March 2034 | 454 |
| Finance lease obligations | | 2,421 |
| Current portion of long-term bank loans and finance lease obligations | | (7,490) |
| | | 18,088 |

All the short term bank loans as at 31 July 2005 were unsecured. Among the long-term bank loans as of 31 July 2005, RMB1,019 million were secured, of which RMB724 million is secured by corporate guarantee granted by China Netcom Group. The remaining balance is secured by corporate guarantee granted by third parties.

As of 31 July 2005, long-term bank loans of RMB1 million were secured by certain property, plant and equipment of the Combined Group. The net book value of such property, plant and equipment amounted to RMB3 million as of 31 July 2005.

Contractual obligations and commercial commitments

The following table sets forth the Combined Group's contractual obligations as of 31 July 2005:

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| | Total | Not later than one year | Later than one year and not later than five years |
|------------------------------------|--------|-------------------------|---|
| | | | (RMB in millions) |
| Short-term debt | 42,234 | 42,234 | - |
| Capacity purchase payable | 241 | 21 | 57 |
| Long-term debt | 25,578 | 7,490 | 14,979 |
| Operating lease commitments | 1,285 | 487 | 584 |
| Capital commitments | 3,309 | 3,058 | 251 |
| Total contractual cash obligations | 72,647 | 53,290 | 15,871 |

The following table sets forth the Combined Group's other commercial commitments as of 31 July 2005:

| | Total | Not later than one year | Later than one year and not later than five years |
|--|-------|-------------------------|---|
| | | | (RMB in millions) |
| Guarantees for US dollar denominated bank loans of third parties | 277 | 277 | - |
| Total commercial commitments | 277 | 277 | - |

The Directors confirm that there are no material changes in indebtedness and contingent liabilities of the Combined Group since 31 July 2005.

Disclaimer

Save as aforesaid and apart from intra-group liabilities, the Combined Group did not have, at the close of business on 31 July 2005, outstanding liabilities or any mortgages, charges, debentures, loan capital issued and outstanding or authorised or otherwise created but unissued, bank overdrafts, loans, liabilities under acceptance or other similar indebtedness, hire purchase and finance lease commitments or any guarantees or other material contingent liabilities.

8 WORKING CAPITAL

The Directors are of the opinion that after taking into account the internal resources of the Combined Group and the sources of financing available to the Combined Group, the Combined Group will, following the completion of the Acquisition, have sufficient working capital for its present requirements.

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The Target Group's forecast combined profit for the year ending 31 December 2005 under HKFRS is set out in the section headed "Prospective Financial Information" in the Letter from the Chairman.

1 BASES AND ASSUMPTIONS

The forecast combined profit of the Target Group for the year ending 31 December 2005 was prepared by the directors of the Company and the management of the Target Group based on the audited combined financial information of the Target Group for the six months ended 30 June 2005 and the forecast of the combined financial information of the Target Group for the remaining six months of the year ended 31 December 2005. The management of 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. The profit forecast has been prepared on a basis consistent in all material respects with the accounting policies currently adopted by the Target Group as summarised in Appendix II to this circular and on the following principal assumptions:

- (1) there will be no material changes in existing political, legal, regulatory, fiscal or economic conditions in the PRC, Hong Kong, or any other territories in which the Target Group currently operates or which are otherwise material to the Target Group's revenues;
- (2) there will be no material changes in legislation or regulations governing the telecommunications industry in the PRC, Hong Kong or any other country or territory in which the Target Group operates or which the Target Group has arrangements or agreements with, which would materially affect the business or operations of the Target Group;
- (3) inflation, interest rates or foreign currency exchange rates will not differ materially from those prevailing as of the date of this circular;
- (4) there will be no material changes in the bases or rates of taxation appropriate to the Target Group, except as otherwise disclosed in this circular; and
- (5) based on information currently available, there will be no tariff reduction that will have a material adverse effect on the Target Group's business.

2 LETTERS

Set out below are the texts of the letters received by the Directors from PricewaterhouseCoopers, the independent reporting accountants of the Company, and from the Financial Advisers in connection with the profit forecast for the year ending 31 December 2005 and prepared for the purpose of inclusion in this circular:

- (1) Letter from PricewaterhouseCoopers

[PRICEWATERHOUSECOOPERS LETTERHEAD GRAPHIC OMITTED]

23 September 2005

The Directors
China Netcom Group Corporation (Hong Kong) Limited

Dear Sirs,

We have reviewed the calculations of and accounting policies adopted in arriving at the forecast of the combined profit for the year ending 31 December

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2005 of China Netcom Group New Horizon Communications Corporation (BVI) Limited and its subsidiary China Netcom Group New Horizon Communications Corporation Limited (collectively the "Target Group") (the "Profit Forecast") as set out in the section headed "Prospective Financial Information" in the Letter from the Chairman in the circular (the "Circular") dated 23 September 2005 issued by China Netcom Group Corporation (Hong Kong) Limited (the "Company") to its shareholders.

We conducted the work in accordance with the Auditing Guideline 3.341 on "Accountants' report on profit forecasts" issued by the Hong Kong Institute of Certified Public Accountants.

The Profit Forecast, for which the directors of the Company and the management of the Target Group are solely responsible, has been prepared by the directors of the Company and the management of the Target Group based on the audited combined financial information of the Target Group for the six months ended 30 June 2005 and the forecast of the combined financial information of the Target Group for the remaining six months of the year ending 31 December 2005.

In our opinion, the Profit Forecast, so far as the calculations and accounting policies are concerned, has been properly compiled on the bases and assumptions made by the directors of the Company and the management of the Target Group as set out in Appendix V to the Circular, and is presented on a basis consistent in all material respects with the accounting policies presently adopted by the Target Group as set out in our Accountants' Report dated 23 September 2005, the text which is set out in Appendix II to the Circular.

Yours faithfully,
PricewaterhouseCoopers
Certified Public Accountants
Hong Kong

(2) Letter from the Financial Advisers

[CICC GRAPHIC OMITTED]
China International Capital
Corporation (Hong Kong) Limited

[CITIGROUP GRAPHIC OMITTED]
Citigroup Global Markets
Asia Limited

[GOLDMAN SACHS GRAPHIC OMITTED]
Goldman Sachs (Asia)
L.L.C.

23 September 2005
The Directors
China Netcom Group Corporation (Hong Kong) Limited
46th Floor
Cheung Kong Center
2 Queen's Road Central
Hong Kong

Dear Sirs,

We refer to the forecast of the combined profit for the year ending 31 December 2005 of China Netcom Group New Horizon Communications Corporation (BVI) Limited and China Netcom Group New Horizon Communications Corporation Limited (collectively the "Target Group") (the "Forecast") as set out in the circular dated 23 September 2005 issued by China Netcom Group Corporation (Hong Kong) Limited (the "Company") to its shareholders.

We have discussed with you the bases and assumptions upon which the Forecast has been made. We have also considered the letter dated 23 September 2005 addressed to you from PricewaterhouseCoopers regarding the accounting policies and calculations upon which the Forecast has been made. On the basis of the

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assumptions made by the management of the Company and the Target Group, and on the bases of the accounting policies and calculations reviewed by PricewaterhouseCoopers, we are of the opinion that the Forecast, for which the management of the Company and the Target Group are solely responsible, has been made after due and careful enquiry.

Yours faithfully,
For and on behalf of
China International Capital
Corporation (Hong Kong)
Limited
Shirley Chen
Managing Director

Yours faithfully,
For and on behalf of
Goldman Sachs (Asia)
L.L.C.
Xiaoyin Zhang
Executive Director

Yours faithfully,
For and on behalf of
Citigroup Global Markets
Asia Limited
Stephen M. Winningham
Managing Director

APPENDIX VI GENERAL INFORMATION

1 RESPONSIBILITY STATEMENT

This circular includes particulars given in compliance with the Hong Kong Listing Rules for the purpose of giving information with regard to the Company. The Directors collectively and individually accept full responsibility for the accuracy of the information contained in this circular and confirm, 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 herein misleading.

2 DISCLOSURE OF INTERESTS

As at Latest Practicable Date, the following Directors and chief executive of the Company had, or were deemed to have, interests or short positions in the shares, underlying shares or debentures of the Company or any of its associated corporations (within the meaning of Part XV of the Securities and Futures Ordinance) which were required to be notified to the Company and the Hong Kong Stock Exchange pursuant to Divisions 7 and 8 of Part XV of the Securities and Futures Ordinance (including interests and short positions which they were deemed or taken to have under such provisions of the Securities and Futures Ordinance), or which are required, pursuant to section 352 of the Securities and Futures Ordinance to be entered in the register referred to therein, or which are required, pursuant to the Model Code for Securities Transactions by Directors of Listed Issuers contained in the Hong Kong Listing Rules, to be notified to the Company and the Hong Kong Stock Exchange.

| Name of Directors | Number and description of equity derivatives | No. of underlying Shares involved in the Options |
|-------------------|--|--|
| Zhang Chunjiang | 920,000 | 920,000 |

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| | | |
|--|---------------------------|-----------|
| Tian Suning (also the chief executive officer) | Options (Note) 920,000 | 920,000 |
| Zhang Xiaotie | Options (Note) 800,000 | 800,000 |
| Miao Jianhua | Options (Note) 700,000 | 700,000 |
| Jiang Weiping | Options (Note) 700,000 | 700,000 |
| Li Liming | Options (Note) 700,000 | 700,000 |
| Yan Yixun | Options (Note) 590,000 | 590,000 |
| Keith Rupert Murdoch | Options (Note) 590,000 | 590,000 |
| | Options (Note) | |
| Total | | 5,920,000 |

Note:

The Options were all granted on 22 October 2004 under the share option scheme approved and adopted by a resolution of the Shareholders passed on 30 September 2004. Grantees of such Options are entitled to exercise the Options at a price of HK\$8.40 per Share in the following periods:

- (i) in respect of 40% of the Options granted, from 17 May 2006 to 16 November 2010;
- (ii) in respect of a further 30% of the Options granted, from 17 May 2007 to 16 November 2010; and
- (iii) in respect of the remaining 30% of the Options granted, from 17 May 2008 to 16 November 2010.

Save as disclosed above, as at the Latest Practicable Date, none of the Directors nor the chief executive of the Company had or was deemed to have any interests or short positions in the shares, underlying shares or debentures of the Company or any of its associated corporations (within the meaning of Part XV of the Securities and Futures Ordinance) which were required to be notified to the Company and the Hong Kong Stock Exchange pursuant to Divisions 7 and 8 of Part XV of the Securities and Futures Ordinance (including interests and short positions which they were deemed or taken to have under such provisions of the Securities and Futures Ordinance), or which were required, pursuant to section 352 of the Securities and Futures Ordinance to be entered in the register referred to therein, or which are required, pursuant to the Model Code for Securities Transactions by Directors of Listed Issuers contained in the Hong Kong Listing Rules, to be notified to the Company and the Hong Kong Stock Exchange.

China Netcom Group is the ultimate holding company of the Company who, through CNC BVI, was beneficially interested in approximately 70.49% of the issued share capital of the Company as at the Latest Practicable Date. The executive Directors also hold executive positions with China Netcom Group. Details of the shareholding of China Netcom Group in the Company are set out in the paragraph headed "Substantial Shareholders" in this Appendix. Save as disclosed herein, none of the Directors is a director or employee of a company which has, or is deemed to have, an interest or short position in the Shares or underlying Shares which would fall to be disclosed to the Company under the provisions of Divisions 2 and 3 of Part XV of the Securities and Futures Ordinance.

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None of the Directors is materially interested in any contract or arrangement subsisting as at the Latest Practicable Date which is significant in relation to the business of the Combined Group taken as a whole.

Since 31 December 2004, the date to which the latest published audited consolidated financial statements of the Group were made up, none of the Directors nor any experts named in the paragraph headed "Qualification of experts" in this Appendix has any direct or indirect interest in any assets which have been acquired or disposed of by or leased to any member of the Combined Group, or are proposed to be acquired or disposed of by or leased to any member of the Combined Group.

3 SUBSTANTIAL SHAREHOLDERS

So far as is known to the Directors and the chief executive of the Company, as at the Latest Practicable Date, the following corporations had, or were deemed to have, interests or short positions in the Shares or underlying Shares which would fall to be disclosed to the Company and the Hong Kong Stock Exchange under the provisions of Divisions 2 and 3 of Part XV of the Securities and Futures Ordinance, or who was, directly or indirectly, interested in 10% or more of the nominal value of any class of share capital carrying rights to vote in all circumstances at general meetings of any member of the Combined Group:

| Name of substantial shareholder | Number of Shares interested | | Percentage of total issued share capital (%) |
|---------------------------------------|-----------------------------|-----------------------|--|
| | directly | Indirectly | |
| China Netcom Group | - | 4,945,148,000 (1) (2) | 75.0 |
| CNC BVI | 4,647,449,014 (1) | 297,698,986 (1) (2) | 75.0 |
| Telefónica Aonica Internacional, S.A. | 329,676,450 | - | 5.0 |

Notes:

(1) China Netcom Group beneficially owns 4,647,449,014 Shares held by its wholly-owned subsidiary, CNC BVI and one share held by CNC Cayman, Limited ("CNC Cayman"), a wholly-owned subsidiary of CNC BVI. The percentage of total issued share capital beneficially held by China Netcom Group is 70.49%.

(2) China Netcom Group is deemed under the Securities and Futures Ordinance to be interested in 297,698,985 Shares held by CNC BVI as trustee on behalf of certain Shareholders.

Save as disclosed above, as at the Latest Practicable Date, the Directors and the chief executive of the Company were not aware of any other person who had, or was deemed to have, an interest or short position in the Shares and underlying Shares, which would fall to be disclosed to the Company and the Hong Kong Stock Exchange under the provisions of Divisions 2 and 3 of Part XV of the Securities and Futures Ordinance, or, who was, directly or indirectly, interested in 10% or more of the nominal value of any class of share capital carrying rights to vote in all circumstances at general meetings of any member of the Group, or any options in respect of such capital.

4 LITIGATION

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As at the Latest Practicable Date, no member of the Combined Group was engaged in any litigation, arbitration or claim of material importance and no litigation, arbitration or claim of material importance is known to the Directors to be pending or threatened against any member of the Combined Group.

5 SERVICE CONTRACTS

As at the Latest Practicable Date, none of the Directors had entered into, or proposed to enter into, any service contract with the Company or any member of the Combined Group (excluding contracts expiring or determinable by the employer within one year without payment of compensations (other than statutory compensation)).

The aggregate of the remuneration payable to and benefits in kind receivable by the Directors will not be varied in consequence of the Acquisition.

6 MATERIAL ADVERSE CHANGE

As at the Latest Practicable Date, the Directors were not aware of any material adverse change in the financial or trading position of the Group since 31 December 2004, being the date to which the latest published audited consolidated financial statements of the Group were made up.

7 CONSENT

CICC, Citigroup, Goldman Sachs, PricewaterhouseCoopers and CSFB have given and have not withdrawn their respective written consents to the issue of this circular with the inclusion of their reports and letters (if any), as the case may be, and references to their names in the form and context in which they respectively appear.

As at 12 September 2005, CSFB group companies had a beneficial interest in 30,034,200 Shares (representing approximately 0.456% of the issued share capital of the Company). In addition, CSFB had a short position of 853,000 Shares (representing approximately 0.013% of the issued share capital of the Company).

Save as disclosed above, none of CICC, Citigroup, Goldman Sachs, PricewaterhouseCoopers and CSFB is beneficially interested in the share capital of any member of the Group and none of them has any right, whether legally enforceable or not, to subscribe for or to nominate persons to subscribe for securities in any member of the Group.

8 QUALIFICATIONS OF EXPERTS

The following are the qualifications of the professional advisers who have given opinions or advice contained in this circular:

| Names | Qualifications |
|-----------|--|
| CICC | a licensed corporation for type 1 (dealing in securities), type 4 (advising on securities), type 6 (advising on corporate finance) and type 9 (asset management) regulated activities under the Securities and Futures Ordinance |
| Citigroup | a deemed licensed corporation for type 1 (dealing in securities), type 4 (advising on securities) and type 6 (advising on corporate finance) regulated activities under the Securities and Futures Ordinance |

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| | |
|--------------------------------|--|
| Goldman Sachs | a licensed corporation for type 1 (dealing in securities), type 4 (advising on securities), type 5 (advising on futures contracts), type 6 (advising on corporate finance) and type 9 (asset management) regulated activities under the Securities and Futures Ordinance |
| PricewaterhouseCoopers CSFB | Certified public accountants a deemed licensed corporation for Type 1 (dealing in securities), Type 4 (advising on securities) and Type 6 (advising on corporate finance) regulated activities under the Securities and Futures Ordinance |

9 MATERIAL CONTRACTS

The following contracts (not being contracts entered into in the ordinary course of business) have been entered into by members of the Group within the two years immediately preceding the date of this circular, and are or may be material:

(a) the Acquisition Agreement;

(b) the Cooperation Agreement dated 15 September 2005 entered into between China Netcom Group and CNC China, pursuant to which CNC China agreed to provide telecommunications goods and services with a monetary value not exceeding RMB480 million to Beijing Organization Committee for the Games of the XXIX Olympiad for the 2008 Beijing Olympic Games. As consideration, CNC China is entitled to the right and opportunity to conduct products-related marketing activities by using the 2008 Olympics composite logo and sponsorship logo as provided for under the Sponsorship Agreement entered into between China Netcom Group and Beijing Organization Committee for the Games of the XXIX Olympiad;

(c) the Memorandum of Understanding dated 21 July 2005 entered into between the Company and Telefónica, S.A. pursuant to which the Company and Telefónica, S.A. shall establish a board strategic alliance and shall explore possible areas of co-operation which would confer mutual benefit to both parties;

(d) ten agreements entered into between China Netcom Group, the Target Company, the Company and CNC China referred to in the section headed "Letter from the Chairman - Continuing connected transactions";

(e) the Underwriting Agreement dated 3 November 2004 entered into among the Company, China Netcom Group, CNC BVI, CICC, Citigroup, Goldman Sachs and the other underwriters in relation to the initial public offering of the Shares in Hong Kong and the U.S. and International Underwriting Agreement dated 10 November 2004 entered into among the Company, China Netcom Group, certain Shareholders, CICC, Citigroup, Goldman Sachs and the other underwriters in relation to the international offering and the U.S. offering of Shares;

(f) the Interconnection Settlement Agreement dated 8 October 2004 entered into between CNC China and China Netcom Group under which CNC China and China Netcom Group agreed to interconnect their respective networks and settle the charges received in respect of domestic and international long distance voice services within their respective service regions;

(g) the Property Leasing Agreement dated 8 October 2004 entered into between CNC China and China Netcom Group under which (i) CNC China agreed to lease properties to China Netcom Group for use as offices and other ancillary purposes; and (ii) China Netcom Group agreed to lease properties to CNC China for use as offices, telecommunications equipment sites and other ancillary

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purposes;

(h) the Property Sub-leasing Agreement dated 8 October 2004 entered into between CNC China and China Netcom Group under which China Netcom Group agreed to sub-let properties to CNC China for use as offices, telecommunications equipment sites and other ancillary purposes;

(i) the Master Services Sharing Agreement dated 8 October 2004 entered into between CNC China and China Netcom Group regarding the provision and sharing of various services between CNC China and China Netcom Group;

(j) the Engineering and Information Technology Services Agreement dated 8 October 2004 entered into between CNC China and China Netcom Group regarding the provision of engineering and information technology-related services to CNC China by China Netcom Group;

(k) the Materials Procurement Agreement dated 8 October 2004 entered into between CNC China and China Netcom Group under which (i) CNC China 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; (ii) CNC China may purchase from China Netcom Group certain products, including cables, modems and yellow pages telephone directories; and (iii) China Netcom Group will provide to CNC China storage and transportation services related to the procurement and purchase of materials or equipment under the agreement;

(l) the Ancillary Telecommunications Services Agreement dated 8 October 2004 entered into between CNC China and China Netcom Group regarding the provision of ancillary telecommunications services to CNC China by China Netcom Group;

(m) the Support Services Agreement dated 8 October 2004 entered into between CNC China and China Netcom Group regarding the provision of various support services by China Netcom Group to CNC China, including equipment leasing and maintenance services, motor vehicles services, safety and security services, basic construction agency services, research and development services, employee training services and advertising services and other support services;

(n) the Telecommunications Facilities Leasing Agreement dated 8 October 2004 entered into between CNC China and China Netcom Group under which China Netcom Group agreed to lease inter-provincial fiber-optic cables and certain international telecommunications resources to CNC China;

(o) the Trademark Licensing Agreement dated 8 October 2004 entered into among CNC China, China Netcom Group and the Company regarding the licensing of the Company's logo and certain trademarks from China Netcom Group on a royalty free basis to CNC China and the Company;

(p) the Restructuring Agreement dated 6 September 2004 entered into among CNC China, China Netcom Group and the Company regarding the restructuring of the businesses and operations previously owned by, or transferred to, the Company;

(q) the Non-competition Agreement dated 6 September 2004 entered into among CNC China, China Netcom Group and the Company in relation to the non-competition undertaking by China Netcom Group;

(r) the Letter of Undertakings dated 5 September 2004 given by China Netcom Group to the Company in relation to certain undertakings given by China Netcom Group in favour of the Company for extending support to the Company's existing operations and future development;

(s) the Capacity Purchase Agreement dated 30 June 2004 entered into between Asia Netcom and EANL, pursuant to which Asia Netcom and its subsidiaries will

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receive from EANL and its subsidiaries a certain amount of long-term telecommunications capacity on the submarine network;

(t) the Capacity Lease Agreement dated 30 June 2004 entered into between Asia Netcom and EANL, pursuant to which, among other things, Asia Netcom and its subsidiaries lease from EANL and its subsidiaries a fixed amount of capacity on EANL's telecommunications network, and may order additional lease capacity from EANL and its subsidiaries;

(u) the Management Services Agreement dated 30 June 2004 entered into between Asia Netcom and EANL, pursuant to which Asia Netcom and its subsidiaries will provide EANL and its subsidiaries with certain services, including government and corporate affairs services, treasury services, financial services, information technology services, legal and corporate secretarial services, tax services, payment services, and comprehensive engineering and operation services in relation to the submarine network;

(v) the Debenture dated 29 July 2004 entered into among Asia Netcom Asia Pacific Limited, Asia Netcom Asia Pacific Commercial Limited and Asia Netcom Hong Kong Limited as Chargors and Industrial and Commercial Bank of China (Asia) Limited as Security Trustee pursuant to which each of the Chargors charges all its rights, title and interest in and to the properties listed in the Debenture in favor of the Security Trustee as trustee for the benefit of the finance parties in a facility agreement dated 2 December 2003;

(w) the Deed of Mortgage of Shares dated 29 July 2004 entered into between Asia Netcom as Mortgagor and Industrial and Commercial Bank of China (Asia) Limited as Security Trustee under which Asia Netcom mortgages and charges by way of first fixed charge all its rights, title and interest, present and future in and to the shares listed in the Deed of Mortgage of Shares to the Security Trustee as trustee for the benefit of the finance parties as defined in a facility agreement dated 2 December 2003;

(x) the Debenture dated 29 July 2004 entered into between Asia Netcom Services (S) Pte. Ltd., Asia Netcom Corporation (Singapore) Pte. Limited, Asia Netcom Singapore Pte. Ltd. and Southeast Asia Netcom (Singapore) Pte. Ltd. as Chargors and Industrial and Commercial Bank of China (Asia) Limited as Security Trustee in which each of the Chargors charges and agrees to charge, inter alia, by first fixed legal charge all its rights, title and interest in and to the real property described the Debenture in favor of the Security Trustee as trustee for the benefit of the finance parties in a facility agreement dated 2 December 2003;

(y) the Group Share Mortgage dated 29 July 2004 entered into among Asia Netcom, Asia Netcom Corporation (Singapore) Pte. Limited and Asia Netcom Singapore Pte. Ltd. as Mortgagors and Industrial and Commercial Bank of China (Asia) Limited as Security Trustee in which each Mortgagor, among other things, mortgages and charges by way of first fixed charge all its rights, title and interest present and future in and to the assets of each Mortgagor from time to time subject to the security interest described in the Group Share Mortgage, to the Security Trustee as trustee for the benefit of the finance parties in a facility agreement dated 2 December 2003;

(z) the Assignment of Building Agreement dated 29 July 2004 entered into between Asia Netcom Singapore Pte. Ltd. as Assignor and Industrial and Commercial Bank of China (Asia) Limited as Security Trustee in which, inter alia, the Assignor assigns and agrees to assign absolutely all the present and future rights, title, interests, benefits, advantages, permits and licences which the Assignor has and the Assignor's rights to the issue of the lease as defined in the Assignment of Building Agreement to the Security Trustee in consideration of the availability of a term loan facility of up to US\$150,000,000 to Asia Netcom under a facility Agreement dated 2 December 2003.

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(aa) the Share Pledge Agreement dated 28 July 2004 entered into among Asia Netcom Corporation (Singapore) Pte. Ltd. as the Pledgor, the seven financial institutions listed in the Share Pledge Agreement as Pledgees and Industrial and Commercial Bank of China (Asia) Limited as Security Trustee pursuant to which the Pledgor pledges by way of first priority pledge all of its rights, titles, interests and benefits in the shares of various companies listed in the Share Pledge Agreement to the Pledgees and the Pledgees accept such pledge as collateral security for Asia Netcom's due and punctual payment, performance and discharge in full of the secured obligations as defined in a facility agreement dated 2 December 2003;

(bb) the Amended and Restated Facility Agreement dated 27 July 2004 entered into among Asia Netcom as Borrower, the seven banks named in the Amended and Restated Facility Agreement as Lenders, Industrial and Commercial Bank of China (Asia) Limited as Arranger and Industrial and Commercial Bank of China (Asia) Limited as Facility Agent whereby the Lenders agree to make available to the Borrower a term loan facility of up to US\$150,000,000;

(cc) the Group Subordination Deed dated 27 July 2004 entered into between Asia Netcom as Subordinated Lender and Industrial and Commercial Bank of China (Asia) Limited as Security Trustee whereby the Subordinated Lender agrees, among other things, that the subordinated indebtedness owing to it is and shall remain subordinated and shall not be repaid or repayable except with the prior written consent of the Security Trustee;

(dd) the Group Subordination Deed dated 27 July 2004 entered into among the Company, China Netcom Corporation International Limited as Subordinated Lenders, Asia Netcom as Borrower and Industrial and Commercial Bank of China (Asia) Limited as Security Trustee pursuant to which each of the Subordinated Lenders agrees, among other things, that the subordinated indebtedness owing to it is and shall remain subordinated and shall not be repaid or repayable except with the prior written consent of the Security Trustee;

(ee) the Debenture dated 27 July 2004 entered into between Asia Netcom as Chargor and Industrial and Commercial Bank of China (Asia) Limited as Security Trustee pursuant to which the Chargor creates fixed and floating charges over its assets and undertakings in favor of the Security Trustee as trustee for the benefit of the finance parties in a facility agreement dated 2 December 2003;

(ff) the Group Assignment of Insurances dated 27 July 2004 entered into among Asia Netcom as Borrower, EANL as Assignors and Industrial and Commercial Bank of China (Asia) Limited as Security Trustee pursuant to which each of the Borrower and Assignor mortgages, charges and agrees to charge, among other things, all of the rights, title, interest and benefit of the Borrower and each Assignor in and to the insurances in favor of the Security Trustee as trustee for the benefit of the finance parties in a facility agreement dated 2 December 2003;

(gg) the Security Assignment dated 27 July 2004 entered into between Asia Netcom as Assignor and Industrial and Commercial Bank of China (Asia) Limited as Security Trustee under which the Assignor assigns absolutely by way of security all of its rights, title and interest described in the Security Assignment to the Security Trustee in consideration of a facility agreement dated 2 December 2003;

(hh) the Charge Over Deposit Account dated 27 July 2004 entered into between Asia Netcom as Chargor and Industrial and Commercial Bank of China (Asia) Limited as Security Trustee under which the Chargor irrevocably charges by way of first floating charge all the rights, title, interest and benefit of the Chargor in and to a deposit account to the Security Trustee as trustee for the benefit of the finance parties in a facility agreement dated 2 December 2003;

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(ii) the Charge Over Accounts dated 27 July 2004 entered into between Asia Netcom as Chargor and Industrial and Commercial Bank of China (Asia) Limited as Security Trustee under which the Chargor irrevocably charges by way of first fixed charge all the rights, title, interest and benefit of the Chargor in and to charged accounts to the Security Trustee as trustee for the benefit of the finance parties in the facility agreement dated 2 December 2003;

(jj) the Deed of Mortgage of Shares in Asia Netcom dated 27 July 2004 entered into between China Netcom Corporation International Limited as Mortgagor and Industrial and Commercial Bank of China (Asia) Limited as Security Trustee under which, among other things, the Mortgagor mortgages and charges by way of first fixed charge the assets of the Mortgagor subject to the security interest described in the Deed of Mortgage of Shares in Asia Netcom as trustee for the benefit of the finance parties in a facility agreement dated 2 December 2003;

(kk) the Guarantee and Indemnity dated 27 July 2004 entered into between the Company as Guarantor and Industrial and Commercial Bank of China (Asia) Limited as Security Trustee in which the Guarantor unconditionally and irrevocably guarantees, among other things, as a continuing obligation, the due and punctual payment and performance of the guaranteed obligations defined in the Guarantee and Indemnity in the currency in which the same is payable under the terms of a facility agreement to the Security Trustee as trustee for the benefit of the finance parties in the facility agreement dated 2 December 2003;

(ll) the Share Purchase and Exchange Agreement dated 11 June 2004 and its amendment agreement dated 20 July 2004 entered into among the Company, CNC BVI and CNC Fund, L.P. under which CNC Fund, L.P. sold 6,400,000 ordinary shares of US\$0.01 each and 30,967,127 of Series A preference shares of US\$0.01 each of the Company to CNC BVI;

(mm) the Share Purchase and Sale Agreement dated 30 June 2004 entered into between Asia Netcom and CNC Network Corporation Limited pursuant to which Asia Netcom sold all its shares in EANL to CNC Network Corporation Limited and caused certain restructuring to take place within Asia Netcom and its subsidiaries prior to or contemporaneously with the closure of such sale;

(nn) the Assignment and Novation Agreement dated 30 June 2004 entered into among Asia Netcom, the Company and CNC Network Corporation Limited pursuant to which CNC Network Corporation Limited's obligation to pay US\$43,362,136.00 under a note issued by CNC Network Corporation Limited to Asia Netcom (as consideration for the sale by Asia Netcom of EANL) is novated to the Company;

(oo) the Asset Injection Agreement dated 29 June 2004 entered into among China Netcom Group, CNC BVI, CNC China and the Company pursuant to which China Netcom Group transferred certain assets, businesses and related liabilities in China firstly to CNC BVI, then to the Company and finally to CNC China and in consideration of which, the Company issued 21,769,032,873 ordinary shares of US\$0.01 each in the Company to CNC BVI;

(pp) the Agreement for Transfer of Assets and Liabilities dated 23 June 2004 entered into between CNC China and China Netcom Group pursuant to which CNC China transferred all of its assets and liabilities in the China to China Netcom Group;

(qq) the Share Purchase Agreement dated 2 December 2003 entered into among the Company, SBAIF Asia Netcom (Cayman) Holdings, China Netcom Corporation International Limited and Asia Netcom pursuant to which SBAIF Asia Netcom (Cayman) Holdings sold 29,400,000 shares of Asia Netcom to China Netcom Corporation International Limited, Asia Netcom and the Company; and

(rr) the Share Purchase Agreement dated 2 December 2003 entered into among the

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Company, Newbridge Asia Netcom (Cayman) Holdings, China Netcom Corporation International Limited and Asia Netcom pursuant to which Newbridge Asia Netcom (Cayman) Holdings sold 29,400,000 shares of Asia Netcom to China Netcom Corporation International Limited, Asia Netcom and the Company.

10 COMPETING INTEREST

China Netcom Group is engaged in fixed-line telecommunications business and other related businesses in the PRC and Asia-Pacific which are similar to that of the Company. The executive Directors also hold executive positions with China Netcom Group. On 6 September 2004, China Netcom Group, the Company and CNC China entered into a non-competition agreement, under which China Netcom Group undertakes not to compete with the Company without the Company's prior written consent.

Apart from the above, none of the Directors nor its associates is or was interested in any business, apart from the Company's business, that competes or competed or is or was likely to compete, either directly or indirectly, with the Company's business.

11 PROCEDURES FOR DEMANDING A POLL AT THE EXTRAORDINARY GENERAL MEETING

In accordance with the Hong Kong Listing Rules, any vote taken at the Extraordinary General Meeting to approve the Acquisition and the Non-exempt Continuing Connected Transactions must be taken by poll. According to article 70 of the articles of association of the Company, a resolution put to the vote of the meeting shall be decided on a show of hands unless (before or on the declaration of the result of the show of hands or on the withdrawal of any other demand for a poll) a poll is demanded by:

- (a) the chairman of the meeting; or
- (b) at least three Shareholders present in person (or in the case of a member being a corporation, by its duly authorised representative) or by proxy and entitled to vote at the meeting; or
- (c) any Shareholder or Shareholders present in person (or in the case of a member being a corporation, by its duly authorised representative) or by proxy and representing in the aggregate not less than one-tenth of the total voting rights of all Shareholders having the right to attend and vote at the meeting; or
- (d) any Shareholder or Shareholders present in person (or in the case of a member being a corporation, by its duly authorised representative) or by proxy and holding shares conferring a right to attend and vote at the meeting on which there have been paid up sums in the aggregate equal to not less than one-tenth of the total sum paid up on all shares conferring that right.

A poll shall be taken at such time (being not later than thirty days after the date of the demand) and in such manner (including the use of ballot or voting papers or tickets) as the chairman of the Extraordinary General Meeting may appoint. On a poll, every Shareholder present at the Extraordinary General Meeting shall be entitled to one vote for every fully paid-up Share of which he is the holder. The result of such poll shall be deemed for all purposes to be the resolution of the meeting at which the poll was so directed or demanded.

12 MISCELLANEOUS

(a) The joint company secretaries of the Company are Zhang Xiaotie and Oliver E Lixin. Mr. E is also the qualified accountant of the Company appointed pursuant to Rule 3.24 of the Hong Kong Listing Rules. Mr. E is a fellow member of the Association of Chartered Certified Accountants.

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(b) The registered office of the Company is at 46th Floor, Cheung Kong Center, 2 Queen's Road Central, Hong Kong.

(c) Computershare Hong Kong Investor Services Limited, the share registrar of the Company in Hong Kong, is at Rooms 1712-1716, 17th Floor Hopewell Centre, 183 Queen's Road East, Wanchai, Hong Kong.

(d) The English text of this circular and form of proxy shall prevail over the Chinese text.

13 DOCUMENTS AVAILABLE FOR INSPECTION

Copies of the following documents will be available for inspection at Linklaters, 10th Floor, Alexandra House, Chater Road, Hong Kong during normal business hours on any Business Day from the date of this circular until 7 October 2005 and at the Extraordinary General Meeting:

- (a) the Acquisition Agreement;
- (b) the Equity Interest Injection Agreement;
- (c) the memorandum and articles of association of the Company;
- (d) the audited consolidated financial statements of the Group for the two years ended 31 December 2003 and 2004;
- (e) the material contracts referred to in the paragraph headed "Material contracts" in this Appendix;
- (f) the letters of consent from CICC, Citigroup, Goldman Sachs, PricewaterhouseCoopers and CSFB referred to in the paragraph headed "Consent" in this Appendix;
- (g) the letter from CSFB dated 23 September 2005, the text of which is set out on pages 38 to 58 of this circular;
- (h) the accountants' report from PricewaterhouseCoopers dated 23 September 2005, the text of which is set out in Appendix II to this circular;
- (i) the report from PricewaterhouseCoopers on the unaudited pro forma financial information of the Combined Group dated 23 September 2005, the text of which is set out in Appendix IV to this circular; and
- (j) the letters from PricewaterhouseCoopers and the Financial Advisers both dated 23 September 2005, the texts of which are set out in Appendix V to this circular.

NOTICE OF THE EXTRAORDINARY GENERAL MEETING

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

NOTICE IS HEREBY GIVEN that an Extraordinary General Meeting of the shareholders of China Netcom Group Corporation (Hong Kong) Limited (the "Company") will be held at 10:00 a.m. on 25 October 2005, in Nathan Room, Conrad Hotel, Hong Kong for the purposes of considering and, if thought fit,

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passing, with or without modifications, the following resolutions as Ordinary Resolutions:

Ordinary Resolutions

1. "THAT the conditional sale and purchase agreement dated 12 September 2005 (the "Acquisition Agreement") entered into among the Company, China Netcom Group Corporation (BVI) Limited ("CNC BVI") and China Network Communications Group Corporation ("China Netcom Group"), a copy of which has been initialled by the chairman of this meeting and for the purpose of identification marked "A", pursuant to which, inter alia, CNC BVI has agreed as legal and beneficial owner to sell, and the Company has agreed to purchase, the entire issued share capital of China Netcom Group New Horizon Communications Corporation (BVI) Limited, which holds the entire equity interest in China Netcom Group New Horizon Communications Corporation Limited 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 in Heilongjiang Province, Jilin Province, Neimenggu Autonomous Region and Shanxi Province in the People's Republic of China, at a consideration of RMB12,800 million, comprising an initial consideration of RMB3,000 million payable in cash to CNC BVI and a deferred consideration of RMB9,800 million payable within five years after completion of the acquisition contemplated under the Acquisition Agreement, be and is hereby generally and unconditionally approved and the directors of the Company be and are hereby authorised to do all such further acts and things and execute such further documents and take all such steps which in their opinion may be necessary, desirable or expedient to implement and/or give effect to the terms of the Acquisition Agreement."
2. "THAT subject to the passing of Ordinary Resolution No.1 set out in the notice convening the Extraordinary General Meeting at which this Resolution is proposed, the continuing connected transactions contemplated under the Engineering and Information Technology Services Agreement and the Materials Procurement Agreement, as described in the paragraph headed "Continuing Connected Transactions" under the section "Letter from the Chairman" of the circular of the Company dated 23 September 2005, together with the relevant annual caps be and are hereby approved and the directors of the Company be and are hereby authorised to do all such further acts and things and execute such further documents and take all such steps which in their opinion may be necessary, desirable or expedient to implement and/or give effect to the terms of such continuing connected transactions."
3. "THAT subject to the passing of Ordinary Resolution No.1 set out in the notice convening the Extraordinary General Meeting at which this Resolution is proposed, the continuing connected transactions contemplated under the Domestic Interconnection Settlement Agreement and the International Long Distance Voice Services Settlement Agreement, as described in the paragraph headed "Continuing Connected Transactions" under the section "Letter from the Chairman" of the circular of the Company dated 23 September 2005 and for which continuing connected transactions no annual caps have been proposed, be and are hereby approved and the directors of the Company be and are hereby authorised to do all such further acts and things and execute such further documents and take all such steps which in their opinion may be necessary, desirable or expedient to implement and/or give effect to the terms of such continuing connected transactions."

By Order of the Board
Zhang Xiaotie Oliver E Lixin
Joint Company Secretaries

Hong Kong, 23 September 2005

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Registered office
46th Floor, Cheung Kong Center
2 Queen's Road Central
Hong Kong
Notes:

1. A member entitled to attend and vote at the Extraordinary General Meeting is entitled to appoint one or more proxies to attend and, on a poll, vote in his stead. A proxy need not be a member of the Company.
2. A form of proxy for use at the meeting is enclosed. In order to be valid, a form of proxy together with any power of attorney or other authority, if any, under which it is signed, or a notarially certified copy of such power of authority, must be deposited at the Company's registered office at 46th Floor, Cheung Kong Center, 2 Queen's Road Central, Hong Kong, at least 48 hours before the time appointed for holding the Extraordinary General Meeting. Completion and return of the form of proxy will not preclude a member from attending and voting in person at the meeting or at any adjourned meeting should a member so wish.
3. In accordance with the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited, voting on the above ordinary resolutions will be taken by poll.

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

Form of proxy for the Extraordinary General Meeting
 to be held on 25 October 2005

I / We (Note 1) _____ of

 being the registered holder(s) of _____ Shares (Note 2) of
 US\$0.04 each in the share capital of the above-named Company HEREBY APPOINT THE
 CHAIRMAN OF THE EXTRAORDINARY GENERAL MEETING (Note 3) or _____

 of _____ as
 my/our proxy to attend and act for me/us at the Extraordinary General Meeting
 (and any adjournment thereof) of the said Company to be held at Nathan Room,
 Conrad Hotel, Hong Kong on 25 October 2005, at 10 a.m. for the purposes of
 considering and, if thought fit, passing the Resolutions as set out in the
 Notice of the Extraordinary General Meeting and at such Extraordinary General
 Meeting (and at any adjournment thereof) to vote for me/us and in my/our name(s)
 in respect of the Resolutions as indicated below (Note 4).

| | | |
|-----------------------|-----|---------|
| | FOR | AGAINST |
| ORDINARY RESOLUTION 1 | | |
| ORDINARY RESOLUTION 2 | | |
| ORDINARY RESOLUTION 3 | | |

Dated this day of 2005 Signed (Note 5)

Notes :

1. Full name(s) and address(es) to be inserted in BLOCK CAPITALS.

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2. Please insert the number of shares registered in your name(s) to which this proxy relates. If no number is inserted, this form of proxy will be deemed to relate to all the shares in the Company registered in your name(s).

3. If any proxy other than the Chairman of the Extraordinary General Meeting is preferred, strike out the words `THE CHAIRMAN OF THE EXTRAORDINARY GENERAL MEETING' and insert the name and address of the proxy desired in the space provided. A member may appoint one or more proxies to attend and vote in his stead. ANY ALTERATION MADE TO THIS FORM OF PROXY MUST BE INITIALED BY THE PERSON WHO SIGNS IT.

4. IMPORTANT: IF YOU WISH TO VOTE FOR THE RESOLUTIONS, TICK THE APPROPRIATE BOX MARKED "FOR". IF YOU WISH TO VOTE AGAINST THE RESOLUTIONS, TICK THE APPROPRIATE BOX MARKED "AGAINST". Failure to complete any or all the boxes will entitle your proxy to cast his votes at his discretion. Your proxy will also be entitled to vote at his discretion on any resolution properly put to the Extraordinary General Meeting other than those referred to in the Notice of the Extraordinary General Meeting.

5. This form of proxy must be signed by you or your attorney duly authorised in writing or, in the case of a corporation, must be either executed under its common seal or under the hand of an officer or attorney or other person duly authorised to sign the same.

6. In the case of joint holders of any shares, any one of such joint holders may vote at the Extraordinary General Meeting, either personally or by proxy, in respect of such shares as if he were solely entitled thereto. However, if more than one of such joint holders is present at the Extraordinary General Meeting, either personally or by proxy, the vote of the joint holder whose name stands first in the Register of Members and who tenders a vote, whether in person or by proxy, will be accepted to the exclusion of the votes of the other joint holder(s).

7. To be valid, this form of proxy together with the power of attorney (if any) or other authority under which it is signed (if any) or a notarially certified copy thereof, must be deposited at the registered office of the Company at 46th Floor, Cheung Kong Center, 2 Queen's Road Central, Hong Kong not less than 48 hours before the time for holding the Extraordinary General Meeting or any adjournment thereof (as the case may be).

8. The proxy need not be a member of the Company but must attend the Extraordinary General Meeting in person to represent you.

9. Completion and delivery of the form of proxy will not preclude you from attending and voting at the Extraordinary General Meeting if you so wish. In such event, the instrument appointing a proxy shall be deemed to be revoked.