



中國通信服務
CHINA COMSERVICE

Solid Foundation
Expand **Infinity**

電信基建服務

Telecommunications
Infrastructure Services

Design Services 設計服務

建設服務 Construction Services

Project Supervision and
Management Services 項目監理服務

Business Process 業務流程外判服務
Outsourcing Services

Network Maintenance 網絡維護

Distribution of Telecommunications

Services & Products 電信服務及產品分銷

Facilities Management 設施管理

Applications, 應用、內容及其他服務

Content and Others

IT Applications

IT 應用

語音增值服務

Value Added Voice Services

Internet Services

互聯網服務

China Communications Services Corporation Limited

Stock Code: 552

Annual Report 2006



Leading Integrated Provider of
Specialized Telecommunications
Support Services

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Financial Highlights

	2005	2006	Change
Revenues (RMB millions)	13,232	14,183	7.2%
Gross profit (RMB millions)	2,688	2,759	2.7%
Profit attributable to shareholders (RMB millions)	598	696	16.5%
Earnings per share (RMB)	0.151	0.172	13.9%
Free cash flow ⁽¹⁾ (RMB millions)	(182)	(27)	N.A.

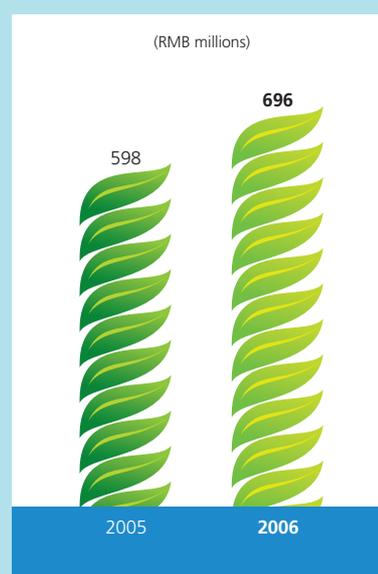
REVENUES



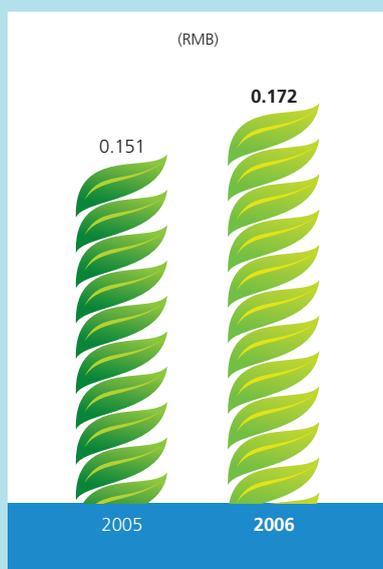
GROSS PROFIT



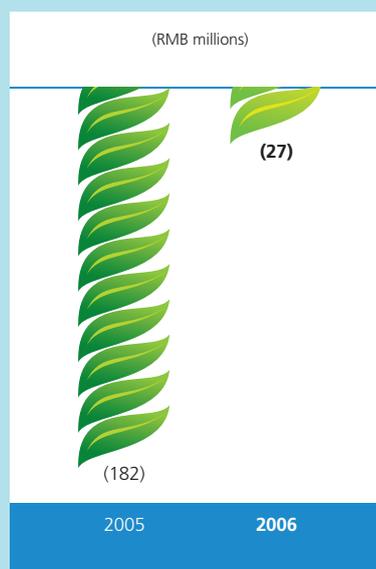
PROFIT ATTRIBUTABLE TO SHAREHOLDERS



EARNINGS PER SHARE



FREE CASH FLOW



(1) Free cash flow = Profit for the year + Depreciation and amortization – Changes in working capital – Capital expenditure

Company Profile and Corporate Information

The controlling shareholder of China Communications Services Corporation Limited (the “Company”) is China Telecommunications Corporation (“China Telecom”). The Company provides telecommunications infrastructure services, business process outsourcing services and applications, content and other services to telecommunications operators, equipment manufacturers, corporate customers, governmental organizations and public customers in the PRC, and are actively expanding business to overseas markets.

On 8 December 2006, the H shares issued by the Company were successfully listed on the Main Board of the Stock Exchange of Hong Kong Limited, and were admitted to the Hang Seng China Enterprises Index (“H shares Index”) on 12 March 2007. As at 31 December 2006, the aggregate share capital of the Company was 5,444,986,000 shares, of which 1,633,484,600 shares were H shares.

Chinese registered name:	中國通信服務股份有限公司
English name:	China Communications Services Corporation Limited
Authorized representative:	Li Ping
Company Secretary and Qualified Accountant:	Chung Wai Cheung, Terence
International auditor:	KPMG
Legal Advisers:	Freshfields Bruckhaus Deringer Jingtian & Gongcheng
Registered address:	Level 5 No.2 and B, Fuxingmen South Avenue, Xicheng District, Beijing, PRC, 100032
Telephone:	(8610) 5850 1528 (852) 3699 0000
Facsimile:	(8610) 5850 1534 (852) 3699 0120
Website:	www.chinaccs.com.hk
H share registrar:	Computershare Hong Kong Investor Services Limited 1712-1716, 17th Floor, Hopewell Centre, 183 Queen’s Road East, Wanchai Hong Kong
Place of Listing:	The Stock Exchange of Hong Kong Limited
Stock code:	552

Chairman's Statement



Dear shareholders,

In 2006, our Company successfully completed its restructuring and was successfully listed on the Main Board of the Hong Kong Stock Exchange. The great success of our initial public offering (the "IPO") and the favourable performance of our share price fully reflects the confidence of the capital markets in our business model and future prospects.

Our restructuring and IPO facilitated substantial changes within the Company, which consolidated our leadership position in the telecommunications support services market in China and enabled our Company to capture the business opportunities presented by the dramatic growth of our industry. Our Company achieved favourable results with stable revenue growth and improved operational efficiency in 2006. We are confident that our distinct business strategies, excellent execution capabilities, comprehensive resources and outstanding staff will enable our Company to maintain a sustainable, healthy growth in future.

In 2006, our Company established a sound corporate governance structure, perfected its management systems, implemented the integration of our business and resources, enhanced and improved our knowledge management and our efforts in human resources development, hence reinforcing our core competitiveness and providing a solid foundation for the continued improvement and optimization of our integrated one-stop services business model.

Our high quality shareholder base and strong shareholder support guarantee the sustainable growth of our business. Our major customers, China Telecommunications Corporation, China Mobile Communications Corporation and China United Telecommunications Corporation are also our key shareholders and this will beneficially facilitate our Company's further expansion of our market share in our industry. We will actively work with leading operators in the Chinese telecommunications sector to explore new business areas, including the development of innovative new products and services. At the same time, we have also established a close partnership with Cisco, one of our strategic shareholders, and other equipment suppliers to develop new business solutions for our customers.

With reference to international best practices, we established a sound Board structure. We invited reputable professionals with extensive knowledge and management experience in the fields of telecommunications, finance, commerce and academia to join our Board. We also established five specialised Board committees comprising independent non-executive directors of the Company to ensure major strategic decisions of the Company are sound and independent. We believe that a sound Board structure will effectively safeguard the interests of our public shareholders.

While making great endeavours to realize our organic growth, we are also actively looking for opportunities for external growth. Pursuant to the non-competition undertaking with our parent company, China Telecommunications Corporation, we have a priority right to acquire its quality assets for telecommunications support services. Through cross-regional and cross-market business integration of such specialized companies to be acquired, we will be able to further enhance our core competitiveness.

In 2007, we will seize business development opportunities to facilitate the sustainable and steady development of the Company and maximize shareholder value. We will also continue to shape a fresh and highly energetic corporate culture which can maximize and consolidate the enthusiasm and creativity of all employees and to closely link the efforts of each employee with the success of the Company. At the same time, as a market leader, we will continue to place emphasis on social responsibility, environmental protection and contribution to the community.

We have full confidence for the future. We believe that China's strong economic growth will provide unlimited business opportunities and the favourable prospects of our industry will provide our Company with substantial room for development and growth. Leveraging our well-established customer relationships, our unique business model, our outstanding staff teams, and our close cooperation with our strategic investors, we believe that we can create higher returns for our shareholders and society through the unified efforts of the Board and our employees.

Finally, on behalf of the Board, I would like to express my sincere gratitude to the shareholders for their trust and support, and to all the staff of the Company for their dedication to the Company.



Wang Xiaochu
Chairman

Beijing, PRC
17 April 2007

Chief Executive Officer's Statement



Dear shareholders,

In 2006, our Company completed its restructuring and was successfully listed in Hong Kong. With the full trust, efficient leadership and strong support of the Board, the management and all employees of the Company have, through joint efforts, fulfilled all the objectives set by the Board and achieved good operating results.

In 2006, our Company further improved the standard of our services, strengthened the development of our operations, and steadily enhanced our operating efficiency. Our revenues reached RMB14,182.80 million, representing an increase of 7.2% from 2005. Effective control of the operating costs was implemented and the level of free cash flow was noticeably improved. EBITDA⁽¹⁾ margin was 10.0%, an increase of 0.7 percentage points from 2005. Profit attributable to shareholders was RMB696.08 million, higher than the profit forecast of RMB650 million stated in our prospectus, representing an increase of 16.5% from 2005. Earnings per share were RMB0.172.

In 2006, as a "service provider to telecommunications operators", we further reinforced our position as a market leader in the industry through a series of measures, including the development of a customer-oriented service culture, the establishment of dedicated customer service teams for our key customers, the acceleration of our business development and hammering out our core competitiveness to fully realize the advantage of our integrated services business model. The Company actively implemented innovative management, optimized the Company's structural and business processes, enhanced our execution capabilities and further improved our operational efficiency. We place high importance on the management of our human resources, implementing strict control over employee numbers and devoting greater resources to the nurturing of our management and 3G technical personnel, hence establishing a strong human resources pool to facilitate our future development.

(1) EBITDA = Gross Profit + Other operating income – Selling, general and administrative expenses – Other operating expenses + Depreciation and amortization

In order to be better positioned to seize opportunities arising from the launch of 3G services, we strengthened our cooperation with telecommunications operators and equipment suppliers in 2006 and participated in the application development, network planning and design-specification development of various 3G technology standards and work relating to the TD-SCDMA trial networks. We believe that with all these initiatives, we will be one of the first and key beneficiaries of the launch of 3G services in China.

Clear business strategies and excellent implementation capabilities are key to achieving excellent operating results. In 2007, we will focus on the execution of five key development strategies as follows:

Core Competitiveness Strategy:

We will fully capitalize on our advantageous edge of local presence and a one-stop services business model to proactively expand our specialized operations and cross-regional cooperation. On the premise of business and service innovation, we will nurture competitive and effective business growth drivers. We will further consolidate our position as a market leader through a combination of organic growth as well as external expansion by strategic acquisition.

Service Focus Strategy:

We will further strengthen our customer service culture and improve our customer-oriented dedicated marketing teams to provide neutral and professional "one-stop" services and prompt responses to customer requests, with a view to enhancing the value of our company and our customers.

Resources Consolidation Strategy:

We will improve operational efficiency and effectiveness through the further optimization of our resource allocation, speeding up structural adjustments and optimizing deployment efficiency. We will utilize a centralized IT management system to improve our management standards and effectively control our operating costs.

"Win-win" Cooperation Strategy:

We will further consolidate our strategic cooperation with telecommunications operators and equipment manufacturers through a multitude of products and excellent service, and strengthen cooperation with upstream and downstream enterprises along the value chain to create value for our customers, thereby creating a "win-win" business model.

Human Resources Strategy:

We will establish a performance appraisal system and a remuneration system which link authority with responsibility, incentive with restriction, and reward with risk. By perfecting our market-oriented recruitment and incentive mechanism, we will be able to optimize our human resources structure and increase the productivity of our staff. We will also place greater emphasis on human resources development so as to maintain a professional management team, a high quality team of professional personnel, and a team of business talent.

We are fully confident with regards to 2007. We believe the rapid development of the telecommunications industry and the launch of 3G services in China will bring enormous business opportunities to the Company. Our option to acquire certain quality assets for telecommunications support services from our parent company will further enhance our development potential. We believe that with the strong support of our shareholders, the leadership of our Board and the joint efforts of our employees, we will continue to maintain our leading position in the industry and create greater value for our shareholders.

Finally, I would like to take this opportunity to express my sincere appreciation to all of our shareholders and directors, as well as our customers, for their support and trust, and gratitude to all our staff for their hard work!



Li Ping
Vice Chairman and Chief Executive Officer

Beijing, PRC
17 April 2007

Telecommunications Infrastructure (TIS) Services



We provide telecommunications infrastructure services, including telecommunications network planning and design, construction, and project supervision and management.

Design Services

We offer planning and design services for fixed line and mobile telecommunications networks. Our services include consultancy, planning, field survey and design of telecommunications networks, civil engineering projects and other auxiliary facilities.

Construction Services

We carry out the construction, installation and adjustment work relating to fixed line and mobile telecommunications infrastructures, and help telecommunications operators form their network capability to provide telecommunications services. Our services include:

- laying and installation of electrical and optical duct and cable networks for communications systems;
- installation, adjustment and testing of communications equipment;
- civil engineering works and construction of other auxiliary infrastructures;
- telecommunications network optimization projects.

Project Supervision and Management Services

We offer clients with project supervision and management services. Through such independent services, we help customers to control the quality, progress, cost and security of communications related projects, organize project completion inspections and acceptance, and conduct settlement auditing services



Business Review

OVERVIEW

We are a leading integrated provider of specialized telecommunications support services to telecommunications operators in the PRC. We offer telecommunications infrastructure (“TIS”) services, including design, construction and project supervision and management, business process outsourcing (“BPO”) services and applications, content and other (“ACO”) services. We also provide services to government agencies, telecommunications equipment manufacturers and other corporate customers.

In 2006, our revenues increased by 7.2% from 2005 to RMB14,182.80 million; of which, revenue from TIS services, which accounted for 52.7% of our total revenues, increased steadily to RMB7,472.43 million, an increase of 3.8%. Revenue from BPO services, which accounted for 36.3% of our total revenues, grew by 18.1% from 2005 to RMB5,153.54 million. Revenue from ACO services, which accounted for 11.0% of our total revenues, amounted to RMB1,556.83 million, a decrease of 6.8% from 2005.

	2005		2006		Change over 2005
	Revenues	Contribution to our total revenues	Revenues	Contribution to our total revenues	
	(RMB million, except percentages)				
TIS services	7,199.59	54.4%	7,472.43	52.7%	3.8%
BPO services	4,363.15	33.0%	5,153.54	36.3%	18.1%
ACO services	1,669.55	12.6%	1,556.83	11.0%	(6.8%)
Total	13,232.29	100%	14,182.80	100%	7.2%

We have established long term business relationships with major telecommunications operators in PRC. China Telecommunications Corporation (“China Telecom”), China Mobile Communications Corporation (“China Mobile”) and China United Telecommunications Corporation (“China Unicom”) are our three largest customers. In 2006, revenues from these three largest customers increased by 14.9% to RMB9,526.81 million and accounted for 67.2% of our total revenues, a rise of 4.5 percentage points, demonstrating our consolidated leading market position among our major customers.

	2005		2006	
	Revenues	Contribution to our total revenues	Revenues	Contribution to our total revenues
	(RMB million, except percentages)			
China Telecom	5,983.08	45.2%	7,533.92	53.1%
China Mobile	1,702.46	12.9%	1,581.02	11.2%
China Unicom	603.69	4.6%	411.87	2.9%
Others	4,943.06	37.3%	4,655.99	32.8%
Total	13,232.29	100.0%	14,182.80	100.0%

TIS SERVICES

Our Company provides a full range of telecommunications infrastructure services, including telecommunications networks planning and design, construction, and project supervision and management. China Telecom, China Mobile and China Unicom are our three major customers. We have been maintaining a leading position in the TIS market. We have won many awards for design, construction and project supervision services from the PRC Ministry of Information Industry (MII) and provincial telecommunications administrations.

In 2006, revenue from TIS services amounted to RMB7,472.43 million, an increase of 3.8% from 2005; of which, revenue from our three major customers increased by 12.9%.

Design services

We provide telecommunications operators with field survey and design, network planning, operation consultancy and technology consultancy services. We also provide architectural design, intranet design and IT solution services for government agencies and corporate customers. In 2006, many of our design service projects have been given awards by the MII and provincial telecommunications administrations. Examples of these awards are: Both the China Telecom CN2 Network Engineering Feasibility Study and IT Roll Planning (2006-2008) for North Telecommunications Limited Company (北方電信有限公司), a subsidiary of China Telecom, were awarded the first prizes for excellent engineering consultancy by the MII; and China Telecom's "Eleventh Five-Year" International Operation Plan was awarded the first prize for excellent communication project consultancy by the Chinese Association of Communication Enterprises.

In 2006, revenue from design services increased by 12.8% from 2005 to RMB1,621.42 million; of which, revenue from our three largest customers grew by 4.8%, an indication of the noticeable impact of our consolidation of our relationships with operator customers and our exploration of new markets. At the same time, by putting more efforts into developing high-end services such as consultancy, we diversified our sources of revenues and enhanced our competitiveness.

Construction services

The services we provide to telecommunications operators are the laying and installation of duct and cable networks for communications systems, civil engineering works and construction of auxiliary infrastructure, installation, adjustment and testing of communications equipment and telecommunications network optimization. By providing network construction services, we assist operators to expand network capacity and coverage to meet their fast growing business demands. We also provide construction services to government agencies and corporate customers, such as integrated distribution systems for intelligent buildings.

In 2006, our construction services developed steadily. Revenue from construction services increased by 1.2% from 2005 to RMB5,546.37 million; of which, revenue from our three largest customers grew by 16.3% from 2005, an indication that our business development for the operators market had produced remarkable results.

Project supervision and management services

We offer clients communications project supervision, civil engineering project supervision, project management and tender agent services, covering all stages and aspects of a project. We help customers control the quality, progress, cost and security of related projects. Our principal customers are telecommunications operators and large corporate customers such as Huawei Technologies and ZTE Corporation.

Our excellent qualifications in supervision and management services enable us to meet the increasing demands from our customers. In 2006, revenue from supervision and management services continued to rise to RMB304.64 million, an increase of 8.4% from 2005; of which, revenue from our three largest customers increased by 11.6% from 2005.

Business Review

BPO SERVICES

We provide comprehensive, high quality BPO services to telecommunications operators, offering a range of network maintenance, distribution of telecommunications services and products and facilities management services. Our target customers include government agencies and corporate customers.

In recent years, it has been a trend for telecommunications operators to outsource certain business processes to control costs and improve service quality. As a specialized leading service provider, we benefited in this regard, and revenue from BPO services continued to grow rapidly. In 2006, revenue from BPO services amounted to RMB5,153.54 million, an increase of 18.1% from 2005; of which, revenue from our three largest customers increased by 46.0% from 2005.

Network maintenance

We offer maintenance and repair services for telecommunications networks and enterprise intranet services for telecommunications operators and corporate customers, including maintenance of telecommunications pipelines, cables and telecommunications related physical premises, mobile telecommunications base stations, communications equipment rooms and telecommunications terminal equipment.

In recent years, the business of network maintenance has remained relatively stable. In 2006, revenue from network maintenance services amounted to RMB576.69 million, decreased slightly by 2.9%.

Distribution of telecommunications services and products

We provide subscriber base development for telecommunications services offered by telecommunications operators, installation and removal of fixed lines and broadband lines, bill delivery and fee collection, distribution of telephone terminals and sale of scratch cards for telecommunications operators. In 2006, revenue from distribution of telecommunications services and products amounted to RMB3,516.02 million, an increase of 36.5% from 2005.

Facilities management

We provide facilities management services for telecommunications operators, government agencies and corporate customers, including the management, maintenance and security of communications premises and equipment rooms, as well as other telecommunications facilities. We also provide the maintenance of intelligent buildings and management services for office buildings, residential and commercial buildings.

In 2006, revenue from facilities management services amounted to RMB1,060.82 million, a decrease of 11.1% from 2005. However, revenue from China Mobile and China Unicom continued to grow, showing that our business development for the mobile operators' market had produced remarkable results.

ACO SERVICES

We offer a variety of IT applications, Internet services, value added voice services and other services for telecommunications operators and corporate customers as well as the public.

In 2006, revenues from these services amounted to RMB1,556.83 million, a decrease of 6.8% from 2005; of which, revenues from value-added voice services and internet services increased by 21.3% and 2.1% respectively, whereas revenue from IT applications services decreased by 15.4%.

IT applications

We offer system integration services, communications network support services and software and hardware development services to telecommunications operators, government agencies and corporate customers.

We continued to cooperate with telecommunications operators to develop and provide comprehensive solutions to satisfy the demands of different customers. In 2006, we organized the construction of an information network in China for an internationally well-known retail stores group to cover its four business regions and 129 stores in different regions across China. The "e-Touch" city security network platform, a security system developed by us, completely meets the needs of the PRC government to pursue the concept of "A Safe City" and has been implemented in Wuhan, Shenzhen and Dongguan in 2006.

In order to avoid the risks of price fluctuations of equipment, in 2006 we significantly reduced equipment purchasing for IT application services, so that we are able to concentrate more on a service-oriented business strategy, which will benefit our business development in the long run.

Internet services

We provide ISP access services, ICP content services either independently or jointly with telecommunications operators, such as Internet information, audio, video, gaming and e-commerce certificate authentication. We also provide electronic payment services and Internet café services.

In 2006, development of our Internet services was smooth and some key products were becoming more mature, such as our audio-visual website "HBOL.net" 鴻波網視, which has over 7 million registered users and ranks in the top three broadband audio-visual websites in the PRC market. Another example is the "ATM easy pay" 銀信ATM交費易 platform we operate in Guangdong, which has nearly 1,000 self-service terminals and a stable customer base of more than one million. Excluding banking systems, this platform is the largest third-party payment system in Guangdong.

Value-added voice services

Our value-added voice services mainly include: call centre services, interactive voice response services (IVR), ring tones and colourful back tones for telephony and PHS users.

In recent years, revenue from value added voice services has been growing rapidly. The revenue for 2006 increased by 21.3% from 2005, which reflected the effective result of our market exploration.

Business Review

BUSINESS OUTLOOK FOR 2007

In 2007, on the premise of innovating and enhancing our business and service, our Company will perfect our customer-oriented dedicated marketing teams to provide neutral and professional “one-stop” integrated services and further strengthen our customer service culture. We will proactively form strategic partnership relationship with equipment manufacturers and create a “win-win” cooperation. We will also improve and promote our one-stop service business model. We will establish cross-regional and cross-market coordination mechanism, achieve synergies with the implementation of business resource integration, proactively explore overseas markets and increase our market share. We will continue to participate in the 3G trial projects organized by the PRC government to be prepared for the launch of 3G services. We will nurture competitive and effective business growth drivers and further consolidate our position as a market leader through a combination of organic growth as well as external expansion by strategic acquisition.

TIS Services

We will further consolidate our relationship with operators and boost customer satisfaction. We will also continue to develop high-end services such as consultancy, project contracting and project management so as to diversify our source of revenues. We will continue to expand into non-operator markets and overseas markets together with our partners to maintain the steady growth of our TIS services.

BPO Services

By seizing the opportunities presented by the transformation of telecommunications operators, we shall actively develop BPO services, and increase our efforts in maintenance services, as well as the facilities management business for non-operators, and endeavour to increase market share in high-end businesses, so as to effect transformation from simple maintenance and labour-intensive traditional facilities management to technical maintenance and knowledge-intensive modern facilities management services.

ACO Services

We will focus on key products and services and quickly replicate them through standardization and customization cross-regionally. Working closely with the telecommunications operators, equipment suppliers and software developers, we will strive to meet the needs of customers along the value chain and enhance our profitability.

3G Services

We are well-prepared in respect of technology, people and equipment to seize the opportunities presented by the launch of 3G services. All of our subsidiaries are well-equipped to take on 3G business. We introduced an integrated telecommunications services solution including design, construction and project supervision and management services, that will greatly reduce the difficulty in project management of operators and increase efficiency and shorten the construction cycle, thereby gaining an absolute advantage in the area of 3G communications construction and services. We believe that we can win half of the bids out of the 10 cities for the government's expanded TD-SCDMA trial tests for technology applications in respect of the design, construction and project supervision and management business. For the 3G trial project in Baoding, we adopted our integrated one-stop services business model by providing design, construction and project supervision and management services and the quality was well accepted by the operators.

Business Process Outsourcing (BPO) Services



We provide comprehensive, high quality BPO services to telecommunications operators in China, offering a range of network maintenance, distribution of telecommunications services and products and facilities management services.

Network Maintenance

We offer services for the maintenance and repair of telecommunications network infrastructure and enterprise intranet, including:

- maintenance of telecommunications pipelines, cables and telecommunications related physical premises;
- maintenance of mobile telecommunications base stations, personal handy phone system base stations and communications equipment rooms; and
- maintenance and repair of equipment.

Distribution of Telecommunications Services & Products

We provide distribution channels for telecommunications services and products, including:

- subscriber base development for telecommunications services offered by telecommunications operators;
- installation and removal of fixed lines and broadband lines for telecommunications operators and bill delivery and fee collection for telecommunications operators;
- distribution and sale of scratch cards for telecommunications operators; and
- distribution of other services developed by telecommunications operators.

Facilities Management

We provide facilities management services for telecommunications operators, including the management, maintenance and security of communications premises and equipment rooms, as well as other telecommunications facilities. We also provide the maintenance of intelligent buildings and management services for office buildings, residential compounds, and commercial buildings.



Management's Discussion & Analysis of Financial Conditions and Results of Operations

SUMMARY

Our revenues in 2006 were RMB14,182.80 million, an increase of 7.2% from 2005. Cost of revenues was RMB11,423.60 million, an increase of 8.3% from 2005. Profit attributable to equity shareholders of the Company was RMB696.08 million, an increase of 16.5% from 2005. Earnings per share were RMB0.172.

REVENUES

Our revenues in 2006 were RMB14,182.80 million, an increase of 7.2% from 2005; of which, revenue from telecommunications infrastructure services was RMB7,472.43 million, an increase of 3.8% from 2005; revenue from business process outsourcing services was RMB5,153.54 million, an increase of 18.1% from 2005; revenue from applications, content and others was RMB1,556.83 million, a decrease of 6.8% from 2005. Business process outsourcing services were the major source of our revenues growth in 2006.

The following table sets forth a breakdown of our revenues for 2005 and 2006, together with their respective rates of change:

	2006	2005	Percentage change
<i>(RMB in thousands, except percentage data)</i>			
Telecommunications Infrastructure Services			
Design services	1,621,416	1,438,025	12.8%
Construction services	5,546,372	5,480,420	1.2%
Project supervision and management services	304,639	281,145	8.4%
	7,472,427	7,199,590	3.8%
Business Process Outsourcing Services			
Network maintenance	576,693	593,653	(2.9)%
Distribution of telecommunications services and products	3,516,023	2,576,583	36.5%
Facilities management	1,060,824	1,192,916	(11.1)%
	5,153,540	4,363,152	18.1%
Applications, Content and Others			
IT applications	567,397	670,923	(15.4)%
Internet service	343,769	336,815	2.1%
Voice VAS	274,196	226,127	21.3%
Others	371,471	435,684	(14.7)%
	1,556,833	1,669,549	(6.8)%
Total revenues	14,182,800	13,232,291	7.2%

Telecommunications Infrastructure Services

In 2006, our revenue from telecommunications infrastructure services was RMB7,472.43 million, which accounted for 52.7% of our revenues and an increase of 3.8% over RMB7,199.59 million for 2005. Revenue from this area was mainly derived from the capital expenditure of telecommunications operators. In 2006, when major telecommunications operators in the PRC have tightened control over their capital expenditure, the Company maintained a steady revenue growth in this area through active business expansion; of which, the revenue from design services was RMB1,621.42 million, representing an increase of 12.8% from 2005.

Business Process Outsourcing Services

In 2006, our revenue from business process outsourcing services was RMB5,153.54 million, which accounted for 36.3% of our revenues, representing an increase of 18.1% over RMB4,363.15 million for 2005; of which, revenue from distribution of telecommunications services and products was RMB3,516.02 million, representing an increase of 36.5% from 2005. The increase was mainly due to the rapid growth in our distribution business of PHS and other mobile handsets. Revenue from facilities management was RMB1,060.82 million, representing a decrease of 11.1% from 2005. The decrease was mainly due to the price fluctuation of part of our facilities management services in 2006.

Applications, Content and Others

Revenue from applications, content and others was RMB1,556.83 million, which accounted for 11.0% of our revenues, representing a decrease of 6.8% from RMB1,669.55 million for 2005. Among the business operations in this area, revenue from IT applications amounted to RMB567.40 million, representing a decrease of 15.4% from 2005, which was mainly due to an adjustment in the way we carried out business with clients in 2006. Accordingly, the cost of hardware and equipment included in the revenues was reduced.

COST OF REVENUES

Our cost of revenues in 2006 was RMB11,423.60 million, representing an increase of 8.3% from 2005 and which accounted for 80.5% of the revenues, representing a slight increase from 79.7% for 2005. Our gross profit margin in 2006 was 19.5%, representing a decrease of 0.8 percentage points from 20.3% for 2005.

The following table sets out a breakdown of our cost of revenues in 2005 and 2006 and their respective rates of change:

	2006	2005	Percentage change
	<i>(RMB in thousands except percentage data)</i>		
Direct personnel costs	2,604,229	2,521,904	3.3%
Depreciation and amortization	249,691	239,300	4.3%
Purchase of materials and telecommunications products	4,333,050	4,337,923	(0.1)%
Subcontracting charges	2,760,555	2,029,152	36.0%
Operating lease charges and others	1,476,071	1,416,101	4.2%
Total cost of revenues	11,423,596	10,544,380	8.3%

Management's Discussion & Analysis of Financial Conditions and Results of Operations

Direct Personnel Costs

In 2006, direct personnel costs were RMB2,604.23 million, which accounted for 18.4% of revenues and an increase of 3.3% over RMB2,521.90 million for 2005. On the one hand, the Company controlled the total number of employees and endeavoured to control the growth of personnel costs at a rate less than the growth of revenues, while on the other hand, we reformed our remuneration system and provided initiatives such as training courses to incentivise the staff.

Depreciation and Amortization

In 2006, depreciation and amortization amounted to RMB249.69 million, which accounted for 1.8% of the revenues and an increase of 4.3% over RMB239.30 million for 2005.

Purchase of Materials and Telecommunications Products

In 2006, the cost of the purchase of materials and telecommunications products was RMB4,333.05 million, which accounted for 30.6% of revenues and a decrease of 0.1% from RMB4,337.92 million for 2005; of which, the cost of the purchase of construction materials was RMB2,006.52 million, a decrease of 29.6% from RMB2,850.96 million for 2005; and the cost of the purchase of telecommunications products was RMB2,326.53 million, an increase of 56.5% over RMB1,486.96 million for 2005.

Subcontracting Charges

In 2006, subcontracting charges were RMB2,760.56 million, which accounted for 19.5% of revenues and represented an increase of 36.0% over RMB2,029.15 million for 2005. The increase in subcontracting charges was mainly because we began demanding our subcontractors for our telecommunications infrastructure services to expand their scope of provision of materials to better manage our working capital in 2006.

Operating Lease Charges and Others

In 2006, operating lease charges and others were RMB1,476.07 million, which accounted for 10.4% of the revenues and represented an increase of 4.2% over RMB1,416.10 million for 2005.

SELLING, GENERAL AND ADMINISTRATIVE EXPENSES

Our selling, general and administrative expenses in 2006 were RMB1,890.70 million, which accounted for 13.3% of revenues and represented a decrease of 3.1% over RMB1,951.12 million for 2005, and of which, provision for bad debts decreased by RMB34.66 million from 2005 and repair and maintenance fee decreased by RMB12.97 million from 2005.

DEFICIT ON REVALUATION OF PROPERTY, PLANT AND EQUIPMENT

Our deficit on revaluation of property, plant and equipment in 2006 as a result of restructuring was RMB105.30 million. The deficit was not a recurring item and it had been recognized as an expense in the income statement. Such decrease in the book value of the property, plant and equipment was mainly due to the decrease in value of buildings, furniture, equipment and vehicles, etc. on a replacement costs basis.

NET FINANCING INCOME

In 2006, our net financing income was RMB85.64 million, an increase of RMB47.24 million over RMB38.40 million for 2005, or 123.0%, and of which, interest income increased by RMB51.47 million, and net foreign exchange loss increased by RMB8.41 million. The increase in interest income was mainly attributed to the interest income accrued on the application money under our IPO in 2006.

INCOME TAX

Except for subsidiaries incorporated in Hainan province or high-technology zone or special economic region in the PRC which are subject to a preferential income tax rate of 15%, the Company and other subsidiaries of the Group are subject to an income tax rate of 33%. The income tax in 2006 was RMB280.71 million and our effective tax rate was 28.1%. The difference between our effective tax rate and the statutory tax rate was mainly due to the effect of the aforesaid preferential tax rate of the subsidiaries.

PROFIT ATTRIBUTABLE TO EQUITY SHAREHOLDERS

In 2006, profit attributable to equity shareholders was RMB696.08 million, an increase of 16.5% over RMB597.56 million for 2005.

CAPITAL EXPENDITURE

Exclusive of the expenditure on acquisition of certain assets during our restructuring, our capital expenditure for 2006 was RMB732.31 million, a decrease of 2.5% over RMB751.00 million for 2005. Our capital expenditure for 2006 accounted for 5.2% of our revenues. In 2006, our capital expenditure included the purchase of production equipments, facilities, machineries, vehicles, office equipments, plant and building and other operating assets.

Management's Discussion & Analysis of Financial Conditions and Results of Operations

CASH FLOWS AND CAPITAL RESOURCES

Cash Flows

In 2006, our net cash inflow was RMB3,385.11 million. In 2005, our net cash outflow was RMB830.11 million. By the end of 2006, the amount of our cash and cash equivalents was RMB7,071.03 million, of which 55.3% was accounted for in Renminbi, and 44.6% was accounted for in Hong Kong dollars.

The following table sets out our cash flow position in 2005 and 2006:

	2006	2005
	<i>(RMB in thousands)</i>	
Net cash generated from operating activities	499,471	275,170
Net cash used in investing activities	(631,582)	(276,593)
Net cash generated from/(used in) financing activities	3,517,224	(828,682)
Net increase/(decrease) in cash and cash equivalents	3,385,113	(830,105)

In 2006, net cash generated from operating activities was RMB499.47 million, an increase of RMB224.30 million from RMB275.17 million for 2005. The significant increase in net cash inflow from operating activities was mainly due to the steady development of our operations and the improvement of our working capital management.

In 2006, net cash used in investing activities was RMB631.58 million, an increase of RMB354.99 million over 2005, which was mainly due to the acquisition of the shareholding and individual assets of relevant subsidiaries during our group restructuring for listing.

In 2006, net cash generated from financing activities was RMB3,517.22 million. In 2005, net cash used in financing activities was RMB828.68 million. Our net cash generated from financing activities was mainly due to our successful IPO in December 2006, raising cash of RMB3,081.04 million.

Working Capital

By the end of 2006, our working capital (non-cash current assets minus operating current liabilities) deficit was RMB534.76 million, an increase of RMB133.46 million from the deficit of RMB401.30 million in 2005. The increase was mainly due to our strengthening the management of prepayments and obtaining more favourable credit terms.

Indebtedness

By the end of 2006, our total indebtedness was RMB95.50 million, all of which was short-term fixed interest rate loans denominated in Renminbi, representing a decrease of RMB114.05 million from RMB209.55 million in 2005. Given our increase in net cash inflow from operating activities and our improvement in operational efficiency, the Company repaid short-term loans upon maturity and reduced new borrowings.

By end of 2006, our gearing ratio⁽¹⁾ was 0.6%, a decrease of 1 percentage point from 1.6% in 2005.

⁽¹⁾ Gearing ratio equals to total debts divided by total assets at the end of each financial year.

Applications, Content and Other (ACO) Services



We offer a variety of IT applications, Internet services, value added voice services, and other services for telecommunications operators and corporate customers, as well as the public.

IT Applications

We offer information technology applications services, including system integration, communications network support services and software and hardware development to telecommunications operators and other corporate users.

Value Added Voice Services

- Upon the demand of telecommunications operators and other corporate customers, we provide marketing, customer and after-sale services on behalf of our customers through our call centers.
- Interactive voice response services (IVR). We provide information services handled and recorded by service officers to telecommunication operators, government agencies and corporate customers.
- Ring tones and colourful back tones services for telephony users' subscription.

Internet Services

We offer Internet services independently or jointly with telecommunications operators, such as ICP content provision, Internet resources provision, e-commerce (such as certificate authentication and electronic payment services), and Internet cafes.



Directors, Supervisors and Senior Management

DIRECTORS



Mr. WANG Xiaochu, age 49, is the Chairman of our Board of Directors and a Non-Executive Director of our Company. Mr. Wang is President of China Telecommunications Corporation (“China Telecom”), and Chairman and Chief Executive Officer of China Telecom Corporation Limited (“China Telecom Listco”). Positions previously held by Mr. Wang include positions such as Director General and Deputy Director General of the Hangzhou Telecommunications Bureau in Zhejiang Province, Director General of the Tianjin Posts and Telecommunications Administration, Chairman and Chief Executive Officer of China Mobile Limited (a company whose shares are listed on the Hong Kong Stock Exchange), and Vice President of China Mobile Communications Corporation (“China Mobile”). He has been involved in a number of information technology projects such as the development of telecommunications network management in China, and as a result received the Class Three National Science and Technology Advancement Award and the Class One Science and Technology Advancement Award awarded by the Ministry of Posts and Telecommunications of the PRC (“MPT”), the former regulatory body under the PRC State Council responsible for the administration of the telecommunications industry. Mr. Wang graduated from the Beijing Institute of Posts and Telecommunications in 1980 and received a doctorate degree in Business Administration from the Hong Kong Polytechnic University in 2005. Mr. Wang has over 26 years of management experience in the telecommunications industry.



Mr. LI Ping, age 53, is the Vice Chairman of our Board of Directors, an Executive Director and Chief Executive Officer of our Company. Mr. Li is Vice President of China Telecom, and an Executive Director of China Telecom Listco. Mr. Li was the Joint Company Secretary of China Telecom Listco until 26 October 2006. Mr. Li is a senior engineer. He graduated from the Beijing Institute of Posts and Telecommunications in 1976 with a major in Radio Telecommunications and received an MBA degree from the State University of New York at Buffalo, U.S.A. in 1989. Prior to joining China Telecom in August 2000, Mr. Li served as Chairman and the President of China Telecom (Hong Kong) International Limited, Vice Chairman and Chief Operating Officer of China Mobile Limited (a company whose shares are listed on the Hong Kong Stock Exchange) and Deputy Director General of the DGT of the MPT. Mr. Li has extensive experience in the management of public companies and has 31 years of operational and management experience in the telecommunications industry in China.



Mr. LIU Aili, age 43, is a Non-Executive Director of our Company. Mr. Liu is Executive Director and Vice President of China Mobile Limited, whose shares are listed on the Hong Kong Stock Exchange. He is also Vice President of China Mobile and Chairman of Paktel Limited. Mr. Liu graduated from Heilongjiang Posts and Telecommunications School with an associate degree and completed a post-graduate program in economics at Shandong University. Mr. Liu also received a master of management degree from the Norwegian School of Management BI and a doctoral degree in Business Administration from Hong Kong Polytechnic University. Mr. Liu previously served as Deputy Director General of Shandong Mobile Telecommunications Administration, Director General of Shandong Mobile Telecommunications Administration and General Manager of Shandong Mobile Communications Enterprises, Vice President of Shandong Mobile Communications Company, Director-General of the Network Department of China Mobile, Chairman and President of Shandong Mobile and Zhejiang Mobile. He is a professor-level senior engineer with over 24 years of management experience in the telecommunications industry.



Mr. ZHANG Junan, age 50, is a Non-Executive Director of our Company. Mr. Zhang is an Executive Director and Vice President of China Unicom Limited, whose shares are listed on the Hong Kong Stock Exchange, and Vice President of China United Telecommunications Corporation (“China Unicom”). Mr. Zhang graduated from the Nanjing University of Posts and Telecommunications majoring in carrier communication in 1982, and received a master’s degree in Business Administration from the National Australian University in 2002. Prior to joining China Unicom in December 2005, Mr. Zhang served as Deputy General Manager and General Manager of the Anhui Provincial Telecommunication Company, and Chairman and General Manager of Anhui Provincial Telecommunication Co., Ltd. Mr. Zhang had served as Director of the Bengbu Municipal Posts and Telecommunications Bureau in Anhui Province and Deputy Director of the Anhui Provincial Posts and Telecommunications Bureau. Mr. Zhang has long and extensive management experience in the telecommunications industry.



Mr. WANG Jun, age 66, is an Independent Non-Executive Director of our Company. Mr. Wang graduated from the Harbin Engineering Institute in the PRC. Mr. Wang was the former Chairman of China International Trust and Investment Corporation (“CITIC”). After his retirement in July 2006, he became the Executive Director and Chairman of the Board of Directors of CITIC 21CN Company Limited, the Chairman and Executive Director of Poly (Hong Kong) Investments Limited and Goldbond Group Holdings Limited, and a Non-Executive Director and honorary Chairman of HKC (Holdings) Limited. All of these companies are listed on the Stock Exchange of Hong Kong.



Mr. CHAN Mo Po, Paul, age 52, is an Independent Non-Executive Director of our Company. Mr. Chan is the Managing Director of PCP CPA Limited. He is also an Independent Non-Executive Director of publicly listed I.T Limited, China Resources Land Limited, Kingmaker Footwear Holdings Limited, Hong Kong Economic Times Holdings Limited and The Wharf (Holdings) Limited. Mr. Chan is a graduate of The Chinese University of Hong Kong where he obtained both his bachelor’s and master’s degrees in Business Administration. Mr. Chan is a Practising Certified Public Accountant in Hong Kong and a fellow member of the Hong Kong Institute of Certified Public Accountants (“HKICPA”), the Association of Chartered Certified Accountants (“ACCA”), the Society of Chinese Accountants and Auditors, the Institute of Chartered Secretaries and Administrators, the Taxation Institute of Hong Kong and the Hong Kong Institute of Company Secretaries. Mr. Chan has over 29 years’ experience in both professional and commercial fields and is a former president of the HKICPA and a former Chairman of the ACCA — Hong Kong.

Directors, Supervisors and Senior Management



Mr. ZHAO Chunjun, age 66, is an Independent Non-Executive Director of our Company. Mr. Zhao is an Independent Non-Executive Director of Daheng New Epoch Technology, Inc., a company listed in the PRC. Mr. Zhao is also a Supervisor of Tsinghua Tongfang Co., Limited, which is also a company listed in the PRC. Mr. Zhao graduated from Tsinghua University in the PRC. Mr. Zhao was Dean of the School of Economics and Management of Tsinghua University between June 2001 and October 2005, having previously served as First Vice Dean between January 1987 and June 2001.



Mr. WU Shangzhi, age 57, is an Independent Non-Executive Director of our Company. Mr. Wu is currently the Chairman and Managing Partner of CDH China Holdings Management Company Limited, ("CDH"). Prior to joining CDH, Mr. Wu was a head of the Direct Investment Department, Managing Director and member of the Management Committee of China International Capital Corporation (CICC) and he was also a Director of Focus Media Holdings Limited, a company listed on Nasdaq in the United States. Mr. Wu served as an Officer at the World Bank and the International Finance Corporation from 1984 to 1993. Mr. Wu graduated from the Massachusetts Institute of Technology with a Ph.D. degree in Mechanical Engineering and a M.S. in Management of Technology.



Mr. HAO Weimin, age 72, is an Independent Non-Executive Director of our Company. Mr. Hao graduated from the PLA Zhangjiakou Institute of Communications Engineering, and the Beijing Institute of Posts and Telecommunications in 1953 and 1963 respectively. He is a professor-level senior engineer with over 50 years' experience in the telecommunications industry. Mr. Hao is the Vice Chairman of the China Association of Communications Enterprises and is also a standing Committee Member of the telecommunication technology committee and the radio frequency planning and consulting committee of the Ministry of Information and Posts. From 1983 to 1986, Mr. Hao was sent to the United States as a visiting scholar to carry out telecommunications research on GTE Network Systems at Stanford University. Mr. Hao has been involved in management and research projects in the fields of management of technology, data communication, satellite communication, network planning and international communication since his return from the United States. Mr. Hao was a Deputy Director-General and Chief Engineer of the Directorate General of Telecommunications of the former MPT and a Vice Chairman and the General Manager of China Orient Telecomm Satellite Co., Limited prior to December 2003.

SUPERVISORS

Ms. XIA Jianghua, age 48, is Chairperson of the Supervisory Committee. Ms. Xia is Vice Director of Auditing Office and Division-Director of its Construction Auditing Division of China Telecom. Ms. Xia is also a Supervisor of China Telecom Group North Corporation. Ms. Xia received a postgraduate certificate in Enterprise Management from the University of International Business and Economics in 2004. Prior to joining China Telecom in 2000, Ms. Xia served as Vice-Divisional Director of the Auditing Bureau of MPT, Vice-Divisional Director (standing) of the Auditing Division of DGT, and from 2000 to 2002 Divisional Director of the Auditing Office of China Telecom.

Mr. HAI Liancheng, age 62, is an Independent Supervisor of our Company. Mr. Hai is the Director General of the Civil Aviation Administration of China (CAAC) Sub-association of the China Association of Chief Financial Officers and Chairman of the CAAC Training Centre for Accounting and Auditing since January 2006. Mr. Hai studied at the Civil Aviation College and Chinese Communist Party's (CPC) School, and obtained a college diploma. Mr. Hai has served as Vice-Divisional Director and Divisional Director of the Financial Division of the Financial Department of CAAC, Vice-Director and Director of the Financial Department of CAAC, General Manager of China Aviation Oil Supply Corporation, and Vice General Manager of China Aviation Oil Holding Company. From September 2001 to February 2006, Mr. Hai served as Chairman of South China BlueSky Aviation Oil Co., Ltd.

Mr. YAN Dong, age 35, is an Employee Representative Supervisor of our Company. Mr. Yan is the Divisional Director of the Coordination and Development Division of the Sideline Industrial Management Department of China Telecom. Mr. Yan received an MBA from Shandong University in 2002. Prior to joining China Telecom in 2004, Mr. Yan served as a Project Manager in Shandong International Trust and Investment Corporation, Office Director, Manager of the Investment Department and Secretary of the Board of Directors of Shandong Luxin Investment Corporation, and General Manager of Shandong Luxin Property Investment and Development Co., Ltd. Mr. Yan has served as Director of Shandong Luxin Property Investment and Development Co., Ltd., Shandong International Investment Industries Corporation, and Yantai Zhenghai Electronic Mask Co., Ltd.

Directors, Supervisors and Senior Management



- 1. Mr. WANG Xiaochu**
Chairman, Non-Executive Director
- 2. Mr. LI Ping**
Vice Chairman, Executive Director, CEO
- 3. Mr. ZHANG Zhiyong**
Executive Vice President, COO
- 4. Mr. LI Zhigang**
Executive Vice President
- 5. Mr. YUAN Jianxing**
Executive Vice President, CFO
- 6. Mr. WANG Qi**
Executive Vice President
- 7. Mr. LI Jian**
Executive Vice President
- 8. Mr. LIU Xiaoyi**
Executive Vice President

MANAGEMENT

Mr. ZHANG Zhiyong, age 42, is an Executive Vice President and Chief Operating Officer of our Company in charge of operations, business development and mergers and acquisitions. Mr. Zhang is Managing Director of the Sideline Industrial Management Department of China Telecom. Mr. Zhang received a bachelor's degree in Radio Engineering from the Changchun Institute of Posts and Telecommunications in 1986 and received a master's degree in Control Engineering from the Yanshan University in 2002 and an MBA from the BI Norwegian School of Management in 2005. Prior to joining China Telecom in November 2002, Mr. Zhang served as Deputy Director of the Qinhuangdao City Posts and Telecommunications Bureau, Director of the Qinhuangdao City Telecommunications Bureau, General Manager of Hebei Telecom Company Limited, Qinhuangdao Branch, and Deputy General Manager of China Telecom Beijing Telecom Co. Ltd. Mr. Zhang has 21 years of operational and management experience in the telecommunications industry in China.

Mr. LI Zhigang, age 44, is an Executive Vice President of our Company in charge of administration, legal and risk management functions. Mr. Li is Deputy Managing Director of the Sideline Industrial Management Department of China Telecom. Mr. Li graduated from the Beijing Institute of Posts and Telecommunications in 1985 with a major in Radio Engineering and received an Executive MBA from Peking University in 2006. Prior to joining China Telecom in June 2000, Mr. Li served as Deputy Divisional Director of the Policy and Legislative Division of the MPT, Divisional Director of the Policy and Legislative Division of the MII, Managing Director of the Corporate Strategic Development Department of China Telecom Listco and Deputy General Manager of Guangdong Telecommunications Company Limited. Mr. Li has 22 years of operational and management experience in the telecommunications industry in China.

Mr. YUAN Jianxing, age 52, is Executive Vice President and Chief Financial Officer of our Company. Mr. Yuan received an MBA degree from the Ukrainian-American Humanitarian Institute "Wisconsin International University (USA) Ukraine" in 2002. Mr. Yuan served as Vice President and General Accountant of Hunan Telecom Company Limited from September 2004 to October 2006. Prior to that, he served as Finance Department Director of the Shanxi Provincial Post and Telecommunications Bureau, General Manager of the Shanxi Provincial Posts and Telecommunications Industrial Company, Director of the Xinzhou Post and Telecommunications Bureau in Shanxi Province, General Manager of Shanxi Telecom Company Limited, Taiyuan Branch, Deputy General Manager of Shanxi Telecom Company Limited and Deputy Managing Director of the Sideline Industrial Management Department of China Telecom. Mr. Yuan has over 29 years' experience in the telecommunications industry.

Mr. WANG Qi, age 51, is an Executive Vice President of our Company. Mr. Wang is the Chief Executive Officer of Guangdong Communications Services Company Limited and is in charge of our Guangdong operations. Mr. Wang graduated from the Chinese Communist Party's (CPC) School of Guangdong in 1998. Mr. Wang joined Guangdong Telecom Industry Group Corporation as General Manager in November 2000. Prior to that, Mr. Wang had served as General Manager of Guangdong Post and Telecommunications Development Corporation, and Director of the Telecom Engineering Administration Centre of Guangdong Telecommunications Corporation. Mr. Wang was involved in a number of major communications network projects for Guangdong Telecom, and was awarded the Excellent Engineering Project Prize issued by the former Ministry of Posts and Telecommunication. Mr. Wang has 33 years of management experience in the telecommunications industry in China.

Directors, Supervisors and Senior Management

Mr. LI Jian, age 45, is an Executive Vice President of our Company. Mr. Li is a Supervisor of the Supervisory Committee of China Telecom Listco and will remain on the Committee until May 2007. He is Deputy Managing Director of the Sideline Industrial Management Department of China Telecom. Mr. Li graduated from Beijing Radio and Television University in 1986 with a major in Accounting and obtained a master's degree in International Management from Australian National University. Prior to joining China Telecom in May 2000, Mr. Li was a Director of the Treasury Division of the Department of Finance of the Ministry of Posts and Telecommunications before moving to China Telecom to take up the post of Director of the Treasury Division and Assets Division, and Director of the General Affairs and Assets Division under the Department of Finance. Mr. Li had also served as Chairman and President of China Telecom (Hong Kong) International Limited and Managing Director of the Investor Relations Department of China Telecom Listco. Mr. Li is an Accountant and has 25 years of operational and management experience in the telecommunications industry in China.

Mr. LIU Xiaoyi, age 39, is an Executive Vice President of our Company. Mr. Liu received a bachelor's degree in Communications Engineering from the Beijing Institute of Posts and Telecommunications in 1989, a master's degree in Communications Engineering from the Beijing University of Posts and Telecommunications in 1994, and an MBA degree from Tsinghua University in 2001. Mr. Liu joined China Telecom in October 2000 and served as a Director of the Data Business Division and as a Senior Manager of the International Division. From June 2002 to September 2006, Mr. Liu was Vice President of China Telecom (USA) Corporation. Mr. Liu has over 18 years' experience in the telecommunications industry.

OTHER SENIOR MANAGEMENT

Mr. CHUNG Wai Cheung, Terence, age 33, has been our Company Secretary, Assistant Chief Financial Officer and Qualified Accountant since 16 October 2006. Mr. Chung graduated from Melbourne University, Australia, with a bachelor of commerce degree in 1996 and received a master's degree in Business Administration from the Australian Graduate School of Management in 2005. Mr. Chung is a member of the Hong Kong Institute of Certified Public Accountants and the CPA Australia. Between March 2001 and October 2006, Mr. Chung worked as Finance Manager and Senior Finance Manager with China Mobile Limited and China Telecom Listco respectively. Mr. Chung has nearly 11 years of experience in auditing, financial management and company secretarial work with accounting firms and listed companies.

Mr. YUAN Jinling, age 56, is the Chief Executive Officer of Shanghai Communications Services Corporation Limited and is responsible for our Shanghai operations. Mr. Yuan graduated from the Shanghai Academy of Social Sciences. Mr. Yuan joined Shanghai Telecom Industry Corporation in October 2000 and served as deputy general manager and general manager. Prior to that, he served as standing vice director of Industrial Development Division of Shanghai Post and Telecommunications Administration Bureau, general manager of Post and Communications Industry Corporation. Mr. Yuan has 33 years of operational and management experience in the telecommunications industry in China.

Mr. SHI Yongsheng, age 57, is the Chief Executive Officer of Zhejiang Communications Services Corporation Limited and is responsible for our Zhejiang operations. Mr. Shi graduated from Australian National University with a master of International Management degree. Mr. Shi joined Zhejiang Telecom Industry Group Corporation as General Manager in June 2005. Prior to that, he had served as General Manager of Hangzhou Telecommunications Branch. Mr. Shi has 35 years of operational and management experience in the telecommunications industry in China.

Mr. YANG Yonghe, age 45, is the Chief Executive Officer of Fujian Communication Services Corporation Limited and is responsible for our Fujian operations. Mr. Yang graduated from Southwest Communication University and obtained a bachelor's degree in accounting. Before Mr. Yang joined Fujian Communication Services Corporation Limited in March 2007 as the General Manager, he held the position of officer to the office of the general manager and officer to the news and publicity department of Fujian Telecom Company Limited. Mr. Yang has 26 years of operational and management experience in the telecommunications industry in China.

Mr. GAO Liangping, age 53, is the Chief Executive Officer of Hubei Communications Services Corporation Limited and is responsible for our Hubei operations. Mr. Gao graduated from Huazhong University of Science and Technology. Mr. Gao joined Hubei Telecom Industry Corporation as Deputy General Manager in February 2004. Prior to that, Mr. Gao served as Deputy General Manager of Wuhan City Telecommunications Branch and General Manager of Wuhan City Telecommunications Industry Co., Ltd. Mr. Gao has 28 years of operational and management experience in the telecommunications industry in China.

Mr. BAO Tiejun, age 49, is the Chief Executive Officer of Hainan Communications Services Corporation Limited and is responsible for our Hainan operations. Mr. Bao graduated from Beijing Normal University. Mr. Bao joined Hainan Dayou Group Company, the predecessor of Hainan Telecom Industry Group Corporation, as General Manager in October 2000, and has since then served as Chairman of the Board of Directors and General Manager of Hainan Telecom Industry Corporation. Prior to that, he served as Office Director of the Hainan Post and Telecommunications Administration Bureau. Mr. Bao has 11 years of operational and management experience in the telecommunications industry in China.

Report of the Directors

The Board of Directors of China Communications Services Corporation Limited (the “Company”) is pleased to present the Report of the Directors of the Company, together with the audited financial statements of the Company and its subsidiaries (the “Group”) prepared in accordance with International Financial Reporting Standards for the year ended 31 December 2006.

PRINCIPAL BUSINESSES

The Group is a leading integrated service provider in the PRC which provides specialized telecommunications support services to telecommunications operators. We offer telecommunications infrastructure services, including design, construction and project supervision and management; business process outsourcing services, including network maintenance, facilities management, and distribution of telecommunications services and products; applications, content and other services, including IT applications, Internet services, and value-added voice services, as well as other services. We also provide services to telecommunications equipment manufacturers and large enterprises in the PRC. The principal business of the Company is investment holding.

RESULTS

Results of the Group for the year ended 31 December 2006 and the financial position of the Company and the Group as at that date are set out in the audited financial statements on page 62 to page 122 in this Annual Report.

DIVIDENDS

As disclosed in the Prospectus of the Company dated 27 November 2006, in accordance with the “Provisional Regulations on the Administration of State-owned Capital and Financial Treatment in the Corporate Restructuring of Enterprises” which was issued by the PRC Ministry of Finance and a resolution passed on 1 November 2006, the directors proposed, and the shareholders approved, the distribution of profit of the Group for the period from 1 April 2006 to 29 August 2006, being the calendar day immediately preceding the date of incorporation of the Company. In the same resolution, the directors proposed, and the shareholders approved, the distribution of profit of the Group for the period from 30 August 2006, being the date of incorporation of the Company, to the calendar day immediately preceding the date of its listing on the Stock Exchange (i.e. 7 December 2006) (together, the “2006 Special Dividend”).

Pursuant to a resolution passed at a directors’ meeting on 17 April 2007, the directors resolved to pay the 2006 Special Dividend to China Telecommunications Corporation (“China Telecom”) and its subsidiaries amounting to RMB535 million in total (being the distributable profit of the Group for the period from 1 April 2006 to 7 December 2006). The Company will pay the 2006 Special Dividend to China Telecom and its subsidiaries in a series of payments commencing in July 2007.

The directors do not recommend the payment of a final dividend for 2006.

USE OF PROCEEDS FROM THE INITIAL PUBLIC OFFERING

The gross proceeds (before deduction of expenses) from the initial public offering of H shares of the Company was about HK\$3,267 million. Up to 31 December 2006, the proceeds were placed in short-term deposit bank accounts. According to the plan of use of proceeds disclosed in the prospectus of the Company dated 27 November 2006, the Company will use approximately 50% of the net proceeds for capital expenditure items over the next 24 months, approximately 40% for the implementation of our business strategies and funding of business expansion, including potential acquisitions of specialized telecommunications support business from China Telecom and other strategic investments and approximately 10% for additional working capital and for other general corporate purposes.

DIRECTORS AND SENIOR MANAGEMENT OF THE COMPANY

The following table sets out information concerning the directors and senior management of the Company as at the date of this report:

Name	Position in the Company	Date of appointment
Wang Xiaochu	Chairman and Non-executive Director	3 August 2006
Li Ping	Vice Chairman, Executive Director, Chief Executive Officer	3 August 2006
Liu Aili	Non-executive Director	12 October 2006
Zhang Junan	Non-executive Director	12 October 2006
Wang Jun	Independent Non-executive Director	26 September 2006
Chan Mo Po, Paul	Independent Non-executive Director	26 September 2006
Zhao Chunjun	Independent Non-executive Director	26 September 2006
Wu Shangzhi	Independent Non-executive Director	26 September 2006
Hao Weimin	Independent Non-executive Director	27 October 2006
Zhang Zhiyong	Executive Vice President and Chief Operating Officer	16 October 2006
Li Zhigang	Executive Vice President	16 October 2006
Yuan Jianxing	Executive Vice President and Chief Financial Officer	16 October 2006
Wang Qi	Executive Vice President	16 October 2006
Li Jian	Executive Vice President	16 October 2006
Liu Xiaoyi	Executive Vice President	16 October 2006
Chung Wai Cheung, Terence	Company Secretary, Assistant Chief Financial Officer and Qualified Accountant	16 October 2006

Report of the Directors

The following table sets out information concerning the senior management of the provincial subsidiaries of the Company as at the date of this report:

Name	Position in the Group	Date of appointment
Wang Qi	Executive Vice President of the Company and Chief Executive Officer of Guangdong Communications Services Corporation Limited	17 August 2006
Yuan Jinling	Chief Executive Officer of Shanghai Communications Services Corporation Limited	17 August 2006
Shi Yongsheng	Chief Executive Officer of Zhejiang Communications Services Corporation Limited	17 August 2006
Yang Yonghe	Chief Executive Officer of Fujian Communications Services Corporation Limited	13 March 2007
Gao Liangping	Chief Executive Officer of Hubei Communications Services Corporation Limited	17 August 2006
Bao Tiejun	Chief Executive Officer of Hainan Communications Services Corporation Limited	17 August 2006

In March 2007, Yang Yonghe was appointed as the chief executive officer of Fujian Communications Services Corporation Limited while Xu Qiude resigned from the position of chief executive officer of Fujian Communications Services Corporation Limited.

SUPERVISORS OF THE COMPANY

The following table sets out information concerning the supervisors of the Company as at the date of this report:

Name	Position in the Company	Date of appointment
Xia Jianghua	Chairperson of the Supervisory Committee	3 August 2006
Hai Liancheng	Independent Supervisor	3 August 2006
Yan Dong	Supervisor (Employee Representative)	15 August 2006

Profile of the directors, supervisors and senior management is set out in the section of this Annual Report entitled "Directors, Supervisors and Senior Management" .

SHARE CAPITAL

The Company was incorporated on 30 August 2006, and the registered capital was 3,960,000,000 ordinary domestic shares with a par value of RMB1.00 each. China Telecom holds 3,623,400,000 ordinary shares, accounting for 91.50% of our total issued shares; Guangdong Telecom Industry Group Corporation (a wholly owned subsidiary of China Telecom) holds 245,520,000 ordinary shares, accounting for 6.20% of the aggregate shares and Zhejiang Telecom Industry Corporation (a wholly owned subsidiary of China Telecom) holds 91,080,000 ordinary shares, accounting for 2.30% of the aggregate shares.

In December 2006, the Company issued 1,484,986,000 H shares with a par value of RMB1.00 each, at a price of HK\$2.20 per H share by way of an initial public offering to Hong Kong and overseas investors. In connection with the initial public offering, the promoters of the Company converted 148,498,600 domestic state-owned shares of RMB1.00 each into H shares on a one domestic share to one H-share basis and transferred them to the National Council for Social Security Fund of the PRC. A total of 1,633,484,600 H shares were listed on the Stock Exchange of Hong Kong Limited ("the Stock Exchange"). As at 31 December 2006, the share capital of the Company comprised:

Shares	Number of Shares	Approximate % of issued share capital
Domestic shares (Total)	3,811,501,400	70%
Domestic shares held by:		
China Telecommunications Corporation ⁽¹⁾	3,487,523,782	64.05%
Guangdong Telecom Industry Group Corporation	236,313,086	4.34%
Zhejiang Telecom Industry Corporation	87,664,532	1.61%
H shares (Total)	1,633,484,600	30%
Total	5,444,986,000	100%

⁽¹⁾ Pursuant to the equity transfer agreement entered into between China Telecommunications Corporation ("China Telecom"), China Mobile Communications Corporation ("China Mobile") and China United Telecommunications Corporation ("China Unicom"), China Telecom agreed to transfer 506,880,000 and 229,680,000 domestic shares to China Mobile and China Unicom respectively. China Telecom will hold the said portion of shares until the date on which the conditions precedent to the equity transfer are met. The equity transfer is conditional upon the equity transfer agreement having been executed, the lapse of at least one year from the listing date and the transfer having been approved by the State-Owned Assets Supervision and Administration Commission of the PRC and the name of the transferee being registered in the Company's share register. Details of the equity transfer agreement are disclosed in the Company's prospectus dated 27 November 2006.

Report of the Directors

MATERIAL INTERESTS AND SHORT POSITIONS IN SHARES AND UNDERLYING SHARES OF THE COMPANY

As at 31 December 2006, the interests or short positions of persons who are entitled to exercise or control the exercise of 5% or more of the voting power at any of the Company's general meetings (excluding the Directors and Supervisors) in the shares and underlying shares of equity derivatives of the Company as recorded in the register required to be maintained under Section 336 of the Securities and Futures Ordinance (Cap 571 of the Laws of Hong Kong) (the "SFO") are as follows:

Name of shareholder	Number of shares held	Type of shares	Percentage of the respective type of shares (%)	Percentage of the total number of shares in issue (%)	Capacity
China Telecommunications Corporation ⁽¹⁾	3,811,501,400	Domestic shares	100.00	70.00	Beneficial Owner
China Mobile Communications Corporation ⁽²⁾	506,880,000	Domestic shares	13.30	9.31	Beneficial Owner
Guangdong Telecom Industry Group Corporation ⁽¹⁾	236,313,086	Domestic shares	6.20	4.34	Beneficial Owner
Cisco Systems International B.V.	176,676,000 (L)	H shares	10.82	3.24	Beneficial Owner
The National Council for Social Security Fund of the PRC	129,129,300 (L)	H shares	7.91	2.37	Beneficial Owner
JPMorgan Chase & Co.	107,515,500 (L)	H shares	6.58	1.97	Investment Manager,
	94,691,500 (P)	H shares	5.80	1.74	Custodian – Licensed Corporation/ Approved Leading Agent
INVESCO Hong Kong Limited (previously known as INVESCO Asia Limited)	85,682,000 (L)	H shares	5.25	1.57	Investment Manager

Remarks: (L): Long Position; (P): Lending Pool

- (1) Since China Telecom indirectly holds 100% of the shares in Guangdong Telecom Industry Group Corporation and Zhejiang Telecom Industry Corporation, the 323,977,618 domestic shares held in total by Guangdong Telecom Industry Group Corporation and Zhejiang Telecom Industry Corporation are considered and aggregated as the equity interest of China Telecom.
- (2) Please refer to the remarks in the section of this report entitled "Share Capital" for details of the equity transfer agreement entered into between China Telecom and China Mobile and the conditions to be met before the equity transfer becomes effective.

Save as stated above, as at 31 December 2006, in the register required to be maintained under Section 336 of the SFO, no other persons were recorded as holding any interests or short positions in the shares or underlying shares of the equity derivatives of the Company.

DIRECTORS' AND SUPERVISORS' INTERESTS AND SHORT POSITIONS IN SHARES, UNDERLYING SHARES AND DEBENTURES

As at 31 December 2006, none of the directors and supervisors of the Company had any interests or short positions in the shares, underlying shares of equity derivatives or debentures of the Company or its associated corporations (within the meaning of Part XV of the SFO) as recorded in the register required to be maintained under Section 352 of the SFO or as otherwise notified to the Company and The Stock Exchange of Hong Kong Limited pursuant to the Model Code for Securities Transactions by Directors of Listed Companies. As at 31 December 2006, the Company had not granted its Directors or Supervisors, or their respective spouses or children below the age of 18 any rights to subscribe for the shares or debentures of the Company or any of its associated corporations and none of them has ever exercised any such right to subscribe for shares or debentures.

PUBLIC FLOAT

Based on information that is publicly available to the Company and within the knowledge of the Directors, the Company has maintained the prescribed public float under the Listing Rules for the period from the date of listing to the date of this report.

DIRECTORS' AND SUPERVISORS' SERVICE CONTRACT

Each of the directors and supervisors has entered into a service contract with the Company. According to the service contract, each of the contracts has an initial term of 3 years and is renewable in accordance with the Articles of Association of the Company when the initial term expires. These contracts are terminable at the option of either party by giving three months' notice in writing or according to the terms of the contract prior to the expiry of the contract.

DIRECTORS' AND SUPERVISORS' INTERESTS IN CONTRACTS

For the year ended 31 December 2006, no Director or Supervisor of the Company had any material interest, whether direct or indirect, in any contract of significance entered into by the Company, any of its holding companies or subsidiaries or fellow subsidiaries, apart from service contracts.

EMOLUMENTS OF THE DIRECTORS AND SUPERVISORS

Based on the overall remuneration policy of the Company and with reference to the payroll standard of same industry companies in the market, the remuneration of Directors and Supervisors is determined after taking into account the scope of duties and their complexities. Please refer to note 11 of the audited financial statements for details of the emoluments of the Directors and Supervisors of the Company in 2006.

PURCHASE, SALE AND REDEMPTION OF SHARES

Neither the Company nor any of its subsidiaries has purchased, sold or redeemed any securities of the Company during the reporting period.

Report of the Directors

SUMMARY OF FINANCIAL INFORMATION

Please refer to pages 123 to 124 of this Annual Report for a summary of the operating results, assets and liabilities of the Group for each of the years in the four-year period ended 31 December 2006.

BANK LOANS AND OTHER BORROWINGS

Please refer to note 30 of the audited financial statements for details of bank loans and other borrowings of the Group.

PROPERTY, PLANT AND EQUIPMENT

Please refer to note 16 of the audited financial statements for movements in the fixed assets of the Group for the year ended 31 December 2006.

DISTRIBUTABLE RESERVES

Please refer to note 41 of the audited financial statements for details of the movements in the reserves of the Company for 2006.

DONATIONS

For the year ended 31 December 2006, the Group made charitable and other donations to a total amount of RMB1.80 million.

SUBSIDIARIES AND ASSOCIATED COMPANIES

Please refer to note 21 and note 22 of the audited financial statements for details of the Company's subsidiaries and the Group's interests in associated companies as at 31 December 2006.

CHANGES IN EQUITY

Please refer to the consolidated statement of changes in equity contained in the audited financial statements (page 66 of this Annual Report).

PLAN OF EMPLOYEES' RETIREMENT BENEFITS

Please refer to note 34 of the audited financial statements for details of the retirement benefits provided by the Group.

PRE-EMPTIVE RIGHTS

There are no provisions for pre-emptive rights in the Articles of Association requiring the Company to offer new shares to the existing shareholders in proportion to their shareholdings.

MAJOR CUSTOMERS AND SUPPLIERS

For the reporting period, the sales to the five largest customers of the Group represented 69.4% of the operating revenue of the Group; of which, the sales to the largest customers of the Group represented 53.1% of the operating revenue of the Group. The purchases from the five largest suppliers of the Group accounted for less than 30% of the total annual purchases of the Group.

So far as the Directors are aware, as disclosed in the prospectus of the Company, of the five largest customers of the Group, China Telecom holds 70% equity interest of the Company, and has agreed to transfer 506,880,000 domestic shares of the Company and 229,680,000 domestic shares of the Company to China Mobile and China Unicom, respectively. China Telecom will keep holding the aforementioned shares prior to the completion of the transfer. As at 31 December 2006, Mr. Liu Aili, a non-executive director of the Company, held 141,500 share purchase options in China Mobile Limited, a subsidiary of China Mobile, one of our five largest customers of the Group, and Mr. Zhang Junan, a non-executive director of the Company, held 500,000 share purchase options in China Unicom Corporation Limited, a subsidiary of China Unicom, one of our five largest customers of the Group.

Other than that, no director of the Group, their associates, or any person holding more than 5% of the issued share capital of the Company has any interests in such suppliers or customers.

CONTINUING CONNECTED TRANSACTIONS

Pursuant to Chapter 14A of the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited, the transactions between the Group and China Telecom and its subsidiaries (excluding our Group and including China Telecom Corporation Limited, collectively the "China Telecom Group") will constitute connected transactions of the Group.

The following table sets out the amounts of continuing connected transactions of the Group during the year ended 31 December 2006:

Transaction	The Group (RMB million)	Annual cap of continuing connected transaction (RMB million)
Engineering services provided to China Telecom Group	4,126.27	4,700.00
Ancillary telecommunications services provided to China Telecom Group	2,197.98	2,300.00
Operation support services provided to/by China Telecom Group	Revenue 1,017.24 Expenditure 104.25	1,300.00 170.00
IT application services provided to/by China Telecom Group	Revenue 147.06 Expenditure 170.93	250.00 190.00
Property leasing provided to/by China Telecom Group	Revenue 45.38 Expenditure 45.33	68.50 76.50
Centralized services provided to China Telecom Group	45.10	250.00

Report of the Directors

Continuing Connected Transactions Agreements Between the Group and China Telecommunications Corporation

The Group and China Telecom entered into six continuing connected transactions agreements on 16 November 2006 to manage the connected transaction between the Group and China Telecom Group. These agreements are the Engineering Framework Agreement, the Ancillary Telecommunications Services Framework Agreement, the Operation Support Services Framework Agreement, the IT Application Services Framework Agreement, the Property Leasing Framework Agreement and the Centralized Services Agreement. The terms of the above six agreements will expire on 31 December 2008 and are automatically renewable for further periods of no more than three years subject to shareholders' approval unless terminated early by either party with three months' written notice.

Engineering Framework Agreement

Pursuant to the Engineering Framework Agreement, the Company agreed to provide certain engineering related services, such as design, construction, project supervision and management for telecommunications infrastructure projects undertaken by China Telecom Group. The charges payable for engineering-related services rendered under the Engineering Framework Agreement shall be determined by reference to market rates or as reflected by prices obtained through the tender process. The Company would be accorded priority by China Telecom Group in the provision of the engineering related services except in tenders, provided that the terms and conditions offered by independent third parties to China Telecom Group are no more favourable than those offered by the Company for the same services, and in return, the Company has undertaken to China Telecom Group that the Company shall not provide services to it on terms which are less favourable than those offered by the Company to independent third parties.

Ancillary Telecommunications Services Framework Agreement

Pursuant to the Ancillary Telecommunications Services Framework Agreement, the Company agreed to provide to China Telecom Group certain ancillary telecommunications services such as maintenance of network facilities including equipment, ducts and cables, equipment rooms and base stations; distribution of telecommunications products and services; provision of application, content and other services such as fixed-line value-added services, wireless value-added services, Internet value-added services, and the development of online gaming, certificate authentication and the value-added business platform of Internet cafes (the "Ancillary Telecommunications Services"). The Ancillary Telecommunications Services Framework Agreement stipulates that the Ancillary Telecommunications Services be provided at:

- (1) government-prescribed price;
- (2) where there is no government-prescribed price but where there is a government-guidance price, the government-guidance price applies
- (3) where there is neither a government-prescribed price nor a government-guidance price, the market price applies. The market price is defined as the price at which the same type of services are provided by independent third parties in the ordinary course of business; or
- (4) where none of the above is applicable, the price is to be agreed between the relevant parties for the provision of the above services, which shall be the reasonable cost incurred in providing the same plus a reasonable profit (For this purpose, "reasonable costs" means the costs confirmed by both parties after negotiations, and "reasonable profits" means a profit ratio confirmed by both parties during the course of normal commercial negotiation, taking into account factors such as historical price, transaction size, average profit ratio within the relevant industry, supply and demand, labour cost, local commodity prices and economic development levels).

The Company will be given priority by China Telecom Group in the provision of the Ancillary Telecommunications Services, provided that the terms and conditions offered by independent third parties to China Telecom Group are no more favourable than those offered by us for the same services, and in return, we have undertaken to China Telecom Group that we shall not provide Ancillary Telecommunications Services to it on terms which are less favourable than those offered by us to independent third parties.

Operation Support Services Framework Agreement

Pursuant to the Operation Support Services Framework Agreement, the Company agreed to provide to China Telecom Group, operation support services, including but not limited to facilities management and renovation, network facilities management in relation to buildings used for telecommunications purposes, labour resources management, equipment maintenance, advertisements, conferencing services, vehicles, and certain repair and leasing of equipment. Under the same Operation Support Services Framework Agreement, China Telecom Group has agreed to provide operation support services such as logistic services, warehouse, medical care, food and beverages, educational, hotel and travelling services, labour services and other services to us. Each of the parties will accord priority to the other party in the provision of the operation support services, provided that the terms and conditions offered by independent third parties to the relevant party are no more favourable than those offered by the other party for the same services, and in return, each of the parties has undertaken to the other that it shall not provide services to the other on terms which are less favourable than those offered to independent third parties. The operation support services under the Operation Support Services Framework Agreement are provided in accordance with the same pricing policy as that of the Ancillary Telecommunications Services Framework Agreement.

IT Application Services Framework Agreement

Pursuant to the IT Application Services Framework Agreement, the Company agreed to provide China Telecom Group with telecommunications network support services, software and hardware development and other related IT services. China Telecom Group has also agreed to provide to the Company certain IT application services including but not limited to, basic telecommunications services such as voice and data, value-added services and information application services. The charges payable for such IT application services under the IT Application Services Framework Agreement shall be determined by reference to market rates, for example, rates as reflected by prices obtained through the tender process (with a minimum of three parties tendering bids). The party receiving the relevant services will accord priority to the party providing such services, provided that the terms and conditions offered by independent third parties to the relevant party are no more favourable than those offered by the other party for the same services, and in return, each of the parties has undertaken to the other that it shall not provide services to the other on terms which are less favourable than those offered to independent third parties.

Centralized Services Agreement

Pursuant to the Centralized Services Agreement, the centralized services to be provided by the Company to China Telecom Group include:

1. the corporate headquarters management function to manage assets of China Telecom Group's retained specialised telecommunications support businesses in provinces, municipalities and autonomous regions including Jiangsu, Anhui, Jiangxi, Sichuan, Chongqing, Hunan, Guizhou, Yunnan, Guangxi, Shaanxi, Ningxia, Gansu, Qinghai, Xinjiang, Tibet and any remaining assets, such as hotels, manufacturing plants not in association with the specialized telecommunications support businesses, schools and hospitals, resulting from the restructuring of the Company in the Company's Primary Service Regions (including Shanghai municipality, and Zhejiang, Fujian, Hubei, Guangdong and Hainan Provinces in the PRC); and
2. the provincial headquarters management function to manage remaining assets resulting from the restructuring of the Company in the Company's Primary Service Regions.

Report of the Directors

Except otherwise agreed by the parties, the aggregate administrative expenses incurred by us for the provision of the centralized services referred to above (all expenses incurred in connection with the above-mentioned headquarters management functions except remuneration for Directors, share appreciation rights and provision of bad debts) will be apportioned pro rata between the Company and China Telecom Group according to the proportional net asset value of each of the relevant parties.

Property Leasing Framework Agreement

Pursuant to the Property Leasing Framework Agreement, the rental charges of each property of the Company and China Telecom Group leased by each party from another party are based on market rates. Rental charges are payable monthly in arrears, except as otherwise agreed by parties, and are subject to review every three years by both parties confirming after negotiations whether to adjust the rental charges and the amount of such adjustment.

CONNECTED TRANSACTION AGREEMENT BETWEEN THE GROUP AND CHINA TELECOM CORPORATION LIMITED (OUR FELLOW SUBSIDIARY)

Strategic Cooperation Agreement

We have entered into a Strategic Cooperation Agreement dated 30 August 2006 with China Telecom Corporation Limited, on behalf of its six wholly-owned subsidiaries, namely Shanghai Telecom Company Limited, Zhejiang Telecom Company Limited, Fujian Telecom Company Limited, Hubei Telecom Company Limited, Guangdong Telecom Company Limited, Hainan Telecom Company Limited and their respective subsidiaries for a period of three years commencing 1 January 2007 until 31 December 2009, renewable by mutual agreement and extendable in geographical areas. The areas for strategic business cooperation between the parties shall include engineering related services in connection with our design, construction, project supervision and management businesses; maintenance and management services including but not limited to our network maintenance and facilities management; and certain business process operation services such as integrated information solutions and call centres; and provision of applications, content and other services such as system integration and value-added services.

It is stipulated that the relevant services provided under the Strategic Cooperation Agreement shall be provided at an applicable standard price determined in the following order:

1. government-prescribed price;
2. where there is no government-prescribed price but there is a government-guided price, the government-guidance price applies;
3. where there is neither a government-prescribed price nor a government-guidance price, the market price applies. The market price is defined as the price at which the same type of services are provided by independent third parties in the ordinary course of business; or
4. where none of the above are applicable, the price is to be agreed between the relevant parties for the provision of the above services based on arm's length negotiation and shall be equal to the reasonable cost incurred in providing the same plus a reasonable profit.

The Group would be accorded priority by China Telecom Corporation Limited in the provision of the relevant services, provided that the terms and conditions offered by independent third parties to China Telecom Corporation Limited are no more favourable than those offered by us for the same services, and in return, under the same terms and conditions, we have undertaken to China Telecom Corporation Limited that we shall not provide services to it on terms which are less favourable than those offered by us to independent third parties.

In relation to the Group's provision of engineering related services in design, construction, project supervision and management businesses, China Telecom Corporation Limited has undertaken that the relevant subsidiaries of China Telecom Corporation Limited in the six provinces (including municipalities), being Shanghai, Zhejiang, Fujian, Hubei, Guangdong and Hainan, shall spend an annual minimum amount of not less than 12.5% of the total annual capital expenditure of the six corresponding wholly-owned provincial subsidiaries of China Telecom Corporation Limited, provided our terms and conditions for the provision of the engineering related services are no less favourable than those offered by any independent third parties and in return, we shall offer at least 5% discount for the engineering-related services to be provided to the relevant wholly-owned provincial subsidiaries of China Telecom Corporation Limited based on the applicable standard prices. Such discount is on normal commercial terms and it is in-line with market practice to give a discount as favourable treatment offered to large enterprise customers which are able to commit to a minimum purchase volume per annum. The percentage discount depends on a number of factors, such as the committed minimum purchase volume, competition and so on. The Company will undertake, among other things, to implement quality control during the provision of the one-stop engineering related services.

In relation to the Company's provision of maintenance and management services including but not limited to our network maintenance and facilities management businesses, China Telecom Corporation Limited has undertaken that the relevant subsidiaries of China Telecom Corporation Limited in the six provinces (including municipalities), being Shanghai, Zhejiang, Fujian, Hubei, Guangdong and Hainan, shall spend an annual minimum amount of not less than RMB1,330 million provided the Company's terms and conditions for the provision of the maintenance and management services are no less favourable than those offered by any independent third parties and in return, the Company has undertaken to fully utilize our competitive edge on having established professional operations with economies of scale to assist China Telecom Corporation Limited to achieve the goals of lowering its costs and expenditure.

In relation to the Company's provision of business process outsourcing services, integrated information solutions, call centre and other services such as system integration and value-added services, China Telecom Corporation Limited has undertaken to use its best endeavours to grant us business opportunities, provided our terms and conditions for the provision of such services are no less favourable than those offered by any independent third parties. In return, the Company will utilize our capacities and resources to support the strategic transformation of China Telecom Corporation Limited into an integrated information service provider.

The annual caps for the provision of the relevant services contemplated under the Strategic Cooperation Agreement have already been set out in the Engineering Framework Agreement, the Ancillary Telecommunications Services Framework Agreement, the Operation Support Services Framework Agreement and the IT Application Services Framework Agreement referred to below and therefore no separate annual caps shall be applied to the Strategic Cooperation Agreement.

The independent non-executive directors have confirmed that all continuing connected transactions for the year ended 31 December 2006 to which the Group was a party:

1. had been entered into, and that the agreements governing those transactions had been entered into, by the Group in the ordinary and usual course of business;
2. had been entered into either:
 - (i) on normal commercial terms; or
 - (ii) where there was no available comparison to judge whether they are on normal commercial terms, are on terms no less favourable than those available to or (if applicable) from independent third parties; and

Report of the Directors

- had been entered into on terms that are fair and reasonable so far as the overall interests of the independent shareholders of the Company are concerned.

The independent non-executive directors have further confirmed that:

The values of continuing connected transactions entered into between the Group and its connected persons which are subject to annual caps have not exceeded their respective annual caps.

The auditors of the Company have performed procedures on the transactions and issued a letter to the Board to advise that:

- the transactions entered into between the Group and China Telecom during the year ended 31 December 2006 have been approved by the Directors;
- they have not found that the transactions entered into between the Group and China Telecom during the year ended 31 December 2006 were not in accordance with the pricing policies as stated in the relevant agreements;
- they have not found that the transactions entered into between the Group and China Telecom during the year ended 31 December 2006 were not in accordance with the terms of the agreements governing the transactions;
- they note that the transactions have not exceeded the 2006 annual caps as disclosed in the prospectus.

EMPLOYEES

As at 31 December 2006, the Group has 71,666 employees illustrated as follows:

	Number of staff	Percentage
Management	5,016	7%
Technical and marketing	20,066	28%
Operations	46,584	65%
Total	71,666	100%

The Company has implemented a performance-linked remuneration system. Remuneration for employees includes basic salary, performance-based bonus and welfare. In addition, the Company also emphasizes the importance of employee training and uses various means of training to improve the quality and capability of key employees.

COMPLIANCE WITH CODE ON CORPORATE GOVERNANCE PRACTICES

Please see the “Corporate Governance Report” set out in this Annual Report of the Company for details of our compliance with the Code on Corporate Governance Practices.

MATERIAL LEGAL PROCEEDINGS

As at 31 December 2006, so far as the Directors are aware, the Company was not involved in any material litigation or arbitration and no material litigation claims had been made against, or were pending or threatened against the Company.

NON-ADJUSTING POST BALANCE SHEET EVENT

The Corporate Income Tax Law of the People’s Republic of China (the “New Tax Law”) has been passed by the Fifth Plenary Session of the Tenth National People’s Congress on 16 March 2007 and will take effect on 1 January 2008. According to the New Tax Law, except for certain subsidiaries of the Company which are taxed at a preferential rate, the income tax rate applicable to the Group will be reduced from 33% to 25% from 1 January 2008. From 1 January 2008, certain subsidiaries which are currently taxed at preferential rates will be subject to a five-year transition period during which the tax rates will gradually be increased to the unified rate of 25% and certain high-tech enterprises will continue to be entitled to a reduced tax rate of 15%. However, the New Tax Law has not set out the details of how the existing preferential tax rate will gradually increase to the standard rate of 25% and the detailed implementation rules regarding the preferential tax policies (e.g. the details of how a taxpayer can be qualified as a high-tech enterprise to enjoy the preferential rate of 15%) have yet to be made public. Consequently, management is not in a position to estimate the impact of the New Tax Law on the deferred tax assets and liabilities of certain subsidiaries which are being taxed at preferential rates. The financial effect of the New Tax Law, if any, will be reflected in the Group’s 2007 financial statements. The enactment of the New Tax Law is not expected to have any financial effect on the amounts accrued in the balance sheet in respect of current tax payable.

AUDITORS

KPMG and KPMG Huazhen were engaged as the international and domestic auditors of the Company for the year ended 31 December 2006. KPMG has audited the accompanying financial statements, which have been prepared in accordance with International Financial Reporting Standards. The Company has retained KPMG and KPMG Huazhen since the date of its listing. A resolution for the reappointment of KPMG and KPMG Huazhen as the international and domestic auditors of the Company for the year ending 31 December 2007 will be proposed at the annual general meeting of the Company.

By order of the Board

Wang Xiaochu

Chairman

Beijing, China
17 April 2007

Report of the Supervisory Committee

Dear Shareholders,

During the reporting period, all the members of the Supervisory Committee conscientiously performed their supervisory duties and earnestly safeguarded the interests of the shareholders and the Company in accordance with the relevant requirements of the Company Law of the PRC and the Company's Articles of Association.

During the reporting period, the Supervisory Committee held one meeting. At the first meeting of the first Supervisory Committee held on 18 September 2006, pursuant to the requirements of the approved Company's Articles of Association, the Supervisors elected by the employees and the meeting of promoters adopted a resolution approving the election of Ms Xia Jianghua as the Chairperson of the Supervisory Committee for a term of three years commencing from the date of the meeting. Ms Xia Jianghua would exercise her duties and powers in accordance with the Company's Articles of Association.

At the meeting held on 10 April 2007, the Supervisory Committee carefully reviewed the unqualified 2006 financial report of the Company and other related information which had been prepared in accordance with PRC accounting principles and International Financial Reporting Standards, audited by external auditors of the Company, and were proposed to be submitted by the Board of Directors to the shareholders' general meeting. The Supervisory Committee believed that the financial report was in conformity with the principle of consistency and reflected the Company's financial position and operating results in a true and complete manner. At the same meeting, the Supervisory Committee also reviewed and approved the Report of the Supervisory Committee and the 2007 Work Plan of the Supervisory Committee.

The Supervisory Committee believes that during the reporting period, all members of the Board of Directors and the senior management were dedicated, conscientious and prudent in their decision-making, and earnestly carried out various resolutions of the shareholders' meeting and the Board of Directors. With a view to maximise the value of the Company and the interest of shareholders, they had made relentless efforts for the development of the Company. The Supervisory Committee was not aware of any violation of laws, regulations and Company's Articles of Association during the year.

In the coming year, the Supervisory Committee will continue to perform its duties in accordance with the Company Law of the PRC, the Company's Articles of Association and relevant regulatory requirements of the Hong Kong Listing Rules, adhere to the principle of good faith, strengthen its supervisory work, ensure the prevention of any conflicts of interest between the shareholders and the Company, faithfully and diligently pursue its supervisory duties and endeavour to do a good job.

By order of the Supervisory Committee

Xia Jianghua

Chairperson of the Supervisory Committee

Beijing, PRC
10 April 2007

Corporate Governance Report

We are committed to maintaining sound corporate governance standards and procedures to ensure the completeness, transparency and quality of our information disclosure, and we endeavour to achieve even more regulated procedures of work, effective management, and rational operation, so as to safeguard shareholders' interests to the greatest extent.

CORPORATE GOVERNANCE PRACTICES

As a company which was newly listed on the Stock Exchange of Hong Kong Limited (the "Stock Exchange") on 8 December 2006, the Company took the initiative to adopt and comply with the Code Provisions in the Code on Corporate Governance Practices (the "Code") as set out in Appendix 14 of the Rules Governing the Listing of Securities on the Stock Exchange (the "Listing Rules"). From the date of the Company's listing on 8 December 2006 to 31 December 2006, the Company has complied with the Code Provisions of the Code.

The Directors of the Company confirm that it is their responsibility to prepare the financial statements of the Company and its subsidiaries (the "Group"), and to ensure that the financial statements are prepared in accordance with relevant laws and the accounting standards applicable to the Company. The Directors also ensure that the financial statements of the Company are published promptly.

The responsibility statement of KPMG, our external auditors, regarding its report on the financial statements of the Group is set out on page 61 of this Annual Report.

SECURITIES TRANSACTIONS OF DIRECTORS

The Company has adopted the Model Code for Securities Transactions by Directors of Listed Issuers (the "Model Code") as set out in Appendix 10 of the Listing Rules regulate the securities transactions of the Directors. Having made specific enquiries in writing to the Directors, each of the Directors had confirmed that he has complied with the Model Code in connection with the Company's securities in the reporting period.

BOARD OF DIRECTORS

The leadership, control, and supervision of the Company is vested in the Board, which is responsible for overseeing the Group's business and affairs, approving operation plans and investment proposals, reviewing financial policies and performance, and formulating the basic management systems of the Company. The Board has delegated to the senior management, the powers and responsibilities to conduct the day-to-day management and operations of the Group and to organize the implementation of the resolutions of the Board, annual business plans and investment proposals. The senior management must obtain the approval of the Board before entering into any material transaction.

Where necessary, all Directors can have full and timely access to all relevant information and obtain the advice and services of the Company Secretary. The Directors may, where appropriate, seek independent professional advice to ensure compliance with the procedures of the Board and all applicable rules and regulations, at the Company's expense.

The Board consists of nine members, who are Mr. Wang Xiaochu (Chairman and Non-executive Director), Mr. Li Ping (Vice Chairman and Executive Director), Mr. Liu Aili and Mr. Zhang Junan, as Non-executive Directors, and Mr. Wang Jun, Mr. Chan Mo Po, Paul, Mr. Zhao Chunjun, Mr. Wu Shangzhi and Mr. Hao Weimin, as Independent Non-executive Directors. Profiles of the Directors are set out in the section entitled "Profiles of Directors and Senior Management" of this Annual Report.

Corporate Governance Report

The Board comprises five independent non-executive directors, constituting more than half of the members of the Board, and which comprises a higher proportion set out as in the Recommended Best Practices of the Code, thus ensuring its independence. The independent non-executive directors are all seniors in their own industries or professions. Among them, Mr. Chan Mo Po, Paul, a certified public accountant in Hong Kong, former president of the Hong Kong Institute of Certified Public Accountants, and former chairman of the Association of Chartered Certified Accountants, is an internationally renowned finance expert having valuable expertise in the fields of accounting and financial management.

To the best of the Directors' knowledge, the members of the Board, in particular between the Chairman and the Chief Executive Officer, do not have any financial, business, family or other material connection with each other, and all of them are free to make independent judgments.

The Company has received an annual written confirmation of independence made by each of the independent directors pursuant to Rule 3.13 of the Listing Rules, and considers all independent non-executive directors to be independent.

MEETINGS OF THE BOARD

Pursuant to the Company's Articles of Association, the Board shall convene at least two meetings a year, and any ad hoc meeting where necessary. Nevertheless, the Board convenes at least four meetings a year in actual practice. In 2006, the Board convened eight meetings. The Directors review and approve financial and operation performance, and consider and approve the overall strategy and policies of the Company at Board meetings.

The Company Secretary assists the Chairman in preparing the agenda for Board meetings. Unless stipulated otherwise by the Board in advance, the time and place for any Board meeting shall be notified to all the Directors at least 14 days prior to the date of the meeting. The agenda and related documents of the meeting will be delivered to all Directors at least 3 days prior to the date of meeting, so that the Directors are apprised of the latest developments and financial position of the Company to make informed decisions. The Board and each of the Directors may contact the senior management independently if necessary.

All the minutes of the meetings of the Board contain details of the matters considered and the resolutions adopted, and are kept by the meeting secretary and available to the Directors for inspection.

The Board held eight meetings in 2006. Individual attendance of each incumbent Board member at the meetings in 2006 is as follows (including attendances by written proxies):

Directors	Actual attendance in 2006/Meetings convened during period of appointment
Executive Directors	
Li Ping (<i>Vice Chairman</i>) (appointed on 3 August 2006)	8/8
Non-executive Directors	
Wang Xiaochu (<i>Chairman</i>) (appointed on 3 August 2006)	8/8
Liu Aili (appointed on 12 October 2006)	2/3
Zhang Junan (appointed on 12 October 2006)	3/3
Independent Non-executive Directors	
Wang Jun (appointed on 26 September 2006)	2/4
Chan Mo Po, Paul (appointed on 26 September 2006)	2/4
Zhao Chunjun (appointed on 26 September 2006)	3/4
Wu Shangzhi (appointed on 26 September 2006)	3/4
Hao Weimin (appointed on 27 October 2006)	1/1

CHAIRMAN AND CHIEF EXECUTIVE OFFICER

The roles of the Chairman and the Chief Executive Officer of the Company are segregated and are held by different persons in order to achieve a balance between powers and duties and avoid any concentration of powers and duties assigned to any individual member of the Board. The functions and duties of the Chairman and the Chief Executive Officer are clearly distinguished. Mr. Wang Xiaochu, Chairman of the Board and concurrently a Non-executive Director, is responsible for overseeing the operations of the Board and formulating the overall strategies and policies of the Company. Mr. Li Ping, the Chief Executive Officer and concurrently the Vice Chairman and Executive Director, is responsible for the day-to-day management and overall operations of the Group.

NON-EXECUTIVE DIRECTORS

The three Non-executive Directors and five Independent Non-executive Directors of the Company are each appointed for a term of three years and may serve consecutive terms if re-elected upon the expiry of the term of their appointment.

BOARD COMMITTEES

As an important part of sound corporate governance practices and for supervision of the overall affairs of the Company in various areas, the Board maintains the following five Board Committees to assist it in discharging its responsibilities, which are the Audit Committee, the Remuneration Committee, the Nomination Committee, the Non-competition Undertaking Review Committee and the Right of First Refusal and Priority Right Committee. All five Board Committees are composed of independent Non-executive Directors, to ensure the full expression of independent and objective views and to fulfill each of its responsibilities of overall safeguard and supervision.

Established in November 2006, the five Board Committees did not hold any meetings in the year as the time period from their establishment to the year end of 2006 was relatively short.

AUDIT COMMITTEE

The Audit Committee consists of three independent non-executive directors: Mr. Chan Mo Po, Paul (chairman), Mr. Wu Shangzhi and Mr. Hao Weimin. The Audit Committee is mainly responsible for examining the appointment of external auditors, considering and supervising the financial reporting procedures and the internal control systems of the Company, reviewing the Company's interim and annual financial statements to ensure a true and fair view of the state of affairs, assessing interim and annual results of the Company after consulting with external auditors, and making recommendations to the Board. The Audit Committee makes an assessment of the effectiveness of the Group's internal control at least once a year to enable the Board to understand the overall financial position and protect the assets of the Group.

REMUNERATION COMMITTEE

The Remuneration Committee consists of three independent non-executive directors: Mr. Wu Shangzhi (chairman), Mr. Chan Mo Po, Paul and Mr. Zhao Chunjun. The Remuneration Committee is mainly responsible for formulating policies on human resources management, reviewing the remuneration policies of the Company, and determining remuneration packages for the Directors based on the overall remuneration policy of the Company and by reference to the level of remuneration packages offered by comparable companies in the market, and the scope and complexity of the Directors' duties.

Corporate Governance Report

NOMINATION COMMITTEE

The Nomination Committee consists of three independent non-executive directors: Mr. Zhao Chunjun (chairman), Mr. Wang Jun and Mr. Hao Weimin. The Nomination Committee is mainly responsible for reviewing the structure, size and composition of the Board and the skills, knowledge and experience of members of the Board, and recommending candidates to the Board in the event of Board vacancies.

Although the Nomination Committee did not hold any meetings in 2006, the Board held three meetings to select and recommend candidates to the Board during the year. The selection criteria include the candidate's integrity, achievements and experience in the telecom industry, and relevant management skills and professional background, and the time he can dedicate to discharging his duties as a director, and to matters of the Company.

NON-COMPETITION UNDERTAKING REVIEW COMMITTEE

The Non-competition Undertaking Review Committee consists of three independent non-executive directors: Mr. Hao Weimin (chairman), Mr. Chan Mo Po, Paul and Mr. Zhao Chunjun. The Non-competition Undertaking Review Committee is mainly responsible for monitoring the implementation of the non-competition undertakings made by China Telecommunications Corporation.

The Company has received a letter issued to the Company by China Telecommunications Corporation stating that they were not in breach of any non-competition undertakings in 2006. The letter has been considered by the Non-competition Undertaking Review Committee and approved by the Board.

RIGHT OF FIRST REFUSAL AND PRIORITY RIGHT COMMITTEE

The Right of First Refusal and Priority Right Committee consists of three independent non-executive directors: Mr. Wu Shangzhi (chairman), Mr. Zhao Chunjun and Mr. Hao Weimin. The Right of First Refusal and Priority Right Committee is mainly responsible for monitoring the enforcement of the right of first refusal and priority right granted by China Telecommunications Corporation and protecting the interest of independent shareholders when such right of first refusal or the priority right is exercised.

REMUNERATION OF THE AUDITORS

The international and domestic auditors of the Company are KPMG and KPMG Huazhen respectively. A breakdown of the remuneration received by the external auditors for the audit and non-audit services provided to the Company during the year is set out below:

Item	Fees (RMB'000)
Services provided as the reporting accountants for the IPO of the Company	21,098
Audit for the year	10,800
	<hr/>
Total	31,898
	<hr/>

SUPERVISORY COMMITTEE

The Company has established a supervisory committee pursuant to the Company Law of the PRC. The Supervisory Committee consists of three members, of which Ms. Xia Jianghua is the chairperson, and Mr. Hai Liancheng serves as the external independent supervisor, and Mr. Yan Dong serves as the staff representative supervisor. The supervisors are appointed for a term of three years and may serve consecutive terms if re-elected upon the expiry of the term. The Supervisory Committee is a standing supervisory institution of the Company and is accountable and reports to all the shareholders. The Supervisory Committee normally meets at least twice a year.

The primary duties of the Supervisory Committee are to supervise the financial activities of the Group, review the financial statements and other financial information prepared by the Board for presentation to the shareholders' general meetings, supervise the Directors, Chief Executive Officer and other senior management personnel in their performance of duties and prevent them from any abuse of power, and represent the Company in dealing with the Directors or institute actions against the Directors on behalf of the Company.

During the year, the Supervisory Committee held one meeting, which was attended by all three supervisors. The main business of the meeting was to elect Ms Xia Jianghua as the chairperson of the Supervisory Committee.

INTERNAL CONTROL

The Board of the Company is granted full authority to maintain the soundness and effectiveness of the internal control system and risk management procedures of the Group, including setting a management structure and its terms of reference to ensure efficient and effective use of the Group's resources to assist the Group in achieving its operation objectives, safeguarding the Group's assets against any unauthorized use or disposal, ensuring an appropriate maintenance of accounting records and the availability of reliable financial information for internal use or external release, and ensuring compliance of all operating activities with laws and regulations. The control system is intended to have in place reasonable safeguards against material misrepresentation or loss, and to manage and eliminate as far as possible any defects in the Group's operating system and the risk of failing to achieve its objectives.

The Group is committed to strengthening its internal control and risk management and has a sound foundation for internal control. In the course of reorganization in preparation for listing, the Group paid particular attention to its internal control and strengthened its risk control. The Group proceeded to establish an internal control system, introduced the concept of comprehensive risk management pursuant to the requirements of the Stock Exchange on internal control and risk management, straightened out its internal organization structure and management structure, and established a department specially designated for internal control and risk management. We also practice a system whereby we designate officers-in-charge of risk management to our provincial branches, and our provincial branches also designate officers-in-charge of risk management and of financial affairs to their professional subsidiaries. The Company pays particular attention to any possible risk exposure in conducting its monthly and quarterly operation analysis, and takes corresponding countermeasures and issues pre-warnings against certain material risks.

The Company endeavours to integrate its internal control and risk management with its day-to-day operations, and proactively adopts IT technology to assimilate the internal control and risk management processes into the IT system, achieving reduction of operational risks, and an enhancement of internal control and risk management.

In 2007, the Board intends to further improve and perfect its internal control and risk management with a view to achieving even greater enhancement of the work flow.

Human Resources Development

In 2006, based on the philosophy of staff welfare should be the concern of an enterprise and talents being essential to the success of an enterprise, the Company, with regard to human resources as its first resource and its most important production element, reformed and renovated its human resources management. During the year, the Company had focused on the control of the total number of workforce and the optimization of human resources structure, improved our overall human resources investment strategy, and enhanced the operating efficiency of human resources, thereby providing a strong manpower support to the operation and development of the Company.

- **Basic information on Employees**

As at the end of 2006, the total number of employees of the Company was 71,666, including 5,016 management staff, which accounted for 7.0% of the total workforce, 20,066 technical and marketing personnel, and 46,584 operational personnel.

We implemented labour control during the year with a staff reduction rate of 2.4%. To streamline the management structure, the number of management staff was decreased by 4%. At the same time, we actively recruited marketing and 3G talents. The number of employees with a bachelor's degree or a higher degree increased by 11%. Our human resources structure was therefore further optimized.

- **Optimizing the Organizational Structure and Improving Business Processes**

According to the Company's overall strategy, we established a head office that are responsible for the strategic targets and a flat organizational structure at the provincial subsidiaries level. We reduced management hierarchy and management staff. We have optimized the procedures of business operation and management and launched an IT system for management of human resources, which enables us to set job positions scientifically and has further enhanced operation efficiency.

- **Establishing a Remuneration Mechanism which Combines Long-term and Short-term Incentives through Performance Review**

The Company has implemented market-oriented human resource policies, and insisted on the concept of letting people demonstrate their talents, and talents create values. Employees achieve their jobs through competition. Both employees and management personnel are subject to a dynamic human resources management mechanism which employs or dismisses a person based on his/her performance. The Company has established a performance check index system which reviews the performance of managers of the Company's province-level subsidiaries and links the results of such performance review directly with their remuneration. On the basis of performance review, the Company has established a long-term incentive mechanism for management and key employees.

- **Strengthening Human Resources Development and Improving Staff Career Development**

We offered various overseas training programs to our staff, including the courses on business development and 3G technologies, to improve our staff's abilities and provide more promotion opportunities to them, offer more room for the development of different types of employees, thereby enhancing the value of the staff and the Company as a whole.

- **Harmonious Relationship between Employees and the Company**

The Company endeavours to create a learning-oriented work environment and culture to maximize the enthusiasm, initiative and creativity of employees. We encourage communication between employees and management at various levels so that the Company and the employees can achieve a harmonious development.

In 2006, the Company devoted much attention to production safety and the health and safety of the employees were well protected.

Notice of the Annual General Meeting

NOTICE IS HEREBY GIVEN that the annual general meeting of China Communications Services Corporation Limited (the "Company") for the year ended 2006 will be held at 10:00 am on 11 June 2007 in Beijing Nan Yue Yuan Hotel, 186 Zheng Wang Fen, Feng Tai District, Beijing, PRC, to consider and, if thought fit, pass the following resolutions:

ORDINARY RESOLUTIONS

1. **THAT** the consolidated financial statements of the Company, the report of the Board of Directors, the report of the Supervisory Committee and the report of the international auditor for the year ended 31 December 2006 be considered and approved, and the Board of Directors of the Company (the "Board") be authorized to prepare the budget of the Company for the year 2007;
2. **THAT** the profit distribution proposal and the declaration and payment of dividend for the year ended 31 December 2006 be considered and approved;
3. **THAT** the reappointment of KPMG and KPMG Huazhen as the international auditor and domestic auditor of the Company, respectively for the year ending 31 December 2007 be considered and approved, and the Board be authorized to fix the remuneration of the auditors;
4. **THAT:**
 - (a) the "Share Appreciation Rights Scheme of China Communications Services Corporation Limited" (the "Share Appreciation Rights Scheme");
 - (b) the authorization of the Board to grant the Share Appreciation Rights to relevant members of the senior management of the Company in accordance with the Share Appreciation Rights Scheme and the relevant legal requirements;
 - (c) the authorization of the Board to formulate implementation rules for the grant of the share appreciation rights in accordance with the Share Appreciation Rights Scheme;
 - (d) the authorization of the Remuneration Committee of the Board to make corresponding adjustments in accordance with the rules and methods set out in the Share Appreciation Rights Scheme in the event that adjustments to the exercise prices or number of the Share Appreciation Rights are necessary due to the changes in the ordinary share capital structure of the Company or other similar reason arising from share issue, share allotment, dividend, demerger, merger, share repurchase, capital reduction, group restructuring or other special ordinary distribution of ordinary shares;
 - (e) the authorization and ratification of the Board to amend the Share Appreciation Rights Scheme, and to decide and formulate any matters relating to the Share Appreciation Rights Scheme within the scope applicable to the Share Appreciation Rights; and
 - (f) the authorization and ratification of the Board to proceed with the examination, registration, filing, approval and consent procedures with relevant government authorities; to sign, execute, amend and complete documents to be submitted to relevant government authorities, organisations and individuals; and to do all acts, matters and things deemed necessary, appropriate or expedient in relation to the Share Appreciation Rights Scheme,

be considered and approved; and

To consider and approve other businesses (if any).

Notice of the Annual General Meeting

And as special business, to consider and, if thought fit, pass the following special resolutions:

SPECIAL RESOLUTIONS

5. **THAT** the Articles of Association of the Company be amended as follows:

- (1) Article 3.5 of the Articles of Association shall be deleted in its entirety and be restated as the following new Article 3.5:

“By the approval of the relevant company approval department authorized by the State Council, the total number of ordinary shares of the Company in issue amounted to 5,444,986,000 shares, of which 3,960,000,000 shares were issued to the promoters of the Company at the time when the Company was established, representing 72.73% of the ordinary share capital issued by the Company.”

- (2) Article 3.6 of the Articles of Association shall be deleted in its entirety and be restated as the following new Article 3.6:

“All the 1,484,986,000 ordinary shares issued by the Company after its incorporation are the overseas-listed foreign-invested shares (H shares). Pursuant to the requirements of the “Provisional Practice for the Administration of Raising Social Security Funds from the Reduction of State-owned Shares”, a total of 148,498,600 shares have been reduced from the State-owned shareholders of the Company and all the reduced shares have become the overseas-listed foreign-invested shares (H Shares). The total amount of the overseas-listed foreign-invested shares (H Shares) issued by the Company shall be 1,633,484,600 shares, representing 30% of the ordinary share capital issued by the Company.

The share capital structure of the Company is as follows: there are a total of 5,444,986,000 ordinary shares issued, of which 3,487,523,782 shares are held by the promoter, China Telecommunications Corporation, representing 64.05% of the total amount of the ordinary shares issued by the Company. The other domestic shares are Guangdong Telecom Industry Group Corporation, holding a total of 236,313,086 shares representing 4.34% of the total amount of the ordinary shares issued by the Company and Zhejiang Telecom Industry Corporation, holding a total of 87,664,532 shares representing 1.61% of the total amount of the ordinary shares issued by the Company. A total of 1,633,484,600 overseas-listed foreign-invested shares are held by holders of overseas-listed foreign-invested shares, representing 30% of the total amount of the ordinary shares issued by the Company.”

- (3) Article 3.9 of the Articles of Association shall be deleted in its entirety and be restated as the following new Article 3.9:

“The registered capital of the Company is RMB5,444,986,000.”

- (4) Any one of the Directors of the Company be hereby authorized to take all such action they deem necessary or appropriate to complete approval and/or registration or filing of the aforesaid amendments to the Articles of Association of the Company.

6. **THAT:**

- (a) subject to paragraph (c) below, the exercise by the Board during the Relevant Period (as hereinafter defined) of all the powers of the Company to allot, issue and deal with additional shares of the Company ("Shares") and to make or grant offers, agreements and options which might require the exercise of such powers be hereby generally and unconditionally approved;
- (b) the approval in paragraph (a) shall authorise the Board during the Relevant Period to make or grant offers, agreements and options which might require the exercise of such powers after the end of the Relevant Period;
- (c) the amount of additional domestic Shares or overseas-listed foreign invested shares ("H Shares") (as the case may be) allotted, issued and dealt with or agreed conditionally or unconditionally to be allotted, issued and dealt with either separately or concurrently by the Board pursuant to the approval in paragraph (a), otherwise than pursuant to (i) a Rights Issue (as hereinafter defined) or (ii) any scrip dividend or similar arrangement providing for the allotment of Shares in lieu of the whole or part of a dividend on Shares in accordance with the articles of association of the Company shall not exceed 20% of each of the Company's existing domestic Shares and H Shares (as the case may be) in issue at the date of passing this special resolution; and
- (d) for the purpose of this special resolution 6:

"Relevant Period" means the period from the passing of special resolution 6 until the earliest of:

- (i) the conclusion of the next annual general meeting of the Company;
- (ii) the expiration of the 12 months period following the passing of these special resolutions; and
- (iii) the revocation or variation of the authority given to the Board under these special resolutions by a special resolution of the Company's shareholders by way of a general meeting.

"Rights Issue" means an offer of shares open for a period fixed by the Board to holders of Shares on the register of members on a fixed record date in proportion of their then holdings of such Shares (subject to such exclusion or other arrangements as the Board may deem necessary or expedient in relation to fractional entitlements or having regard to any legal or practical restrictions or obligations under the laws of, or the requirement of, any recognised regulatory body or any stock exchange in any territory applicable to the Company) and an offer, allotment or issue of shares by way of rights shall be construed accordingly.

7. **THAT** the Board be authorized to increase the registered capital of the Company to reflect the issue of shares in the Company authorized under special resolution 6, and to make such appropriate and necessary amendments to the Articles of Association of the Company as they think fit to reflect such increases in the registered capital of the Company and to take any other action and complete any formality required to effect such increase of the registered capital of the Company.

By Order of the Board
Chung Wai Cheung, Terence
Company Secretary

Beijing, PRC
26 April 2007

Notice of the Annual General Meeting

Notes:

(1) In relation to resolution 4, the details of the proposed Share Appreciation Rights Scheme are as follow:

Reasons for the Share Appreciation Rights Scheme

The Share Appreciation Rights Scheme is aimed to align the interests of target employees with the Company and to enhance the value of the Company and its shareholders. On this basis, the Board has, subject to the requisite shareholders approval, adopted the "Share Appreciation Rights Scheme of China Communications Services Corporation Limited" (the "Scheme") which grants share appreciation rights (the "SAR" or "SARs") to eligible participants subject to terms and conditions as described below.

Under the Scheme, a SAR constitutes the right to receive an amount of cash equivalent to the appreciation, if any, in the fair market value of a H share of our Company (the "Fair Market Value") and the exercise price of the SARs (the "Exercise Price") is determined upon grant according to a pre-set method. No shares will be issued under the Scheme; accordingly, the shareholding of the shareholders of the Company will not be diluted by any grant or exercise of SARs.

Validity Period of the Scheme

The Scheme will be valid for 10 years effective from the date of approval by the shareholders of the Company.

Amount of SARs to be granted

The total number of H shares represented by all SARs to be granted under the Scheme during its term may not exceed 10% of the entire share capital of the Company at the time of completion of the global offering of the Company in 2006. The SARs will be granted every two years within the 10-year validity period of the Scheme. The total number of H shares represented by the SARs to be granted for the first time under the Scheme will not exceed 1% of the share capital of the Company

A participant who is granted SARs (including both exercised and unexercised) that represent more than 1% of the entire issued share capital of the Company in any 12 consecutive months within the validity period of the Scheme will no longer be eligible for any further grant. As a principle, the maximum expected income from the SARs granted to any member of the senior management of the Company within the validity period of the Scheme should be no more than 40% of his/her total amount of emolument.

Determination of Fair Market Value and Exercise Price

As required by regulations issued by the State-Owned Assets Supervision and Administration Commission of the PRC, the exercise price of any SARs shall be the higher of 1) the closing price of the our Company's H shares on the date of grant; and 2) the average closing price of the H shares in the five consecutive trading days prior to the date of grant. "Closing price" refers to the price stated in the daily quote of the Stock Exchange of Hong Kong Limited.

Fair market value will be the lower of 1) the closing price on the date of the exercise of SARs by a grantee; and 2) the average closing price of our Company's H shares in the 5 consecutive days prior to the date of exercise; or, if none of these two approaches apply, a price determined by the remuneration committee of the Company in good faith will apply.

Vesting period and validity period of SARs

There will be a minimum period of two years from the date of grant before such SARs are exercisable subject to the following vesting schedule:

- (a) after two years from the date of grant, 1/3 of the SARs granted may be exercised by the grantee;
- (b) after three years from the date of grant, a further 1/3 of the SARs granted may be exercised by the grantee; and
- (c) after four years from the date of grant, the remaining 1/3 of the SARs granted may be exercised by the grantee.

The SARs granted under the Scheme will be valid for a term of 7 years commencing from the date of grant. Any granted SARs that are not exercised within such 7 years will lapse automatically.

Scope of eligible participants of the Scheme

The eligible participants of the Scheme include:

- (a) the general manager, vice managers and department managers of the Company; the general manager, deputy managers and department managers of a provincial level subsidiary of the Company; and the general managers and deputy managers of specialized subsidiaries of the Company;
- (b) directors (excluding independent directors) and members of the supervisory committee of the Company and other senior management members; and
- (c) other key talents, nominated and designated by the Remuneration Committee of the Company from time to time according to their contribution to the Company.

Method of grant and acceptance

SARs will be granted to qualified eligible participants by way of an agreement fulfilment of the following conditions:

- (a) the operational performance of the Company or relevant subsidiary having met the pre-set criteria; and
- (b) the proposed grantee having been evaluated and meeting the requirements of the Measures of Performance Evaluation In Connection with the Granting of SARs formulated by the Company.

Payment to grantees on exercise of SARs

Upon exercising SARs, the grantee will be paid in cash in Renminbi by the Company an amount that equals the difference between the fair market value and the exercise price as multiplied by the number of SARs exercised, with any tax and fees under applicable laws duly deducted.

The proposed adoption of a SAR scheme was disclosed in the prospectus of the Company dated 27 November 2006. The current Scheme approved by the Board of the Company is in conformity with the said disclosure.

- (2) With regards to resolution 5 above, as the Articles of Association of the Company only exist in Chinese, the Chinese text of the proposed resolution shall prevail over the English text. Further to the Company's listing on the main board of the Stock Exchange of Hong Kong Limited on 8 December 2006, the joint bookrunners fully exercised the over-allotment option (as described in the prospectus of the Company) in full on behalf of the international underwriters on 20 December 2006. As such, both the number of shares and the registered capital of the Company were changed and accordingly corresponding amendments to the Articles of Association are proposed to be made.
- (3) Shareholders who submit the share transfer application forms to the Company's share registrar before 4:30 pm on 11 May 2007 (Friday) and then register as shareholders on the register of members of the Company are entitled to attend the annual general meeting.
- (4) Each shareholder entitled to attend and vote at the annual general meeting may appoint one or more proxies to attend and vote on his behalf at the annual general meeting. A proxy need not be a shareholder. Each shareholder who wishes to appoint one or more proxies should first review the annual report of the Company for the year 2006, which is expected to be despatched to shareholders around 27 April 2007 (Friday).
- (5) To be valid, the form of proxy together with the power of attorney or other authorisation document (if any) signed by the authorized person or notorially certified power of attorney must be delivered to the Office of the Board of the Company for holders of domestic shares and to the Computershare Hong Kong Investor Services Limited for holders of H shares not less than 24 hours before the designated time for the holding of the annual general meeting. Completion and return of a form of proxy will not preclude a shareholder from attending in person and voting at the annual general meeting if he so wishes. The address of the share registrar for the Company's H shares is Computershare Hong Kong Investor Services Limited, 1806-1807, 18/F., Hopewell Centre, 183 Queen's Road East, Wanchai, Hong Kong.

Notice of the Annual General Meeting

(6) A proxy of a shareholder may vote by hand or vote on a poll, but a proxy of a shareholder who has appointed more than one proxy may only vote on a poll.

(7) The registration procedure for attending the annual general meeting:

(a) shareholders attending the annual general meeting in person or by proxy shall present their identity certification. If the attending shareholder is a corporation, its legal representative or person authorized by the board or other decision making authority shall present a copy of the relevant resolution of the board or other decision making authority in order to attend the annual general meeting.

(b) shareholders intending to attend the annual general meeting shall return the attendance slip via hand delivery, mail or fax to the Office of the Board of the Company on or before 22 May 2007 (Tuesday).

(8) Closure of the register of members:

The register of members of the Company will be closed from 12 May 2007 (Saturday) to 11 June 2007 (Monday) (both days inclusive).

(9) The annual general meeting is expected to last for half a day and shareholders (in person or by proxy) attending the annual general meeting shall be responsible for their own transport and accommodation expenses.

(10) The address of the Office of the Board is as follows:

31 Jinrong Street
Xicheng District, Beijing
PRC, 100032

Contact person: Chung Wai Cheung, Terence
Telephone: (8610) 5850 2290
Facsimile: (8610) 5850 1534

(11) As at the date of this announcement, our Chairman and non-executive director is Wang Xiaochu, our Vice Chairman, Chief Executive Officer and executive director is Li Ping, our non-executive directors are Liu Aili and Zhang Junan, and our independent non-executive directors are Wang Jun, Chan Mo Po, Paul, Zhao Chunjun, Wu Shangzhi and Hao Weimin.

Independent Auditor's Report

Independent auditor's report to the shareholders of China Communications Services Corporation Limited

(Established in The People's Republic of China with limited liability)

We have audited the consolidated financial statements of China Communications Services Corporation Limited (the "Company") set out on pages 62 to 122, which comprise the consolidated and Company balance sheets as at 31 December 2006, and the consolidated income statement, the consolidated statement of changes in equity and the consolidated cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory notes.

Directors' responsibility for the financial statements

The directors of the Company are responsible for the preparation and the true and fair presentation of these financial statements in accordance with International Financial Reporting Standards promulgated by the International Accounting Standards Board and the disclosure requirements of the Hong Kong Companies Ordinance. This responsibility includes designing, implementing and maintaining internal control relevant to the preparation and the true and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

Auditor's responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. This report is made solely to you, as a body, and for no other purpose. We do not assume responsibility towards or accept liability to any other person for the contents of this report.

We conducted our audit in accordance with Hong Kong Standards on Auditing issued by the Hong Kong Institute of Certified Public Accountants. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance as to whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and true and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by the directors, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the consolidated financial statements give a true and fair view of the state of affairs of the Company and of the Group as at 31 December 2006 and of the Group's profit and cash flows for the year then ended and have been properly prepared in accordance with International Financial Reporting Standards promulgated by the International Accounting Standards Board and the disclosure requirements of the Hong Kong Companies Ordinance.

KPMG

Certified Public Accountants

8th Floor, Prince's Building
10 Chater Road
Central, Hong Kong

17 April 2007

Consolidated Income Statement

For the year ended 31 December 2006
(Expressed in Renminbi)

	Note	2006 RMB'000	2005 RMB'000
Revenues	3	14,182,800	13,232,291
Cost of revenues	4	(11,423,596)	(10,544,380)
Gross profit		2,759,204	2,687,911
Other operating income	5	159,414	115,672
Selling, general and administrative expenses		(1,890,702)	(1,951,122)
Other operating expenses	6	(12,298)	(21,066)
Deficit on revaluation of property, plant and equipment	16(b)	(105,299)	—
Net financing income	7	85,644	38,403
Share of profits less (losses) of associates		(30)	11,687
Negative goodwill	8	4,039	159,499
Profit before tax	9	999,972	1,040,984
Income tax	10	(280,712)	(260,482)
Profit for the year		719,260	780,502
Attributable to:			
Equity shareholders/owner		696,078	597,556
Minority interests		23,182	182,946
Profit for the year		719,260	780,502
Special dividend	14 (a)	535,011	—
Basic and diluted earnings per share (RMB)	15	0.172	0.151

The notes on pages 70 to 122 form part of these financial statements.

Consolidated Balance Sheet

At 31 December 2006
(Expressed in Renminbi)

	Note	2006 RMB'000	2005 RMB'000
Non-current assets			
Property, plant and equipment, net	16	2,232,848	2,567,336
Investment properties	17	286,892	675,863
Construction in progress	18	265,804	396,124
Lease prepayments	19	103,190	145,050
Intangible assets	20	32,968	25,596
Interests in associates	22	7,927	180,749
Other investments	23	138,475	208,605
Deferred tax assets	24	74,221	18,803
Total non-current assets		3,142,325	4,218,126
Current assets			
Inventories	25	828,124	524,096
Accounts and bills receivable, net	26	3,351,262	2,995,507
Prepayments and other current assets	28	938,640	2,086,453
Cash and cash equivalents	29	7,071,029	3,685,916
Total current assets		12,189,055	9,291,972
Total assets		15,331,380	13,510,098
Current liabilities			
Interest-bearing borrowings	30	95,500	209,545
Accounts and bills payable	31	2,860,065	1,947,466
Receipts in advance for contract work		612,818	880,638
Accrued expenses and other payables	32	2,069,705	2,808,127
Income tax payable		110,202	371,126
Total current liabilities		5,748,290	6,216,902
Net current assets		6,440,765	3,075,070
Total assets less current liabilities		9,583,090	7,293,196
Total liabilities		5,748,290	6,216,902

The notes on pages 70 to 122 form part of these financial statements.

Consolidated Balance Sheet

At 31 December 2006
(Expressed in Renminbi)

	Note	2006 RMB'000	2005 RMB'000
Equity			
Share capital	33	5,444,986	—
Reserves		4,036,323	6,772,775
Equity attributable to equity shareholders of the Company		9,481,309	6,772,775
Minority interests		101,781	520,421
Total equity		9,583,090	7,293,196
Total liabilities and equity		15,331,380	13,510,098

Approved and authorised for issue by the Board of Directors on 17 April 2007.

Li Ping

*Vice Chairman of the Board
Executive Director and Chief Executive Officer*

Yuan Jianxing

*Executive Vice President
Chief Financial Officer*

The notes on pages 70 to 122 form part of these financial statements.

Balance Sheet

At 31 December 2006
(Expressed in Renminbi)

	Note	2006 RMB'000
Non-current assets		
Property, plant and equipment, net	16	9
Investments in subsidiaries	21	5,373,776
Total non-current assets		5,373,785
Current assets		
Prepayments and other current assets	28	2,360
Cash and cash equivalents	29	3,150,555
Total current assets		3,152,915
Total assets		8,526,700
Current liabilities		
Accrued expenses and other payables	32	54,780
Total current liabilities		54,780
Net current assets		3,098,135
Total assets less current liabilities		8,471,920
Total liabilities		54,780
Equity		
Share capital	33	5,444,986
Reserves		3,026,934
Total equity		8,471,920
Total liabilities and equity		8,526,700

Approved and authorised for issue by the Board of Directors on 17 April 2007.

Li Ping

*Vice Chairman of the Board
Executive Director and Chief Executive Officer*

Yuan Jianxing

*Executive Vice President
Chief Financial Officer*

The notes on pages 70 to 122 form part of these financial statements.

Consolidated Statement of Changes in Equity

For the year ended 31 December 2006

(Expressed in Renminbi)

Equity attributable to equity shareholders of the Company											
	Note	Share capital RMB'000	Share premium (note f) RMB'000	Capital reserve (note g) RMB'000	Revaluation reserve RMB'000	Statutory surplus reserve (note e) RMB'000	Other reserve RMB'000	Retained earnings/ shareholder's equity RMB'000	Total RMB'000	Minority interests RMB'000	Total equity RMB'000
As at 1 January 2005		—	—	—	—	—	—	6,138,601	6,138,601	714,187	6,852,788
Contributions	(a)	—	—	—	—	—	—	835,836	835,836	23,085	858,921
Acquisition of minority interests through contributions from CTC		—	—	—	—	—	—	317,849	317,849	(317,849)	—
Distributions	(b)	—	—	—	—	—	—	(890,590)	(890,590)	—	(890,590)
Profit for the year		—	—	—	—	—	—	597,556	597,556	182,946	780,502
Profit distributions	(c)	—	—	—	—	—	—	(226,477)	(226,477)	(81,948)	(308,425)
As at 31 December 2005		—	—	—	—	—	—	6,772,775	6,772,775	520,421	7,293,196
As at 1 January 2006		—	—	—	—	—	—	6,772,775	6,772,775	520,421	7,293,196
Contributions	(a)	—	—	—	—	—	—	478,335	478,335	—	478,335
Acquisition of minority interests through contributions from CTC		—	—	—	—	—	—	315,957	315,957	(315,957)	—
Profit distributions	(c)	—	—	—	—	—	—	(655,027)	(655,027)	(126,996)	(782,023)
Distributions	(b)	—	—	—	—	—	—	(834,638)	(834,638)	—	(834,638)
Net assets distributed to CTC in connection with the Restructuring	(d)	—	—	—	—	—	—	(1,660,674)	(1,660,674)	—	(1,660,674)
Recognition of deferred tax assets	24	—	—	—	—	—	42,507	—	42,507	—	42,507
Revaluation of property, plant and equipment	16(b)	—	—	—	294,442	—	—	—	294,442	1,131	295,573
Capitalisation upon legal establishment of the Company	1	3,960,000	—	1,413,776	—	—	—	(4,384,991)	988,785	—	988,785
Issuance of shares upon public offering	(f)	1,484,986	1,807,727	—	—	—	—	—	3,292,713	—	3,292,713
Share issue expenses	(f)	—	(249,944)	—	—	—	—	—	(249,944)	—	(249,944)
Profit for the year		—	—	—	—	—	—	696,078	696,078	23,182	719,260
Appropriation	(e)	—	—	—	—	69,969	—	(69,969)	—	—	—
As at 31 December 2006		5,444,986	1,557,783	1,413,776	294,442	69,969	42,507	657,846	9,481,309	101,781	9,583,090

The notes on pages 70 to 122 form part of these financial statements.

Notes:

- (a) The capital contributions during the years ended 31 December 2005 and 2006 represent the injection of cash and other assets, including property, plant and equipment and the increase in shareholdings in the subsidiaries.
- (b) The distributions during the years ended 31 December 2005 and 2006 represent the reduction in capital of certain subsidiaries and distributions of cash and other assets, including property, plant and equipment by certain subsidiaries upon transformation into limited liability companies.
- (c) Profit distributions represent the appropriation made and dividend declared by certain of the subsidiaries of the Group prior to the establishment of the Company.
- (d) Pursuant to the Restructuring (as defined in note 1(b)), certain assets and liabilities of the Predecessor Operations were not transferred to the Group and were reflected as distributions to the then owner in the consolidated statement of changes in equity for the year ended 31 December 2006.
- (e) Statutory surplus reserve
According to the Company's Article of Association, the Company is required to transfer 10% of its net profit as determined in accordance with the PRC Accounting Rules and Regulations to its statutory surplus reserve until the reserve balance reaches 50% of the registered capital. The transfer to this reserve must be made before distribution of a dividend to shareholders.

Statutory surplus reserve can be used to make good previous years' losses, if any, or to expand the Company's business, and may be converted into share capital by the issuance of new shares to shareholders in proportion to their existing shareholdings or by increasing the par value of the shares currently held by them, provided that the balance after such issue is not less than 25% of the registered capital.

For 2006, the Company transferred RMB69,969,000, being 10% of the current year's net profit as determined in accordance with the PRC Accounting Rules and Regulations, to this reserve.

- (f) Share premium
The share premium represents the difference between the total amount of the par value of shares issued and the amount of the net proceeds received from the initial public offering.
- (g) Capital reserve
The capital reserve represents the difference between the total amount of the par value of shares issued and the amount of the net assets transferred from CTC, Guangdong Telecom Industry Group Corporation and Zhejiang Telecom Industry Corporation upon the formation of the Company.

Consolidated Cash Flow Statement

For the year ended 31 December 2006
(Expressed in Renminbi)

	Note	2006 RMB'000	2005 RMB'000
Operating activities			
Profit before tax		999,972	1,040,984
Adjustments for:			
— Depreciation and amortisation		400,221	401,579
— Impairment losses on property, plant and equipment		—	2,079
— Interest income		(111,451)	(59,982)
— Finance costs		17,898	22,081
— Share of profits less (losses) of associates		30	(11,687)
— Negative goodwill		(4,039)	(159,499)
— Dividend income		(22,473)	(30,198)
— Gain on disposal of investments		(28,948)	(4,327)
— Impairment losses on investments		—	2,177
— Gain on disposal of property, plant and equipment and other assets		(6,163)	(3,576)
— Deficit on revaluation of property, plant and equipment		105,299	—
— Write off of non-payable liabilities		(268)	(18,783)
Operating profit before changes in working capital		1,350,078	1,180,848
(Increase)/decrease in inventories		(334,030)	107,536
Increase in accounts and bills receivable		(515,527)	(399,156)
(Increase)/decrease in prepayments and other current assets		(260,885)	243,183
Increase/(decrease) in accounts and bills payable		1,102,712	(54,065)
Decrease in receipts in advance for contract work		(267,820)	(322,356)
Decrease in accrued expenses and other payables		(138,409)	(187,826)
Net cash inflow from operations		936,119	568,164
Interest paid		(17,898)	(17,514)
Interest received		57,912	54,728
Income tax paid		(476,662)	(330,208)
Cash generated from operating activities		499,471	275,170

The notes on pages 70 to 122 form part of these financial statements.

	Note	2006 RMB'000	2005 RMB'000
Investing activities			
Payments on acquisition of property, plant and equipment and other assets		(1,159,883)	(583,499)
Proceeds from disposal of property, plant and equipment and other assets		253,621	125,194
Net cash inflow arising from acquisition of subsidiaries	35(a)	16,139	13,849
Payments for acquisition of investments		(13,162)	(18,145)
Proceeds from disposal of investments		250,102	140,221
Dividends received		21,601	45,787
Net cash used in investing activities		(631,582)	(276,593)
Financing activities			
Proceeds from bank and other loans		664,900	214,000
Repayments of bank and other loans		(618,945)	(188,838)
Dividends paid		(661,314)	(316,582)
Contributions from owner		1,458,519	391,059
Distributions to owner		(841,544)	(523,495)
Advances from/(to) owner and fellow subsidiaries		373,466	(404,826)
Net proceeds from issuance of new shares upon listing and interest income on subscription monies		3,142,142	—
Net cash generated from/(used in) financing activities		3,517,224	(828,682)
Net increase/(decrease) in cash and cash equivalents		3,385,113	(830,105)
Cash and cash equivalents at the beginning of year		3,685,916	4,516,021
Cash and cash equivalents at the end of year	29	7,071,029	3,685,916

For major non-cash transactions, please refer to note 35(b).

Notes to the Consolidated Financial Statements

(Expressed in Renminbi)

1. PRINCIPAL ACTIVITIES AND ORGANISATION

(a) Principal activities

China Communications Services Corporation Limited (the "Company") and its subsidiaries (hereinafter collectively referred to as the "Group") is a leading integrated service provider to the telecommunications industry in the People's Republic of China (the "PRC"). Its principal activities comprise provision of a full range of telecommunications support services to the telecommunications operators in the PRC, including (i) telecommunications infrastructure design, construction and supervision and management; (ii) business process outsourcing (including network maintenance, facilities management, distribution of telecommunications service and products); and (iii) a variety of other services including applications, content and others.

(b) Organisation

The Company was established in the PRC on 30 August 2006 as a joint stock limited company under the Company Law of the PRC as part of the Restructuring (as defined below) of China Telecommunications Corporation ("CTC"), a state-owned enterprise under the direct supervision of the State Council of the PRC. Pursuant to the Restructuring (as defined below), the Group assumed the telecommunications support services previously carried on by various subsidiaries wholly-owned or controlled by CTC in six provinces and municipality in the PRC, namely, Guangdong Province, Zhejiang Province, Shanghai Municipality, Fujian Province, Hubei Province and Hainan Province (collectively, the "Predecessor Operations") from CTC. The Company was founded by CTC, Guangdong Telecom Industry Group Corporation and Zhejiang Telecom Industry Corporation by ways of the injection of those subsidiaries carrying on the Predecessor Operations and cash contributions.

In connection with the Restructuring (as defined below), the Predecessor Operations together with the related assets and liabilities that were to be transferred to the Group were segregated from CTC effective on 31 March 2006 (the "Restructuring"). The Restructuring comprised the following:

- (i) CTC has undergone a restructuring programme in connection with its full range of telecommunications related services, namely (1) telecommunications infrastructure design, construction and supervision and management; (2) business process outsourcing (including network maintenance, facilities management and distribution of telecommunications services and products); and (3) a variety of other services including applications, content and others.
- (ii) The net assets have been injected into the Company by ways of asset injection of those subsidiaries carrying on the Predecessor Operations in consideration of approximately 3,623.4 million ordinary shares with a par value of RMB1 each (the "Asset Injection").
- (iii) The Group, immediately after the Restructuring, contains substantially all of the operating assets and liabilities relating to the Predecessor Operations, comprising (1) telecommunications infrastructure design, construction and supervision and management; (2) business process outsourcing (including network maintenance, facilities management, distribution of telecommunications services and products); and (3) a variety of other services including applications, content and others.
- (iv) In connection with the Restructuring, certain assets and liabilities historically associated with the Predecessor Operations were not transferred to the Company and were retained by CTC.

1. PRINCIPAL ACTIVITIES AND ORGANISATION (Continued)

(b) Organisation (Continued)

The above Restructuring procedures primarily resulted in an effect of the transfer from CTC to the Company of the operating assets and liabilities relating to the telecommunications related services carried on by the Predecessor Operations, which were previously owned or controlled by CTC prior to the Restructuring.

In December 2006, the Company issued 1,291,293,000 H shares with a par value of RMB1.00 each, at a price of HK\$2.20 per H share by way of an initial public offering (the "IPO") to Hong Kong and overseas investors. In connection with the IPO, 129,129,300 domestic state-owned shares of RMB1.00 each owned by CTC and its subsidiaries were converted into H shares and transferred to the National Council for Social Security Fund of the PRC ("SSF"). In December 2006, the Company also issued 193,693,000 H shares with a par value of RMB1.00 each, at a price of HK\$2.20 per H share upon the exercise of the over-allotment option. In connection with the exercise of the over-allotment option, 19,369,300 domestic state-owned shares of RMB1.00 each owned by CTC and its subsidiaries were converted into H shares and transferred to SSF. A total of 1,633,484,600 H shares were listed on the Stock Exchange of Hong Kong Limited (the "Stock Exchange").

2 SIGNIFICANT ACCOUNTING POLICIES

(a) Statement of compliance

The financial statements of the Company and the Group have been prepared in accordance with International Financial Reporting Standards ("IFRSs") promulgated by the International Accounting Standards Board ("IASB"). IFRSs includes all applicable individual International Financial Reporting Standards, International Accounting Standards ("IASs") and related interpretations. The financial statements also comply with the disclosure requirements of the Hong Kong Companies Ordinance and the applicable disclosure provisions of the Rules Governing the Listing of Securities on the Stock Exchange.

A summary of the significant accounting policies adopted by the Group is set out below.

(b) Basis of preparation of the financial statements

The consolidated financial statements for the year ended 31 December 2006 comprise the Group and its interests in associates.

The financial statements are prepared on the historical cost basis, except that property, plant and equipment (see note 16) is stated at its revalued amount, (see note 2(g)). The accounting policies have been consistently applied by the Group and are consistent with those used in the previous year.

The preparation of financial statements in conformity with IFRSs requires management to make judgements, estimates and assumptions that affect the application of policies and reported amounts of assets, liabilities, income and expenses. The estimates and associated assumptions are based on historical experience and various other factors that are believed to be reasonable under the circumstances, the results of which form the basis of making the judgements about carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates.

Notes to the Consolidated Financial Statements

(Expressed in Renminbi)

2 SIGNIFICANT ACCOUNTING POLICIES (Continued)

(b) Basis of preparation of the financial statements (Continued)

The estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which the estimate is revised if the revision affects only that period, or in the period of the revision and future periods if the revision affects both current and future periods.

Judgements made by management in the application of IFRSs that have significant effect on the financial statements and estimates with a significant risk of material adjustment in the next year are discussed in note 38.

The IASB has issued certain new and revised IFRSs which are effective for accounting periods on or after 1 January 2006. The adoption of these new and revised IFRSs did not result in significant changes to the Group's accounting policies applied in these financial statements for the years presented.

The Group has not applied any new standards or interpretations that is not yet effective for the current accounting period (see note 43).

(c) Basis of consolidation

(i) *Subsidiaries and minority interests*

Subsidiaries are those companies controlled by the Group. Control exists when the Group has the power, directly or indirectly, to govern the financial and operating policies of an entity so as to obtain benefits from its activities. In assessing control, potential voting rights that presently are exercisable or convertible are taken into account. The financial statements of subsidiaries are included in the consolidated financial statements from the date that control commences until the date that control ceases.

Intra-group balances and transaction and any unrealised profits arising from intra-group transactions are eliminated in full in preparing the consolidated financial statements. Unrealised losses resulting from intra-group transactions are eliminated in the same way as unrealised gains but only to the extent that there is no evidence of impairment.

Minority interests represent the portion of the net assets of subsidiaries attributable to interests that are not owned by the Group, whether directly or indirectly through subsidiaries, and in respect of which the Group has not agreed any additional terms with the holders of those interests which would result in the Group as a whole having a contractual obligation in respect of those interests that meets the definition of a financial liability. Minority interests are presented in the consolidated balance sheet within equity, separately from equity attributable to the equity shareholders/ owner of the Company. Minority interests in the results of the Group are presented on the face of the consolidated income statement as an allocation of the total profit or loss for the year between minority interests and the equity shareholders/ owner of the Company.

Where losses applicable to the minority exceed the minority's interest in the equity of a subsidiary, the excess, and any further losses applicable to the minority, are charged against the Group's interest except to the extent that the minority has a binding obligation to, and is able to, make additional investment to cover the losses. If the subsidiary subsequently reports profits, the Group's interest is allocated all such profits until the minority's share of losses previously absorbed by the Group has been recovered.

2 SIGNIFICANT ACCOUNTING POLICIES (Continued)

(c) Basis of consolidation (Continued)

(i) *Subsidiaries and minority interests (Continued)*

Loans from holders of minority interests and other contractual obligations towards these holders are presented as financial liabilities in the consolidated balance sheet in accordance with notes 2 (p) or (q) depending on the nature of the liability.

In the Company's balance sheet, investments in subsidiaries are stated at cost less impairment losses (see note 2(l)).

(ii) *Associates*

Associates are those entities in which the Group has significant influence, but not control, over its management, including participation in the finance and operating decisions.

An investment in an associate is accounted for in the consolidated financial statements under the equity method and is initially recorded at cost and adjusted thereafter for the post-acquisition change in the Group's share of the associate's net assets. The consolidated income statement includes the Group's share of the post-acquisition, post-tax results of the associates for the year, including any impairment loss on goodwill relating to the investment associates recognised for the year (see notes 2(d) and 2(l)).

When the Group's share of losses exceeds its interest in the associate, the Group's interest is reduced to nil and recognition of further losses is discontinued except to the extent that the Group has incurred legal or constructive obligations or made payments on behalf of the associate. For this purpose, the Group's interest in the associate is the carrying amount of the investment under the equity method together with the Group's long-term interests that in substance form part of the Group's net investment in the associate.

Unrealised profits and losses resulting from transactions between the Group and its associates are eliminated to the extent of the Group's interest in the associate, except where unrealised losses provide evidence of an impairment of the asset transferred, in which case they are recognised immediately in the consolidated income statement.

(d) Goodwill

Goodwill represents the excess of the cost of a business combination or an investment in an associate over the Group's interest in the net fair value of the acquiree's identifiable assets, liabilities and contingent liabilities.

Goodwill is stated at cost less any accumulated impairment losses. Goodwill is allocated to cash-generating units and is tested annually for impairment (see note 2(l)). In respect of associates, the carrying amount of goodwill is included in the carrying amount of the interest in the associate.

Any excess of the Group's interest in the net fair value of the acquiree's identifiable assets, liabilities and contingent liabilities over the cost of a business combination or an investment in an associate is recognised immediately in the consolidated income statement.

On disposal of a cash generating unit or an associate during the year, any attributable amount of purchased goodwill is included in the calculation of the profit or loss on disposal.

Notes to the Consolidated Financial Statements

(Expressed in Renminbi)

2 SIGNIFICANT ACCOUNTING POLICIES (Continued)

(e) Other investments in debt and equity securities

The Group's policies for investments in debt and equity securities, other than investments in subsidiaries and associates, are as follows:

Investments in debt and equity securities are initially stated at cost, which is their transaction price unless fair value can be more reliably estimated using valuation techniques whose variables include only data from observable markets. Cost includes attributable transaction costs, except where indicated otherwise below. These investments are subsequently accounted for as follows, depending on their classification:

Dated debt securities that the Group have the positive ability and intention to hold to maturity are classified as held-to-maturity securities. Held-to-maturity securities are stated in the consolidated balance sheet at amortised cost less impairment losses (see note 2(l)).

Investments in equity securities that do not have a quoted market price in an active market and whose fair value cannot be reliably measured are recognised in the consolidated balance sheet at cost less impairment losses (see note 2(l)).

Investments are recognised/derecognised on the date the Group commits to purchase/sell the investments or they expire.

(f) Investment properties

Investment properties are land or/and buildings which are owned to earn rental income and/or for capital appreciation.

Investment properties are stated in the consolidated balance sheet at cost less accumulated depreciation and impairment losses (see note 2(l)). Depreciation is calculated to write off the cost less estimated residual value if applicable and is charged to the consolidated income statement on a straight-line basis over the estimated useful lives ranging from 20 years to 30 years.

Rental income from investment properties is accounted for as described in note 2(v)(iv).

When an item of property, plant and equipment is transferred to investment property following a change in its use or when an investment property becomes owner-occupied and reclassified as property, plant and equipment, its carrying amount at the date of reclassification becomes its initial cost for accounting purposes.

(g) Other property, plant and equipment

The following items of property, plant and equipment are initially recognised in the consolidated balance sheet at cost less accumulated depreciation and impairment losses (see note 2(l)):

- buildings held for own use which are situated on leasehold land, where the fair value of the building could be measured separately from the fair value of the leasehold land at the inception of the lease (see note 2(k)); and
- other items of plant and equipment.

2 SIGNIFICANT ACCOUNTING POLICIES (Continued)

(g) Other property, plant and equipment (Continued)

The cost of self-constructed items of property, plant and equipment includes the cost of materials, direct labour, the initial estimate, where relevant, of the costs of dismantling and removing the items and restoring the site on which they are located, and an appropriate proportion of production overheads and borrowing costs (see note 2(y)).

Gains or losses arising from the retirement or disposal of an item of property, plant and equipment are determined as the difference between the net disposal proceeds and the carrying amount of the item and are recognised in the consolidated income statement on the date of retirement or disposal.

Depreciation is calculated to write off the cost of items of property, plant and equipment, less their estimated residual value, if any, using the straight-line method over their estimated useful lives as follows:

Buildings	20–30 years
Buildings improvements	5 years
Motor vehicles	5–10 years
Furniture, fixtures and other equipment	5–10 years

Both the useful life of an asset and its residual value, if any, are reviewed annually.

Subsequent to the revaluation which was required by PRC rules and regulations in connection with the Restructuring and which was based on depreciated replacement costs (see note 16), property, plant and equipment are carried at revalued amount, being the fair value at the date of the revaluation, less subsequent accumulated depreciation and impairment losses and any accumulated depreciation at the date of the revaluation is restated proportionately 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. When an item of property, plant and equipment is revalued, the entire class of property, plant and equipment to which that asset belongs is revalued simultaneously. When an asset's carrying amount is increased as a result of a revaluation, the increase is credited directly to equity as a component of revaluation reserve. However, a revaluation increase is recognised as income to the extent that it reverses a revaluation decrease of the same asset previously recognised as an expense. When an asset's carrying amount is decreased as a result of a revaluation, the decrease is recognised as an expense in the consolidated income statement. However, a revaluation decrease is charged directly against any related revaluation surplus to the extent that the decrease does not exceed the amount held in the revaluation reserve in respect of that same asset. Revaluations are performed with sufficient regularity to ensure that the carrying amount of these assets does not differ materially from that which would be determined using fair values at the balance sheet date.

Notes to the Consolidated Financial Statements

(Expressed in Renminbi)

2 SIGNIFICANT ACCOUNTING POLICIES (Continued)

(h) Construction in progress

Construction in progress is stated at cost less impairment losses (see note 2(l)). Cost comprises direct costs of construction and borrowing costs on related borrowed funds to the extent that they are regarded as an adjustment to interest charges, during the period of construction.

Capitalisation of these costs ceases and the construction in progress is transferred to property, plant and equipment and investment properties when substantially all the activities necessary to prepare the asset for its intended use are completed. No depreciation is provided in respect of construction in progress until it is completed and ready for its intended use.

(i) Lease prepayments

Lease prepayments represent land use rights paid to the PRC's governmental authorities. Land use rights are carried at cost and are charged to the consolidated income statement on a straight-line basis over the respective periods of the rights.

(j) Intangible assets (other than goodwill)

Intangible assets that are acquired by the Group are stated in the consolidated balance sheet at cost less accumulated amortisation and impairment losses (see note 2(l)) (where the estimated useful life is finite).

Amortisation of intangible assets with finite useful lives is charged to the consolidated income statement on a straight-line basis over the estimated useful lives of intangible assets. Intangible assets with an indefinite useful life are systematically tested for impairment at each balance sheet date. Intangible assets are amortised over 5 years to 10 years from the date they are available for use.

(k) Leased assets

An arrangement, comprising a transaction or a series of transactions, is or contains a lease if the Group determines that the arrangement conveys a right to use a specific asset or assets for an agreed period of time in return for a payment or a series of payments. Such a determination is made based on an evaluation of the substance of the arrangement and is regardless of whether the arrangement takes the legal form of a lease.

Assets that are held by Group under leases which do not transfer to the Group substantially all the risks and rewards of ownership are classified as being held under operating leases.

Where the Group has the use of assets held under operating leases, payments made under the leases are charged to the consolidated income statement in equal instalments over the accounting periods covered by the lease term, except where an alternative basis is more representative of the pattern of benefits to be derived from the leased asset. Lease incentives received are recognised in the consolidated income statement as an integral part of the aggregate net lease payments made. Contingent rentals are charged to the consolidated income statement in the accounting period in which they are incurred.

2 SIGNIFICANT ACCOUNTING POLICIES (Continued)

(I) Impairment of assets

(i) *Impairment of investments in debt and equity securities and other receivables*

Investments in debt and equity securities and other current and non-current receivables that are stated at cost or amortised cost or are classified as available-for-sale securities are reviewed at each balance sheet date to determine whether there is objective evidence of impairment. If any such evidence exists, any impairment loss is determined and recognised as follows:

- For unquoted equity securities and current receivables that are carried at cost, the impairment loss is measured as the difference between the carrying amount of the financial asset and the estimated future cash flows, discounted at the current market rate of return for a similar financial asset where the effect of discounting is material. Impairment losses for equity securities are not reversed.
- For trade and other current receivables and other financial assets carried at cost or amortised cost, the impairment loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows, discounted at the financial asset's original effective interest rate (i.e. the effective interest rate computed at initial recognition of these assets), where the effect of discounting is material.

If in a subsequent period the amount of an impairment loss decreases and the decrease can be linked objectively to an event occurring after the impairment loss was recognised, the impairment loss is reversed through the consolidated income statement. A reversal of an impairment loss shall not result in the asset's carrying amount exceeding that which would have been determined had no impairment loss been recognised in prior years.

- For available-for-sale securities, the cumulative loss that has been recognised directly in equity is removed from equity and is recognised in the consolidated income statement. The amount of the cumulative loss that is recognised in the consolidated income statement is the difference between the acquisition cost (net of any principal repayment and amortisation) and current fair value, less any impairment loss on that asset previously recognised in the consolidated income statement.

Impairment losses recognised in the consolidated income statement in respect of available-for-sale equity securities are not reversed through the consolidated income statement. Any subsequent increase in the fair value of such assets is recognised directly in equity.

Impairment losses in respect of available-for-sale debt securities are reversed if the subsequent increase in fair value can be objectively related to an event occurring after the impairment loss was recognised. Reversals of impairment losses in such circumstances are recognised in the consolidated income statement.

Notes to the Consolidated Financial Statements

(Expressed in Renminbi)

2 SIGNIFICANT ACCOUNTING POLICIES (Continued)

(I) Impairment of assets (Continued)

(ii) Impairment of other assets

Internal and external sources of information are reviewed at each balance sheet date to identify indications that the following assets may be impaired or, except in the case of goodwill, an impairment loss previously recognised no longer exists or may have decreased:

- property, plant and equipment;
- investment properties;
- construction in progress;
- lease prepayments;
- intangible assets;
- investments in subsidiaries and associates; and
- goodwill.

If any such indication exists, the asset's recoverable amount is estimated. In addition, for goodwill, intangible assets that are not yet available for use and intangible assets that have indefinite useful lives, the recoverable amount is estimated annually whether or not there is any indication of impairment.

- Calculation of recoverable amount
The recoverable amount of an asset is the greater of its net selling price and value in use. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of time value of money and the risks specific to the asset. Where an asset does not generate cash inflows largely independent of those from other assets, the recoverable amount is determined for the smallest group of assets that generates cash inflows independently (i.e. a cash-generating unit).
- Recognition of impairment losses
An impairment loss is recognised in the consolidated income statement whenever the carrying amount of an asset, or the cash-generating unit to which it belongs, exceeds its recoverable amount. Impairment losses recognised in respect of cash-generating units are allocated first to reduce the carrying amount of any goodwill allocated to the cash-generating unit (or group of units) and then, to reduce the carrying amount of the other assets in the unit (or group of units) on a pro rata basis, except that the carrying value of an asset will not be reduced below its individual fair value less costs to sell, or value in use, if determinable.

2 SIGNIFICANT ACCOUNTING POLICIES (Continued)

(l) Impairment of assets (Continued)

(ii) Impairment of other assets (Continued)

- Reversals of impairment losses
In respect of assets other than goodwill, an impairment loss is reversed if there has been a favourable change in the estimates used to determine the recoverable amount. An impairment loss in respect of goodwill is not reversed.

A reversal of impairment losses is limited to the asset's carrying amount that would have been determined had no impairment loss been recognised in prior years. Reversals of impairment losses are credited to the consolidated income statement in the relevant period in which the reversals are recognised.

(m) Inventories

Inventories are carried at the lower of cost and net realisable value.

Cost is calculated using the weighted average cost formula and comprises all costs of purchase and other costs incurred in bringing the inventories to their present location and condition.

Net realisable value is the estimated selling price in the ordinary course of business less the estimated costs necessary to make the sale.

When inventories are sold, the carrying amount of those inventories is recognised as an expense in the period in which the related revenue is recognised. The amount of any write-down of inventories to net realisable value and all losses of inventories are recognised as an expense in the period the write-down or loss occurs. The amount of any reversal of any write-down of inventories is recognised as a reduction in the amount of inventories recognised as an expense in the period in which the reversals occurs.

(n) Construction contracts

The accounting policy for contract revenue is set out in note 2(v)(i). When the outcome of a construction contract can be estimated reliably, contract costs are recognised as an expense by reference to the stage of completion of the contract at the balance sheet date. When it is probable that total contract costs will exceed total contract revenue, the expected loss is recognised as an expense immediately. When the outcome of a construction contract cannot be estimated reliably, contract costs are recognised as an expense in the period in which they are incurred.

Construction contracts in progress at the balance sheet date are recorded in the balance sheet at the net amount of costs incurred plus recognised profit less recognised losses and progress billings, and are presented in the consolidated balance sheet as the "Unbilled revenue for contract work" (as an asset) or the "Receipts in advance for contract work" (as a liability), as applicable. Progress billings not yet paid by the customer are included in the consolidated balance sheet under "Accounts and bills receivable". Amounts received before the related work is performed are included in the consolidated balance sheet, as a liability, as "Receipts in advance for contract work".

Notes to the Consolidated Financial Statements

(Expressed in Renminbi)

2 SIGNIFICANT ACCOUNTING POLICIES (Continued)

(o) Trade and other receivables

Trade and other receivables are initially recognised at fair value and thereafter stated at amortised cost less impairment losses for bad and doubtful debts (see note 2(l)), except where the receivables are interest-free loans made to related parties without any fixed repayment terms or the effect of discounting would be immaterial. In such cases, the receivables are stated at cost less impairment losses for bad and doubtful debts (see note 2(l)).

(p) Interest-bearing borrowings

Interest-bearing borrowings are recognised initially at fair value less attributable transaction costs. Subsequent to initial recognition, interest-bearing borrowings are stated at amortised cost with any difference between the amount initially recognised and redemption value being recognised in the consolidated income statement over the period of the borrowings, together with any interest and fees payable, using the effective interest method.

(q) Trade and other payables

Trade and other payables are initially recognised at fair value and thereafter stated at amortised cost unless the effect of discounting would be immaterial, in which case they are stated at cost.

(r) Cash and cash equivalents

Cash and cash equivalents comprise cash at bank and on hand, demand deposits with banks and other financial institutions, and short-term, highly liquid investments that are readily convertible into known amounts of cash and which are subject to an insignificant risk of changes in value, having been within three months of maturity at acquisition.

(s) Employee benefits

(i) *Short-term employee benefits and contributions to defined contribution retirement plans*
Salaries, annual bonuses, paid annual leave, contributions to defined contribution plans and the cost of non-monetary benefits are accrued in the year in which the associated services are rendered by employees. Where payment or settlement is deferred and the effect would be material, these amounts are stated at their present values.

(ii) *Termination benefits*
Termination benefits are recognised when, and only when, the Group demonstrably commits itself to terminate employment or to provide benefits as a result of voluntary redundancy by having a detailed formal plan which is without realistic possibility of withdrawal.

(t) Income tax

Income tax for the year comprises current tax and movements in deferred tax assets and liabilities. Current tax and movements in deferred tax assets and liabilities are recognised in the consolidated income statement except to the extent that they relate to items recognised directly in equity, in which case they are recognised in equity.

Current tax is the expected tax payable on the taxable income for the year, using tax rates enacted or substantively enacted at the balance sheet date, and any adjustment to tax payable in respect of previous years.

2 SIGNIFICANT ACCOUNTING POLICIES (Continued)

(t) Income tax (Continued)

Deferred tax assets and liabilities arise from deductible and taxable temporary differences respectively, being the differences between the carrying amounts of assets and liabilities for financial reporting purposes and their tax bases. Deferred tax assets also arise from unused tax losses and unused tax credits.

Apart from certain limited exceptions, all deferred tax liabilities, and all deferred tax assets to the extent that it is probable that future taxable profits will be available against which the asset can be utilised, are recognised. Future taxable profits that may support the recognition of deferred tax assets arising from deductible temporary differences include those that will arise from the reversal of existing taxable temporary differences, provided those differences relate to the same taxation authority and the same taxable entity, and are expected to reverse either in the same period as the expected reversal of the deductible temporary difference or in periods into which a tax loss arising from the deferred tax asset can be carried forward. The same criteria are adopted when determining whether existing taxable temporary differences support the recognition of deferred tax assets arising from unused tax losses and credits, that is, those differences are taken into account if they relate to the same taxation authority and the same taxable entity, and are expected to reverse in a period, or periods, in which the tax loss or credit can be utilised.

The limited exceptions to recognition of deferred tax assets and liabilities are those temporary differences arising from goodwill not deductible for tax purposes, the initial recognition of assets or liabilities that affect neither accounting nor taxable profit (provided they are not part of a business combination).

The amount of deferred tax recognised is measured based on the expected manner of realisation or settlement of the carrying amount of the assets and liabilities, using tax rates enacted or substantively enacted at the balance sheet date. Deferred tax assets and liabilities are not discounted.

The carrying amount of a deferred tax asset is reviewed at each balance sheet date and is reduced to the extent that it is no longer probable that sufficient taxable profits will be available to allow the related tax benefit to be utilised. Any such reduction is reversed to the extent that it becomes probable that sufficient taxable profits will be available.

Additional income taxes that arise from the distribution of dividends are recognised when the liability to pay the related dividends is recognised.

Current tax balances and deferred tax balances, and movements therein, are presented separately from each other and are not offset. Current tax assets are offset against current tax liabilities, and deferred tax assets against deferred tax liabilities, if the Company or the Group has the legally enforceable right to set off current tax assets against current tax liabilities and the following additional conditions are met:

- in the case of current tax assets and liabilities, the Group intends either to settle on a net basis, or to realise the asset and settle the liability simultaneously; or
- in the case of deferred tax assets and liabilities, if they relate to income taxes levied by the same taxation authority on either:
 - the same taxable entity; or

Notes to the Consolidated Financial Statements

(Expressed in Renminbi)

2 SIGNIFICANT ACCOUNTING POLICIES (Continued)

(t) Income tax (Continued)

- different taxable entities, which, in each future period in which significant amounts of deferred tax liabilities or assets are expected to be settled or recovered, intend to realise the current tax assets and settle the current tax liabilities on a net basis or realise and settle simultaneously.

(u) Provisions and contingent liabilities

Provisions are recognised for liabilities of uncertain timing or amount when the Group has a legal or constructive obligation arising as a result of a past event, it is probable that an outflow of economic benefits will be required to settle the obligation and a reliable estimate can be made. Where the time value of money is material, provisions are stated at the present value of the expenditure expected to settle the obligation.

Where it is not probable that an outflow of economic benefits will be required, or the amount cannot be estimated reliably, the obligation is disclosed as a contingent liability, unless the probability of outflow of economic benefits is remote. Possible obligations, whose existence will only be confirmed by the occurrence or non-occurrence of one or more future events are also disclosed as contingent liabilities unless the probability of outflow of economic benefits is remote.

(v) Revenue recognition

Provided it is probable that the economic benefits will flow to the Group and the revenue and costs, if applicable, can be measured reliably, revenue is recognised in the consolidated income statement as follows:

(i) Contract revenue

When the outcome of a construction contract can be estimated reliably, revenue from a fixed price contract is recognised using the percentage of completion method, measured by reference to the percentage of contract costs incurred to date to estimated total contract costs for the contract.

When the outcome of a construction contract cannot be estimated reliably, revenue is recognised only to the extent of contract costs incurred that it is probable will be recoverable.

(ii) Services rendered

Revenue from design services rendered is recognised in the consolidated income statement in proportion to the stage of completion of the transaction at the balance sheet date.

Revenue from other services rendered is recognised upon the delivery or performance of the services.

(iii) Sales of goods

Revenue is recognised when goods are delivered at the customers' premises which is taken to be the point in time when the customer has accepted the goods and the related risks and rewards of ownership. Revenue excludes value added tax or other sales taxes and is after deduction of any trade discounts.

2 SIGNIFICANT ACCOUNTING POLICIES (Continued)

(v) Revenue recognition (Continued)

(iv) *Rental income from operating leases*

Rental income receivable under operating leases is recognised in the consolidated income statement in equal instalments over the periods covered by the lease term, except where an alternative basis is more representative of the pattern of benefits to be derived from the use of the leased asset. Lease incentives granted are recognised in the consolidated income statement as an integral part of the aggregate net lease payments receivable. Contingent rentals are recognised as income in the accounting period in which they are earned.

(v) *Dividends*

- Dividend income from unlisted investments is recognised when the shareholder's right to receive payment is established.
- Dividend income from listed investments is recognised when the share price of the investment goes ex-dividend.

(vi) *Interest income*

Interest income is recognised as it accrues using the effective interest method.

(w) Government grants

Government grants are recognised in the consolidated balance sheet initially when there is reasonable assurance that they will be received and that the Group will comply with the conditions attaching to them. Grants that compensate the Group for expenses incurred are recognised as revenue in the consolidated income statement on a systematic basis in the same periods in which the expenses are incurred. Grants that compensate the Group for the cost of an asset are deducted in arriving at the carrying amount of the asset and consequently are recognised in the consolidated income statement over the useful life of the asset.

(x) Translation of foreign currencies

The functional and presentation currency of the Group is Renminbi ("RMB"). Foreign currency transactions during the year are translated into RMB at the applicable rates of exchange quoted by the People's Bank of China ("PBOC") prevailing on the transaction dates. Monetary assets and liabilities denominated in foreign currencies are translated into RMB at the applicable rates ruling at the balance sheet date. Foreign currency differences, other than those capitalised as construction in progress (see note 2(h)), are recognised as income or expense in the consolidated income statement.

(y) Borrowing costs

Borrowing costs are expensed in the consolidated income statement in the period in which they are incurred, except to the extent that they are capitalised as being directly attributable to the acquisition, construction or production of an asset which necessarily takes a substantial period of time to get ready for its intended use or sale.

The capitalisation of borrowing costs as part of the cost of a qualifying asset commences when expenditure for the asset is being incurred, borrowing costs are being incurred and activities that are necessary to prepare the asset for its intended use or sale are in progress. Capitalisation of borrowing costs is suspended or ceases when substantially all the activities necessary to prepare the qualifying asset for its intended use or sale are interrupted or complete.

Notes to the Consolidated Financial Statements

(Expressed in Renminbi)

2 SIGNIFICANT ACCOUNTING POLICIES (Continued)

(z) Research and development costs

Research and development costs are recognised as expenses in the period in which they are incurred.

(aa) Segment reporting

A segment is a distinguishable component of the Group that is engaged either in providing products or services (business segment), or in providing products or services within a particular economic environment (geographical segment), which is subject to risks and rewards that are different from those of other segments.

(bb) Dividends or profit distributions

Dividends or profit distributions are recognised as a liability in the period in which they are declared.

(cc) Related parties

For the purposes of these financial statements, a party is considered to be related to the Group if:

- (i) the party has the ability, directly or indirectly through one or more intermediaries, to control the Group or exercise significant influence over the Group in making financial and operating policy decisions, or has joint control over the Group;
- (ii) the Group and the party are subject to common control;
- (iii) the party is an associate of the Group or a joint venture in which the Group is a venturer;
- (iv) the party is a member of key management personnel of the Group or the Group's parent, or a close family member of such an individual, or is an entity under the control, joint control or significant influence of such individuals;
- (v) the party is a close family member of a party referred to in (i) or is an entity under the control, joint control or significant influence of such individuals; or
- (vi) the party is a post-employment benefit plan which is for the benefit or employees of the Group or of any entity that is a related party of the Group.

Key management personnel are those persons having authority and responsibility for planning, directing and controlling the activities of the Group, directly or indirectly, including any director (whether executive or otherwise) of the Group.

Close family members of an individual are those family members who may be expected to influence, or be influenced by, that individual in their dealings with the entity.

3 REVENUES

Revenues are derived from the provision of integrated telecommunications support services, net of sales taxes, and after allowance for trade discounts. The Group's revenues by business nature can be summarised as follows:

	2006 RMB'000	2005 RMB'000
Revenue from telecommunications infrastructure services	7,472,427	7,199,590
Revenue from business process outsourcing services	5,153,540	4,363,152
Revenue from applications, content and others	1,556,833	1,669,549
	14,182,800	13,232,291

4 COST OF REVENUES

	2006 RMB'000	2005 RMB'000
Depreciation and amortisation	249,691	239,300
Direct personnel costs	2,604,229	2,521,904
Operating lease charges	199,236	138,022
Purchase of materials and telecommunications products	4,333,050	4,337,923
Subcontracting charges	2,760,555	2,029,152
Others	1,276,835	1,278,079
	11,423,596	10,544,380

5 OTHER OPERATING INCOME

	2006 RMB'000	2005 RMB'000
Dividend income from unlisted securities	22,473	30,198
Government grants	37,119	27,444
Net gain on disposal of investments	28,948	4,327
Net gain on disposal of property, plant and equipment	6,163	3,576
Penalty income	1,801	1,458
Management fee income	45,104	—
Write-off of non-payable liabilities	268	18,783
Others	17,538	29,886
	159,414	115,672

Notes to the Consolidated Financial Statements

(Expressed in Renminbi)

6 OTHER OPERATING EXPENSES

	2006 RMB'000	2005 RMB'000
Impairment losses on other investments	—	2,177
Impairment losses on property, plant and equipment	—	2,079
Donation	1,800	2,998
Penalty charge	3,297	5,917
Others	7,201	7,895
	12,298	21,066

7 NET FINANCING INCOME

	2006 RMB'000	2005 RMB'000
Interest income	111,451	59,982
Net foreign exchange (loss)/gain	(7,909)	502
Interest on bank advances and other borrowings wholly repayable within five years	(17,898)	(22,081)
	85,644	38,403

For the years ended 31 December 2005 and 2006, no borrowing costs were capitalised in relation to construction in progress.

8 NEGATIVE GOODWILL

	2006 RMB'000	2005 RMB'000
Negative goodwill arising from acquisition of subsidiaries (note 35(a))	—	158,813
Negative goodwill arising from acquisition from minority interests	4,039	686
	4,039	159,499

Negative goodwill has arisen on the acquisition as a result of gains from bargain purchases.

9 PROFIT BEFORE TAX

	2006 RMB'000	2005 RMB'000
(a) Staff costs:		
Salaries, wages and other benefits	3,394,249	3,270,807
Contributions to defined contribution retirement schemes	355,425	302,863
	3,749,674	3,573,670
(b) Other items:		
Depreciation and amortisation	400,221	401,579
Auditors' remuneration	10,800	7,912
Cost of inventories	4,333,050	4,337,923
Impairment losses on trade and other receivables	3,742	38,400
Operating lease charges	257,425	190,478
Research and development costs	15,872	53,353
Share of associates' taxation	—	4,428

10 INCOME TAX

(a) Income tax in the consolidated income statement represents:

	2006 RMB'000	2005 RMB'000
Current tax		
PRC enterprise income tax	293,623	264,541
Deferred tax		
Origination and reversal of temporary differences (note 24)	(12,911)	(4,059)
Total income tax	280,712	260,482

Notes to the Consolidated Financial Statements

(Expressed in Renminbi)

10 INCOME TAX (Continued)

(b) Reconciliation between tax expense and accounting profit at applicable tax rates:

	2006 RMB'000	2005 RMB'000
Profit before tax	999,972	1,040,984
Expected PRC income tax expense at a statutory tax rate of 33% (note (i))	329,991	343,525
Differential tax rates on subsidiaries' income (note (i))	(98,732)	(147,088)
Non-deductible expenses (note (ii))	84,858	84,606
Non-taxable income (note (iii))	(46,435)	(46,666)
Tax losses not recognised (note (iv))	11,030	26,105
Income tax	280,712	260,482

Notes:

- (i) The provision of PRC income tax of the Group is calculated based on a statutory rate of 33% of the assessable profit of the Group as determined in accordance with the relevant PRC income tax rules and regulations for the years ended 31 December 2005 and 2006, except for certain subsidiaries of the Group, which are taxed at preferential rate of 15%.
- (ii) The amounts include personnel and other miscellaneous expenses in excess of statutory deductible limits for tax purpose. The amounts for the year ended 31 December 2006 also include the deficit on revaluation of property, plant and equipment.
- (iii) Non-taxable income mainly represents dividend income and negative goodwill.
- (iv) The amount includes deferred tax assets not recognised amounting to RMB4.8 million (2005: RMB26.1 million) in respect of the tax losses of the entities distributed to the then owner pursuant to the Restructuring.

11 DIRECTORS' AND SUPERVISORS' EMOLUMENTS

The names of the directors and the supervisors of the Company and their remuneration for the year ended 31 December 2006 are as follows:

Name of directors and supervisors	Fees	Salaries, allowances and other benefits in kind	Discretionary bonus	Pension scheme contributions	2006 Total
	RMB'000	RMB'000	RMB'000	RMB'000	RMB'000
Wang Xiaochu	—	—	—	—	—
Li Ping	—	—	—	—	—
Liu Aili	—	—	—	—	—
Zhang Junan	—	—	—	—	—
Wang Jun	53	—	—	—	53
Chan Mo Po, Paul	63	—	—	—	63
Zhao Chunjun	40	—	—	—	40
Wu Shangzhi	40	—	—	—	40
Hao Weimin	27	—	—	—	27
Xia Jianghua	—	—	—	—	—
Yan Dong	—	98	192	34	324
Hai Liancheng	31	—	—	—	31
	254	98	192	34	578

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11 DIRECTORS' AND SUPERVISORS' EMOLUMENTS (Continued)

The names of the directors and the supervisors of the Company and their remuneration for the year ended 31 December 2005 are as follows:

Name of directors and supervisors	Fees	Salaries, allowances and other benefits in kind	Discretionary bonus	Pension scheme contributions	2005 Total
	RMB'000	RMB'000	RMB'000	RMB'000	RMB'000
Wang Xiaochu	—	—	—	—	—
Li Ping	—	—	—	—	—
Liu Aili	—	—	—	—	—
Zhang Junan	—	—	—	—	—
Wang Jun	—	—	—	—	—
Chan Mo Po, Paul	—	—	—	—	—
Zhao Chunjun	—	—	—	—	—
Wu Shangzhi	—	—	—	—	—
Hao Weimin	—	—	—	—	—
Xia Jianghua	—	—	—	—	—
Yan Dong	—	—	—	—	—
Hai Liancheng	—	—	—	—	—
	—	—	—	—	—

The number of directors and supervisors whose remuneration fell within the following band is as follows:

	2006	2005
HK\$ equivalent Nil to 1,000,000	12	12

12 INDIVIDUALS WITH HIGHEST EMOLUMENTS

The five highest paid employees of the Group are as follows:

	2006	2005
Directors and supervisors	—	—
Non-director and non-supervisor employees	5	5
	5	5

12 INDIVIDUALS WITH HIGHEST EMOLUMENTS (Continued)

The remuneration paid to the above non-director, non-supervisor, highest paid employees are as follows:

	2006 RMB'000	2005 RMB'000
Salaries, allowances and benefits in kind	782	705
Bonuses	1,921	1,886
Pension scheme contributions	418	484
	3,121	3,075

The number of these non-director, non-supervisor, highest paid employees whose remuneration fell within the following band is as follows:

	2006	2005
HK\$ equivalent Nil to 1,000,000	5	5

13 PROFIT ATTRIBUTABLE TO EQUITY SHAREHOLDERS OF THE COMPANY

The consolidated profit attributable to equity shareholders of the Company includes a profit of RMB55,375,000 which has been dealt with in the financial statements of the Company.

14 DIVIDENDS

(a) Special dividend

As disclosed in the Prospectus of the Company dated 27 November 2006, in accordance with the "Provisional Regulation relating to Corporate Restructuring of Enterprises and Related Management of State-owned Capital and Financial Treatment" which was issued by the PRC Ministry of Finance and a resolution passed on 1 November 2006, the directors proposed and the shareholders approved the distribution of profit of the Group for the period from 1 April 2006 to 29 August 2006, being the calendar day immediately preceding to the date of incorporation of the Company. In the same resolution, the directors proposed and the shareholders approved the distribution of profit of the Group for the period from 30 August 2006 to the calendar day immediately preceding the date of its listing on the Stock Exchange (i.e. 7 December 2006) (together, the "2006 Special Dividend").

Pursuant to a resolution passed at directors' meeting on 17 April 2007, the directors resolved to pay the 2006 Special Dividend to CTC and its subsidiaries amounting to RMB535 million in total (being the distributable profit of the Group for the period from 1 April 2006 to 7 December 2006). The Company will pay the 2006 Special Dividend to CTC and its subsidiaries in a series of payments commencing in July 2007.

(b) Final dividend

The directors do not recommend the payment of final dividend for 2006.

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15 EARNINGS PER SHARE

The calculation of basic earnings per share is based on the profit attributable to equity shareholders of the Company for the year ended 31 December 2006 of RMB696,078,000 (2005: RMB597,556,000) and the weighted average number of shares in issue during the year ended 31 December 2006 of 4,057,643,000 (2005: 3,960,000,000). The weighted average number of shares in issue during the year ended 31 December 2005 represents the number of shares issued and outstanding upon the legal formation of the Company on 30 August 2006 as if such shares have been outstanding for the above entire year. The weighted average number of shares for the year ended 31 December 2006 also reflects the issuance of 1,484,986,000 shares in 2006 in connection with the Company's initial public offering (see note 33). The weighted average number of shares in issue is set out below:

	2006 Thousands shares	2005 Thousands shares
Shares issued to CTC upon formation of the Company in 2006 as if such shares have been outstanding for the entire year in 2006 and 2005 (see note 33)	3,960,000	3,960,000
Effect of shares issued in December 2006	97,643	—
	4,057,643	3,960,000

There was no difference between basic and diluted earnings per share as there were no dilutive potential shares outstanding for the periods presented.

16 PROPERTY, PLANT AND EQUIPMENT, NET

The Group

	Buildings RMB'000	Buildings improvements RMB'000	Motor vehicles RMB'000	Furniture, fixtures and other equipment RMB'000	Total RMB'000
Cost:					
As at 1 January 2005	2,020,000	158,598	643,025	998,421	3,820,044
Through acquisition of subsidiaries	16,572	—	15,582	27,338	59,492
Transferred from construction in progress	123,778	21,519	5,515	57,426	208,238
Additions	63,263	17,274	61,099	126,551	268,187
Disposals	(35,823)	(14,228)	(33,178)	(118,395)	(201,624)
Distributions	(143,127)	(2,479)	(886)	(74)	(146,566)
As at 31 December 2005	2,044,663	180,684	691,157	1,091,267	4,007,771
Accumulated depreciation and impairment losses:					
As at 1 January 2005	348,096	82,620	351,354	420,658	1,202,728
Through acquisition of subsidiaries	3,291	—	6,935	15,021	25,247
Depreciation charge	76,947	26,792	81,975	166,417	352,131
Written back on disposal	(9,309)	(9,907)	(20,124)	(54,896)	(94,236)
Impairment losses	2,024	—	—	55	2,079
Distributions	(44,859)	(1,890)	(694)	(71)	(47,514)
As at 31 December 2005	376,190	97,615	419,446	547,184	1,440,435
Net carrying value:					
As at 31 December 2005	1,668,473	83,069	271,711	544,083	2,567,336

Notes to the Consolidated Financial Statements

(Expressed in Renminbi)

16 PROPERTY, PLANT AND EQUIPMENT, NET (Continued)

The Group (Continued)

	Buildings RMB'000	Buildings improvements RMB'000	Motor vehicles RMB'000	Furniture, fixtures and other equipment RMB'000	Total RMB'000
Cost or valuation:					
As at 1 January 2006	2,044,663	180,684	691,157	1,091,267	4,007,771
Through acquisition of subsidiaries	35,536	2,160	8,111	22,214	68,021
Transferred from construction in progress	158,093	32,102	3,425	51,154	244,774
Additions	275,522	4,598	115,697	228,219	624,036
Disposals	(221,797)	(27,287)	(114,385)	(136,925)	(500,394)
Distributions	(839,671)	(11,423)	(178,800)	(178,731)	(1,208,625)
Revaluation	(42,490)	(11,341)	(108,655)	(259,486)	(421,972)
As at 31 December 2006	1,409,856	169,493	416,550	817,712	2,813,611
Representing:					
Cost	282,636	31,766	99,668	215,675	629,745
Valuation (on a depreciated replacement cost basis as at 31 March 2006)	1,127,220	137,727	316,882	602,037	2,183,866
	1,409,856	169,493	416,550	817,712	2,813,611
Accumulated depreciation and impairment losses:					
As at 1 January 2006	376,190	97,615	419,446	547,184	1,440,435
Through acquisition of subsidiaries	6,522	1,284	4,563	13,704	26,073
Depreciation charge	61,071	25,922	108,937	174,830	370,760
Written back on disposal	(74,171)	(18,071)	(86,553)	(106,156)	(284,951)
Distributions	(162,069)	(8,808)	(108,500)	(79,931)	(359,308)
Revaluation	(149,757)	(17,003)	(191,501)	(253,985)	(612,246)
As at 31 December 2006	57,786	80,939	146,392	295,646	580,763
Net carrying value:					
As at 31 December 2006	1,352,070	88,554	270,158	522,066	2,232,848

16 PROPERTY, PLANT AND EQUIPMENT, NET (Continued)

The Company

	Furniture, fixtures and other equipment RMB'000
Cost :	
Additions	9
As at 31 December 2006	9
Accumulated depreciation:	
As at 31 December 2006	—
Net carrying value:	
As at 31 December 2006	9

- (a) All the Group's buildings are located in the PRC.
- (b) Valuation pursuant to the Restructuring

As required by the relevant PRC rules and regulations with respect to the Restructuring, all the property, plant and equipment of the Group were valued by China United Assets Appraisal Co., Ltd (the "PRC valuers"), independent valuers registered in the PRC, on a depreciated replacement cost basis.

The surplus arising from the valuation of these assets has been credited to owner's equity and minority interests as at 31 March 2006 amounting to RMB294 million and RMB1 million respectively. The deficit arising from the valuation of these assets amounting to RMB105 million, has been recognised as an expense in 2006.

The above buildings were also valued separately by Savills Valuation and Professional Services Limited, independent qualified valuers in Hong Kong, as at 30 September 2006. The value arrived at by them was approximately the same as that arrived at by the PRC valuers as adjusted for the depreciation for the period from 1 April 2006 to 30 September 2006.

- (c) Certain of the Group's bank loans were secured by certain of the Group's property, plant and equipment as described in note 30.
- (d) Up to the date of issue of these financial statements, the Group was in the process of applying for or changing registration of the title certificates of certain of its properties with an aggregate carrying value of approximately RMB161 million as at 31 December 2006. The directors of the Company are of the opinion that the Group is entitled to lawfully and validly occupy or use the above mentioned properties.

Notes to the Consolidated Financial Statements

(Expressed in Renminbi)

16 PROPERTY, PLANT AND EQUIPMENT, NET (Continued)

- (e) Had property, plant and equipment been carried at cost less accumulated depreciation, the historical carrying amounts as at 31 December 2006 would have been as follows:

	RMB'000
Buildings	1,246,187
Buildings improvements	83,244
Motor vehicles	191,798
Furniture, fixtures and other equipment	527,136
	2,048,365

17 INVESTMENT PROPERTIES

	The Group	
	2006 RMB'000	2005 RMB'000
Cost:		
As at 1 January	835,588	766,517
Through acquisition of subsidiaries	10,323	18,770
Transferred from construction in progress	2,109	4,266
Additions	188,031	46,035
Disposals	(100,700)	—
Distributions	(616,363)	—
As at 31 December	318,988	835,588
Accumulated depreciation:		
As at 1 January	159,725	118,342
Through acquisition of subsidiaries	—	2,933
Depreciation charge	16,927	38,450
Written back on disposal	(32,435)	—
Distributions	(112,121)	—
As at 31 December	32,096	159,725
Net carrying value:		
As at 31 December	286,892	675,863
Fair value	292,172	798,853

All the Group's investment properties are located in the PRC and are with medium-term leases.

17 INVESTMENT PROPERTIES (Continued)

The Group leases out its properties under operating leases. The leases typically run for period of one year to ten years, with an option to renew the lease after that date at which time all terms are renegotiated. None of the leases includes contingent rentals. At the balance sheet date, the Group's total future minimum lease payments under non-cancellable operating leases were receivables as follows:

	The Group	
	2006 RMB'000	2005 RMB'000
Within 1 year	7,014	31,371
After 1 year but within 5 years	20,286	28,769
After 5 years	11,731	4,876
	39,031	65,016

During the year ended 31 December 2006, RMB41 million (2005: RMB59 million) was recognised as rental income in the consolidated income statement and RMB5 million (2005: RMB9 million) in respect of direct operating expenses relating to investment properties was recognised as expenses in the consolidated income statement.

Up to the date of these financial statements, the Group was in the process of applying for or changing registration of the title certificates of certain of its properties with an aggregate carrying value of approximately RMB3.4 million as at 31 December 2006. The directors of the Company are of the opinion that the Group is entitled to lawfully and validly occupy or use the above mentioned properties.

18 CONSTRUCTION IN PROGRESS

	The Group	
	2006 RMB'000	2005 RMB'000
Cost:		
As at 1 January	396,124	185,546
Through acquisition of subsidiaries	—	26,004
Additions	223,382	417,190
Transferred to property, plant and equipment	(244,774)	(208,238)
Transferred to investment properties	(2,109)	(4,266)
Distributions	(106,819)	(20,112)
As at 31 December	265,804	396,124

Notes to the Consolidated Financial Statements

(Expressed in Renminbi)

19 LEASE PREPAYMENTS

	The Group	
	2006 RMB'000	2005 RMB'000
Cost:		
As at 1 January	155,522	151,781
Through acquisition of subsidiaries	10,192	6,681
Additions	49,819	5,619
Disposals	(23,532)	(8,559)
Distributions	(81,865)	—
As at 31 December	110,136	155,522
Accumulated depreciation:		
As at 1 January	10,472	8,807
Through acquisition of subsidiaries	1,501	—
Amortisation charge	3,612	2,363
Written back on disposal	(1,919)	(698)
Distributions	(6,720)	—
As at 31 December	6,946	10,472
Net carrying value:		
As at 31 December	103,190	145,050

Lease prepayments represent payments for land use rights paid to the PRC authorities. The Group's lease prepayments are located in the PRC and are with medium-term leases.

20 INTANGIBLE ASSETS

	The Group	
	2006 RMB'000	2005 RMB'000
Cost:		
As at 1 January	45,171	33,893
Through acquisition of subsidiaries	2,609	216
Additions	20,337	13,921
Disposals	(2,527)	(2,859)
Distributions	(9,926)	—
As at 31 December	55,664	45,171
Accumulated amortisation:		
As at 1 January	19,575	11,103
Through acquisition of subsidiaries	1,382	139
Amortisation charge	8,922	8,635
Written back on disposal	(829)	(302)
Distributions	(6,354)	—
As at 31 December	22,696	19,575
Net carrying value:		
As at 31 December	32,968	25,596

Intangible assets mainly represent computer software used in telecommunications infrastructure projects.

21 INVESTMENT IN SUBSIDIARIES

	The Company
	2006 RMB'000
Unlisted investments, at cost	5,373,776

Notes to the Consolidated Financial Statements

(Expressed in Renminbi)

21 INVESTMENT IN SUBSIDIARIES (Continued)

The following list contains only the particulars of subsidiaries at 31 December 2006 which principally affected the results, assets or liabilities of the Group.

Name of Company	Type of legal entity	Place of incorporation/ establishment	Held by the Company		Issued and fully paid up/registered capital	Principal Activities
			Directly	Indirectly		
Guangdong Communications Services Company Limited	Limited Liability Company	The PRC	100	—	RMB857 million	Provision of integrated telecommunications support services through its subsidiaries in Guangdong Province
Zhejiang Communications Services Company Limited	Limited Liability Company	The PRC	100	—	RMB1,098 million	Provision of Integrated telecommunications support services through its subsidiaries in Zhejiang Province
Shanghai Communications Services Company Limited	Limited Liability Company	The PRC	100	—	RMB976 million	Provision of integrated telecommunications support services through its subsidiaries in Shanghai Municipality
Fujian Communications Services Company Limited	Limited Liability Company	The PRC	100	—	RMB311 million	Provision of integrated telecommunications support services through its subsidiaries in Fujian Province
Hubei Communications Services Company Limited	Limited Liability Company	The PRC	100	—	RMB317 million	Provision of integrated telecommunications support services through its subsidiaries in Hubei Province
Hainan Communications Services Company Limited	Limited Liability Company	The PRC	100	—	RMB79 million	Provision of integrated telecommunications support services through its subsidiaries in Hainan Province

22 INTERESTS IN ASSOCIATES

	The Group	
	2006 RMB'000	2005 RMB'000
Share of net assets	7,927	180,749

As at 31 December 2006, the Group's associates are unlisted, established and operated in the PRC. The Group's interests in associates are individually and in aggregate not material to the Group's financial condition or results of operations for the year.

23 OTHER INVESTMENTS

	The Group	
	2006 RMB'000	2005 RMB'000
At cost:		
Unlisted equity securities	101,697	208,069
Held-to-maturity unlisted debt securities	36,778	536
	138,475	208,605

The above investments are individually and in the aggregate not material to the Group's financial condition or results of operations.

Notes to the Consolidated Financial Statements

(Expressed in Renminbi)

24 DEFERRED TAX ASSETS

Deferred tax assets attributable to the following:

	The Group	
	2006 RMB'000	2005 RMB'000
Impairment losses, primarily for receivables and inventories	5,216	8,016
Pre-operating expenses	1,562	2,231
Revaluation of lease prepayments	41,334	—
Unused tax losses (note (i))	26,109	8,556
	74,221	18,803
Deferred tax assets		

Movements in temporary differences for the year ended 31 December 2005 and 2006 are as follows:

The Group

	As at 1 January 2006 RMB'000	Recognised in consolidated income statement RMB'000	Recognised in owner's equity RMB'000	As at 31 December 2006 RMB'000
Impairment losses, primarily for receivables and inventories	8,016	(2,800)	—	5,216
Pre-operating expenses	2,231	(669)	—	1,562
Revaluation of lease prepayments	—	(1,173)	42,507	41,334
Unused tax losses	8,556	17,553	—	26,109
	18,803	12,911	42,507	74,221
Deferred tax assets				

(note 10 (a))

24 DEFERRED TAX ASSETS (Continued)

	As at 1 January 2005 RMB'000	Recognised in consolidated income statement RMB'000	As at 31 December 2005 RMB'000
Impairment losses, primarily for receivables and inventories	4,972	3,044	8,016
Pre-operating expenses	2,900	(669)	2,231
Unused tax losses	6,872	1,684	8,556
Deferred tax assets	14,744	4,059	18,803

(note 10 (a))

Notes:

- (i) Expiry of recognised tax losses

	2006 RMB'000
Year of expiry	
2008	130
2009	8,968
2010	16,978
2011	53,042
	79,118

- (ii) In connection with the Restructuring, the Group's land use rights were revalued as required by the relevant PRC rules and regulations as at 31 March 2006. The revalued amount will serve as the tax base for future years. The land use rights were not revalued for financial reporting purposes and accordingly, deferred tax assets of RMB42.5 million is created with a corresponding increase in equity. Based upon the level of historical taxable income and projections for future taxable income, management believes it is probable that the Group will realise the benefits of the deferred tax assets.
- (iii) As at 31 December 2006, the Group has not recognised deferred tax assets in respect of tax losses of RMB20.6 million (2005: RMB156.9 million) as it is not probable that future taxable profits against which the losses can be utilised will be available. The tax losses will be expired in 2011.

Notes to the Consolidated Financial Statements

(Expressed in Renminbi)

25 INVENTORIES

	The Group	
	2006 RMB'000	2005 RMB'000
Construction materials	337,247	127,539
Finished goods	435,373	346,566
Spare parts and consumables	55,504	49,991
	828,124	524,096

The analysis of the amount of inventories recognised as an expense is as follows:

	The Group	
	2006 RMB'000	2005 RMB'000
Carrying amount of inventories consumed and sold	4,333,050	4,337,923
Write down of inventories	1,011	2,304
	4,334,061	4,340,227

26 ACCOUNTS AND BILLS RECEIVABLE, NET

	The Group	
	2006 RMB'000	2005 RMB'000
Bills receivable	58,675	10,071
Unbilled revenue for contract work (note 27)	376,409	242,930
Trade receivables	2,916,178	2,742,506
	3,351,262	2,995,507

26 ACCOUNTS AND BILLS RECEIVABLE, NET (Continued)

- (a) Included in accounts and bills receivable are amounts due from fellow subsidiaries of RMB1,740 million (2005: RMB1,728 million) as at 31 December 2006. The amounts due from fellow subsidiaries are unsecured, interest free and are expected to be recovered within one year.
- (b) In general, debts are due for payment upon billing. Subject to negotiation, credit terms within a range of one to three months are available for certain customers with well-established trading and payment records.
- (c) The ageing analysis of accounts and bills receivable (net of impairment losses) is as follows:

	The Group	
	2006 RMB'000	2005 RMB'000
Within 1 year	3,171,309	2,782,245
After 1 year but less than 2 years	157,771	155,258
After 2 years but less than 3 years	16,583	47,570
After 3 years	5,599	10,434
	3,351,262	2,995,507

27 CONSTRUCTION CONTRACTS

The aggregate amounts of costs incurred plus recognised profit less recognised losses to date, included in the gross amount due from/to customers for contract work at 31 December 2006 are RMB1,236 million (2005: RMB1,276 million).

In respect of construction contracts in progress at the balance sheet date, the amounts of retentions receivable from customers, recorded within "Accounts and bills receivable" at 31 December 2006 are RMB10 million (2005: RMB19 million).

28 PREPAYMENTS AND OTHER CURRENT ASSETS

	The Group		The Company
	2006 RMB'000	2005 RMB'000	2006 RMB'000
Advances to staff	88,462	64,848	—
Amounts due from fellow subsidiaries	252,729	1,320,403	—
Prepayments in connection with construction work and equipment purchases	275,054	285,081	—
Prepaid expenses and deposits	199,638	152,608	—
Others	122,757	263,513	2,360
	938,640	2,086,453	2,360

The amounts due from fellow subsidiaries are unsecured, interest free and are expected to be recovered within one year.

Notes to the Consolidated Financial Statements

(Expressed in Renminbi)

29 CASH AND CASH EQUIVALENTS

	The Group		The Company
	2006 RMB'000	2005 RMB'000	2006 RMB'000
Cash at bank and in hand	6,934,427	3,024,172	3,150,555
Deposits with banks and other financial institutions	136,602	661,744	—
Cash and cash equivalents	7,071,029	3,685,916	3,150,555

Renminbi is not a freely convertible currency and the remittance of funds out of the PRC is subject to the exchange restrictions imposed by the PRC government.

Included in cash and cash equivalents are the following amounts denominated in a currency other than the functional currency of the Group:

	The Group		The Company
	2006 HKD'000	2005 HKD'000	2006 HKD'000
Hong Kong dollars	3,139,190	183	3,134,926

The cash and cash equivalents denominated in Renminbi and Hong Kong dollars bear interest at 0.72% to 2.25% (2005: 0.72% to 2.25%) and 2.75% to 4.30% (2005: 3.00%) per annum for the year ended 31 December 2006 respectively.

30 INTEREST-BEARING BORROWINGS

The Group's short-term borrowings are denominated in Renminbi and comprise:

	The Group	
	2006 RMB'000	2005 RMB'000
Borrowings from banks		
— secured	50,000	—
— unsecured	45,500	151,500
Loans from fellow subsidiaries		
— unsecured	—	58,045
	95,500	209,545

30 INTEREST-BEARING BORROWINGS (Continued)

The Group's interest rate per annum on short-term borrowings is:

	The Group	
	2006	2005
Borrowings from banks	4.65%–5.86%	4.96%–6.42%
Loans from fellow subsidiaries	—	4.25%–5.58%

As at 31 December 2006, bank loans amounting to RMB50 million (2005: Nil) were secured by certain of the Group's property, plant and equipment with net book value of RMB21 million.

31 ACCOUNTS AND BILLS PAYABLE

Accounts and bills payable comprise:

	The Group	
	2006 RMB'000	2005 RMB'000
Trade payable	2,697,409	1,908,436
Bills payable	162,656	39,030
	2,860,065	1,947,466

The ageing analysis of accounts and bills payable is as follows:

	The Group	
	2006 RMB'000	2005 RMB'000
Within 1 year	2,784,827	1,929,576
After 1 year but less than 2 years	69,504	13,790
After 2 years but less than 3 years	3,368	3,139
After 3 years	2,366	961
	2,860,065	1,947,466

Included in accounts and bills payable are amounts due to fellow subsidiaries of RMB110 million (2005: RMB121 million) as at 31 December 2006. The amounts due to fellow subsidiaries are unsecured, interest free and are expected to be settled within one year.

Notes to the Consolidated Financial Statements

(Expressed in Renminbi)

32 ACCRUED EXPENSES AND OTHER PAYABLES

	The Group		The Company
	2006 RMB'000	2005 RMB'000	2006 RMB'000
Wages and welfare payables	472,499	783,407	—
Amounts due to fellow subsidiaries	302,844	715,328	1,150
Advances received	95,785	98,623	—
Other taxes payable	123,425	188,814	3,335
Dividends payable	202,851	82,142	—
Payables for construction and purchase of fixed assets	179,784	236,463	—
Others	692,517	703,350	50,295
	2,069,705	2,808,127	54,780

The amounts due to fellow subsidiaries are unsecured, interest free and are expected to be settled within one year.

Dividends payable represent dividends declared by certain of the subsidiaries now comprising the Group and payable to the then owners.

33 SHARE CAPITAL

	The Group and the Company	
	2006 RMB'000	2005 RMB'000
Registered, issued and fully paid:		
3,811,501,400 (2005: Nil) domestic state-owned ordinary shares of RMB1.00 each	3,811,501	—
1,633,484,600 (2005: Nil) H shares of RMB1.00 each	1,633,485	—
	5,444,986	—

	The Group and the Company	
	2006 Thousands shares	2005 Thousands shares
At 1 January	—	—
Issuance of domestic state-owned ordinary shares	3,960,000	—
Conversion of domestic state-owned ordinary shares into H shares	(148,499)	—
Issuance of H shares	1,633,485	—
	5,444,986	—
At 31 December		

33 SHARE CAPITAL (Continued)

The Company was incorporated on 30 August 2006 with a registered share capital of 3,960,000,000 domestic state-owned ordinary shares with a par value of RMB1.00 each. Such shares were issued to CTC, Guangdong Telecom Industry Group Corporation and Zhejiang Telecom Industry Corporation, as a consideration for the transferring of the Predecessor Operations and injection of cash to the Company (see note 1). In December 2006, the Company issued 1,484,986,000 H shares with a par value of RMB1.00, at a price of HK\$2.20 per H share and 148,498,600 domestic state-owned shares of RMB1.00 each owned by CTC were converted into H shares in connection with the initial public offering. For more details, please refer to note 1(b).

All shareholders are entitled to receive dividends as declared from time to time except for the special dividends described in note 14 and are entitled to one vote per share at meetings of the Company. All shares rank equally with regard to the Company's residual assets.

34 RETIREMENT BENEFIT OBLIGATIONS

In accordance with the labour regulations of the PRC, the Group participates in various defined contribution retirement schemes organised by the municipal and provincial governments for its employees. The Group is required to make contributions to the retirement schemes at rates ranging from 16.5% to 20% of the salaries, bonuses and certain allowances of the employees. A member of the scheme is entitled to a pension equal to a fixed proportion of the salary prevailing at his or her retirement date.

The Group has no other material obligation for the payment of pension benefits associated with these schemes beyond the annual contributions described above.

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35 NOTES TO CONSOLIDATED CASH FLOW STATEMENT

(a) Acquisition of subsidiaries

During the year ended 31 December 2006, the Group acquired several subsidiaries as follows:

	2006 RMB'000	2005 RMB'000
Property, plant and equipment, net	41,948	34,245
Investment properties	10,323	15,837
Construction in progress	—	26,004
Lease prepayments	8,691	6,681
Intangible assets	1,227	77
Inventories	14,068	393
Accounts and bills receivable, net	46,623	202,941
Prepayments and other current assets	31,133	116,220
Cash and cash equivalents	16,139	64,913
Accounts and bills payable	(39,104)	(4,970)
Accrued expenses and other payables	(25,598)	(94,015)
Income tax payable	(26)	(68,921)
Net identifiable assets and liabilities	105,424	299,405
Contributed by owner (note)	(105,424)	(89,528)
Negative goodwill arising on consolidation	—	(158,813)
Total purchase price paid, satisfied in cash	—	51,064
Less: cash of the subsidiaries acquired	(16,139)	(64,913)
Net cash inflow in respect of the purchase of subsidiaries	(16,139)	(13,849)

Note: These represent the acquisition of subsidiaries made by owner, being transferred to the Group by way of capital contribution.

(b) Major non-cash transactions

	2006 RMB'000	2005 RMB'000
Contributions in forms of property, plant and equipment, lease prepayments and other assets	203,128	467,862
Distributions in forms of property, plant and equipment, lease prepayments and other assets	222,806	367,095
Distribution of net assets to owner pursuant to the Restructuring	1,430,962	—

36 COMMITMENTS AND CONTINGENT LIABILITIES

(a) Capital commitments

As at 31 December 2006, the Group has capital commitment for acquisition and construction of property, plant and equipment as follows:

	The Group	
	2006 RMB'000	2005 RMB'000
Authorised and contracted for	75,184	129,649
Authorised but not contracted for	36,969	62,020

(b) Operating lease commitments

As at 31 December 2006, the Group's total future minimum lease payments under non-cancellable operating leases were payable as follows:

	The Group	
	2006 RMB'000	2005 RMB'000
Within 1 year	58,832	46,783
After 1 year but within 5 years	104,802	129,844
After 5 years	7,615	11
	171,249	176,638

The Group leases a number of properties under operating leases. The leases typically run for period of one year to six years, with an option to renew the lease when all terms are renegotiated. None of the leases includes contingent rentals.

(c) Contingent liabilities

The Group had no material contingent liabilities and no financial guarantees issued.

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37 FINANCIAL INSTRUMENTS

Exposure to credit, interest and liquidity risks arises in the normal course of the Group's business. These risks are limited by the Group's financial management policies and practices described below.

(a) Credit risk

Management has a credit policy in place and the exposure to credit risks is monitored on an ongoing basis. Credit evaluations are performed on all customers requiring credit over a certain amount. Normally, the Group does not obtain collateral from customers.

The Group's major customers are CTC and its subsidiaries (collectively referred to as "CTC Group"), and China Mobile Limited. The Group has a certain concentration of credit risk as the Group's largest customer accounted for 52% of the total accounts and bills receivable as at 31 December 2006 (2005: 58%). The Group has no significant credit risk with any of these customers since the Group maintains long-term and stable business relationships with these large customers in the telecommunications industry.

(b) Interest rate risk

The interest rates and terms of repayment of outstanding loans and deposits of the Group at balance sheet date are disclosed in notes 30 and 29 respectively.

(c) Liquidity risk

Individual operating entities within the Group are responsible for their own cash management, including the short-term investment of cash surpluses and the raising of loans to cover expected cash demands, subject to approval by the board of the entities when the borrowings exceed certain predetermined levels of authority. The Group's policy is to regularly monitor current and expected liquidity requirements, to ensure that it maintains sufficient reserves of cash and adequate committed lines of funding from major financial institutions to meet its liquidity requirements in the short and longer term.

(d) Fair value

The fair values of cash and cash equivalents, accounts and bills receivable, prepayments and other current assets, accounts and bills payable and accrued expenses and other payables are not materially different from their carrying amounts.

The fair values of the Group's interest-bearing borrowings are estimated to approximate to their fair value based on the nature or short-term maturity.

The fair values of Group's other investments could not be reasonably estimated without incurring excessive costs, since there are no listed market prices for such interest in the PRC.

37 FINANCIAL INSTRUMENTS (Continued)

(e) Foreign currency risk

Substantially all the revenue-generating operations of the Group are transacted in Renminbi, which is not freely convertible into foreign currencies. On 1 January 1994, the PRC government abolished the dual rate system and introduced a single rate of exchange quoted by the PBOC. However, the unification of the exchange rate does not imply convertibility of Renminbi into other foreign currencies. All foreign exchange transactions continue to take place either through the PBOC or other institutions authorised to buy and sell foreign currencies. Approval of foreign currency payments, including remittances of dividends, by the PBOC or other institutions requires submitting a payment application form together with relevant supporting documents.

38 SIGNIFICANT ACCOUNTING ESTIMATES AND JUDGEMENTS

In determining the carrying amounts of certain assets and liabilities, the Group makes assumptions of the effects of uncertain future events on those assets and liabilities at the balance sheet date. These estimates involve assumptions about such items as risk adjustment to cash flows or discount rates used, future changes in salaries and future changes in prices affecting other costs. The Group's estimates and assumptions are based on historical experience and expectations of future events and are reviewed periodically. In addition to assumptions and estimations of future events, judgements are also made during the process of applying the Group's accounting policies.

(a) Construction contracts

As explained in notes 2(n) and 2(v)(i) revenue and profit recognition on an uncompleted project is dependent on estimating the total outcome of the construction contract, as well as the work done to date. Based on the Group's recent experience and the nature of the construction activity undertaken by the Group, the Group makes estimates of the point at which it considers the work is sufficiently advanced such that the costs to complete and revenue can be reliably estimated. As a result, until this point is reached the amounts due from customers for contract work as disclosed in note 27 will not include profit which the Group may eventually realise from the work done to date. In addition, actual outcomes in terms of total cost or revenue may be higher or lower than estimated at the balance sheet date, which would affect the revenue and profit recognised in future years as an adjustment to the amounts recorded to date.

(b) Impairment for bad and doubtful debts

The Group estimates impairment losses for bad and doubtful debts resulting from the inability of the customers to make the required payments. The Group bases the estimates on the aging of the accounts receivable balance, customer credit-worthiness, and historical write-off experience. If the financial condition of the customers were to deteriorate, actual write-offs would be higher than estimated.

Notes to the Consolidated Financial Statements

(Expressed in Renminbi)

38 SIGNIFICANT ACCOUNTING ESTIMATES AND JUDGEMENTS (Continued)

(c) Impairment of long-lived assets

If circumstances indicate that the carrying amount of a long-lived asset may not be recoverable, the asset may be considered "impaired", and an impairment loss may be recognised in accordance with accounting policy for impairment of long-lived assets as described in note 2(l). The carrying amounts of long-lived assets are reviewed periodically in order to assess whether the recoverable amounts have declined below the carrying amounts. These assets are tested for impairment whenever events or changes in circumstances indicate that their recorded carrying amounts may not be recoverable. When such a decline has occurred, the carrying amount is reduced to recoverable amount. The recoverable amount is the greater of the net selling price and the value in use. In determining the value in use, expected future cash flows generated by the asset are discounted to their present value, which requires significant judgement relating to level of revenue and amount of operating costs. The Group uses all readily available information in determining an amount that is a reasonable approximation of recoverable amount, including estimates based on reasonable and supportable assumptions and projections of revenue and amount of operating costs. Changes in these estimates could have a significant impact on the carrying value of the assets and could result in additional impairment charge or reversal of impairment in future periods.

39 RELATED PARTIES

The Group is part of a large group of companies under CTC and has significant transactions and relationships with members of CTC. Apart from the transactions and balances disclosed in the financial statements set out above, there are the following related party transactions:

(a) Transactions with CTC Group

Because of the relationships between the Group, CTC and members of the CTC, it is possible that the terms of those transactions are not the same as those that would result from transactions among unrelated parties.

The principal transactions with CTC Group which were carried out in the ordinary course of business are as follows:

	2006 RMB'000	2005 RMB'000
Income from related parties:		
Engineering related services (note (i))	4,126,272	3,326,337
IT application services (note (ii))	147,058	106,422
Provision of ancillary telecommunications services (note (iii))	2,197,976	1,496,072
Provision of operation support services (note (iv))	1,017,242	1,015,466
Property leasing (note (v))	45,375	38,783
Management fee income (note(vi))	45,104	—
Expenses paid to related parties:		
Property leasing charges (note (vii))	45,325	35,962
IT application service charges (note (viii))	170,925	176,796
Operation support service charges (note (ix))	104,247	101,722
Interest paid (note (x))	2,160	2,954

39 RELATED PARTIES (Continued)

(a) Transactions with CTC Group (Continued)

Notes:

- (i) The amount represents the engineering related services, such as design, construction and project management for telecommunications infrastructure project provided to CTC Group.
- (ii) The amount represents the telecommunications network support services, software and hardware development and other IT related services provided to CTC Group.
- (iii) The amount represents ancillary telecommunications services such as maintenance of network facilities including optical ducts and cables, exchange buildings and base stations; operation of distribution channels, fixed line and wireless value-added service, internet contents and information services provided to CTC Group.
- (iv) The amount represents the facilities management, advertising, conferencing services and certain repair and leasing of equipments services provided to CTC Group.
- (v) The amount represents rental income in respect of premises leased to CTC Group.
- (vi) The amounts represent management fee income in respect of centralised services provided to CTC Group.
- (vii) The amount represents operating leases in respect of business premises paid and payable to CTC Group.
- (viii) The amount represents basic telecommunications service, value-added service and information application service charged by CTC Group.
- (ix) The amount represents the charge paid and payable to CTC Group for logistics, labour resources, cultural, educational, hygiene and other supporting services.
- (x) Interest paid/payable represents the interest paid or payable to CTC Group in respect of the loans from fellow subsidiaries.

Amounts due from/to CTC Group included in respective balances are summarised as follows:

	2006 RMB'000	2005 RMB'000
Accounts and bills receivable, net	1,740,358	1,728,006
Prepayments and other current assets	252,729	1,320,403
Total amounts due from CTC Group	1,993,087	3,048,409
Interest-bearing borrowings	—	58,045
Accounts and bills payable	110,036	121,293
Receipts in advance for contract work	82,105	429,144
Accrued expenses and other payables	465,788	773,610
Total amounts due to CTC Group	657,929	1,382,092

Notes to the Consolidated Financial Statements

(Expressed in Renminbi)

39 RELATED PARTIES (Continued)

(a) Transactions with CTC Group (Continued)

As at 31 December 2005 and 2006, no impairment losses for bad and doubtful debts were recorded in respect of amounts due from CTC Group.

The directors are of the opinion that the above transactions with related parties were conducted on normal commercial terms in the ordinary course of business and the terms are fair and reasonable so far as the shareholders of the Company are concerned.

In connection with the Restructuring, the Company and CTC entered into a number of agreements effective as at 16 November 2006 to take up the existing agreements signed between the Predecessor Operations and CTC as set out in items (1), (2) and (3) below, together with a new agreement governing the provision of headquarter management function by the Company as set out in item (4). The terms of the principal agreements impacting the results of operations of the Group are summarised as follows:

- (1) The Group has entered into agreements with CTC pursuant to which the Group provides CTC Group with construction, design and project supervision and management for telecommunications infrastructure projects. In addition, the Group has entered into information technology service agreements with CTC pursuant to which the Group provides CTC Group with telecommunications network support service, software and hardware development and other IT related services. The amounts charged for these services are determined by reference to market rates as reflected in prices obtained through a tender.
- (2) The Group has entered into facilities leasing agreements with CTC pursuant to which the Group leases certain premises and other facilities to CTC Group, and vice versa. The rental charges are based on market rate, with reference to amounts stipulated by local price bureau.
- (3) The Group has entered into operation support services agreements for facilities management, advertising, conferencing, logistics, cultural, educational, hygiene and other community services with CTC. In addition, the Group has entered into ancillary services agreements with CTC. The ancillary services provided to CTC Group include repairs and maintenance of telecommunications equipment and facilities and certain customer services. Pursuant to these agreements, the Group charges CTC Group, and vice versa, for these services in accordance with the following terms:
 - government prescribed price;
 - where there is no government prescribed prices but where there is a government guided price, the government guided price will apply;
 - where there is neither a government prescribed price nor a government guided price, the market price will apply;
 - 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.

39 RELATED PARTIES (Continued)

(a) Transactions with CTC Group (Continued)

- (4) The Group has entered into agreement with CTC pursuant to which the Group takes up the role as headquarter management function to manage assets of the telecommunications support business of provinces, municipalities and autonomous regions including Jiangsu, Anhui, Jiangxi, Sichuan, Chongqing, Hunan, Guizhou, Yunan, Guangxi, Shaanxi, Ningxia, Gansu, Qinghai, Xingjiang, Tibet and any assets retained by CTC after the Restructuring. The aggregate administrative costs incurred by the Group for the provision of the centralised services are apportioned pro rata between the Group and CTC Group according to the net asset ratio of each of the relevant party.
- (5) The Group acquired certain property, plant and equipment from CTC Group for a total consideration of RMB295 million in 2006 subsequent to the incorporation of the Company.

(b) Transactions with other state-controlled entities in the PRC

The Group is a state-controlled entity and operates in an economic regime currently predominated by entities directly or indirectly owned or controlled by the PRC government and numerous government authorities and agencies (collectively referred to as “state-controlled entities”). Apart from transactions mentioned in the above, the Group conducts a majority of its business activities with state-controlled entities in the ordinary course of business. These transactions are carried out at terms similar to those that would be entered into with non-state-controlled entities. Transactions with other state-controlled entities in the PRC include but not limited to the following:

- sales and purchase of goods, properties and other assets;
- rendering and receiving services;
- depositing and borrowing money; and
- use of public utilities.

The Group prices its services and products based on guideline ceiling rates prescribed by relevant government agencies, where applicable, or based on the commercial negotiations. The Group has also established its procurement policies and approval processes for purchase of products and services, which do not depend on whether the counter parties are state-controlled entities or not.

Notes to the Consolidated Financial Statements

(Expressed in Renminbi)

39 RELATED PARTIES (Continued)

(b) Transactions with other state-controlled entities in the PRC (Continued)

Having considered the transactions potentially affected by related party relationships, the entity's pricing strategy, procurement policies and approval processes, and the information that would be necessary for an understanding or the potential effect of the related party relationships on the consolidated financial statements, the directors are of the opinion that the following amounts due from/to state controlled entities in the PRC require disclosure.

Cash deposited with the state-controlled banks in the PRC and the interest income are as follows:

	2006 RMB'000	2005 RMB'000
Cash and cash equivalents	3,913,664	3,682,502
Interest income	42,572	59,982

(c) Transactions with key management personnel

Remuneration for key management personnel, including amounts paid to the Company's directors and supervisors as disclosed in note 11 and certain of the highest paid employees as disclosed in note 12, is as follows:

	2006 RMB'000	2005 RMB'000
Salaries and other emoluments	872	820
Retirement benefits	490	556
Bonuses	2,224	2,183
	3,586	3,559

Total remuneration is included in "Staff costs" in note 9.

39 RELATED PARTIES (Continued)

(d) Contributions to defined contribution retirement plans

The Group participates in various defined contribution retirement plans organised by municipal and provincial governments for its staff. The details of the Group's employee benefits plan are disclosed in note 34. As at 31 December 2005 and 2006, there was no material outstanding contribution to post-employment benefit plans.

(e) Transactions with ten largest state-controlled customers and suppliers

The directors consider that the transactions with state-controlled entities which require disclosure in the financial statements have been set out above. The following are the additional disclosure in respect of transactions entered into by the Group with its ten largest state-controlled customers and suppliers:

Transactions with the Group's ten largest customers, which are state-controlled entities, amounting to approximately RMB10,023 million for the year ended 31 December 2006 (2005: RMB8,756 million).

Transactions with the Group's ten largest suppliers, which are state-controlled entities, amounting to RMB539 million for the year ended 31 December 2006 (2005: RMB289 million).

40 SEGMENTAL REPORTING

For the years ended 31 December 2005 and 2006, the Group principally has one business segment, the provision of integrated telecommunications service to the telecommunications industry in the PRC. The Group mainly operates in the PRC. Accordingly, no business and geographical segment information are presented.

Notes to the Consolidated Financial Statements

(Expressed in Renminbi)

41 DISTRIBUTABLE RESERVES

The movement of shareholders' equity of the Company for 2006 is as follows:

	Share capital RMB'000	Share premium RMB'000	Capital reserves RMB'000	Statutory surplus reserves RMB'000	Retained earnings/ (loss) RMB'000	Total RMB'000
	(Note 33)					
Capitalisation upon legal establishment of the Company (Note 1)	3,960,000	—	1,413,776	—	—	5,373,776
Issuance of shares upon public listing	1,484,986	1,807,727	—	—	—	3,292,713
Shares issue expenses	—	(249,944)	—	—	—	(249,944)
Profit for the period	—	—	—	—	55,375	55,375
Appropriation	—	—	—	69,969	(69,969)	—
At 31 December 2006	5,444,986	1,557,783	1,413,776	69,969	(14,594)	8,471,920

According to the Company's Articles of Association, the amount of retained profits available for distribution to equity shareholders of the Company is the lower of the amount determined in accordance with the PRC Accounting Rules and Regulations and the amount determined in accordance with IFRSs after the appropriation to statutory surplus reserve as detailed in Note (e) to the consolidated statement of changes in equity.

At 31 December 2006, there were no distributable reserves attributable to the equity shareholders of the Company.

42 COMPARATIVE FIGURES

Subcontracting charges of RMB499 million in 2005 have been reclassified to direct personnel costs to conform with the current year's presentation.

43 POSSIBLE IMPACT OF AMENDMENTS, NEW STANDARDS AND INTERPRETATIONS ISSUED BUT NOT YET EFFECTIVE FOR THE ANNUAL ACCOUNTING YEAR ENDED 31 DECEMBER 2006

Up to the date of issue of these financial statements, the IASB has issued amendments, new standards and interpretations which are not yet effective for the accounting year ended 31 December 2006 and which have not been adopted in these financial statements. Of these developments, the following relate to matters they may be relevant to the Group's operations and financial statements:

		Effective for accounting periods beginning on or after
IFRS 7	Financial instruments: Disclosures	1 January 2007
IFRS 8	Operating segments	1 January 2007
Amendment to IAS 1 (August 2005)	Presentation of financial statements: capital disclosures	1 January 2009
IFRIC 10	Interim financial reporting and impairment	1 November 2006

The Group is in the process of making an assessment of what the impact of these amendments, new standards and new interpretations is expected to be in the period of initial application. So far it has concluded that while the adoption of them may result in new or amended disclosures, it is unlikely to have a significant impact on the Group's results of operations and financial position.

44 IMMEDIATE AND ULTIMATE CONTROLLING PARTY

At 31 December 2006, the directors consider the immediate and ultimate controlling party of the Group to be CTC, a stated-owned enterprise established in the PRC. CTC does not produce financial statements available for public use.

Notes to the Consolidated Financial Statements

(Expressed in Renminbi)

45 NON-ADJUSTING POST BALANCE SHEET EVENT

The Corporate Income Tax Law of the People's Republic of China ("new tax law") has been passed by the Fifth Plenary Session of the Tenth National People's Congress on 16 March 2007 and will take effect on 1 January 2008. According to the new tax law, except for certain subsidiaries of the Company which are taxed at preferential rates, the income tax rate applicable to the Group will be reduced from 33% to 25% from 1 January 2008. From 1 January 2008, certain subsidiaries that are currently taxed at preferential rates will be subject to a five-year transition period during which the tax rates will gradually be increased to the unified rate of 25% and certain high-tech enterprises will continue to be entitled to a reduced tax rate of 15%. However, the new tax law has not set out the details as to how the existing preferential tax rate will gradually increase to the standard rate of 25% and the detailed implementation rules regarding the preferential tax policies (e.g. the details of how a taxpayer can be qualified as a high-tech enterprise to enjoy the preferential rate of 15%) have yet to be made public. Consequently, management is not in a position to estimate the impact of the new tax law on the deferred tax assets and liabilities of certain subsidiaries which are being taxed at preferential rates. The financial effect of the new tax law, if any, will be reflected in the Group's 2007 financial statements. The enactment of the new tax law is not expected to have any financial effect on the amounts accrued in the balance sheet in respect of current tax payable.

Financial Summary

(Amounts in thousands, except per share data)

	For the year ended 31 December			
	2006 RMB	2005 RMB	2004 RMB	2003 RMB
Results				
Revenue from telecommunications infrastructure services	7,472,427	7,199,590	7,241,852	6,693,087
Revenue from business process outsourcing services	5,153,540	4,363,152	3,637,461	3,157,619
Revenue from applications, content and others	1,556,833	1,669,549	1,369,515	1,066,558
Total revenues	14,182,800	13,232,291	12,248,828	10,917,264
Depreciation and amortisation	249,691	239,300	206,567	168,268
Direct personnel costs	2,604,229	2,521,904	1,423,520	1,268,439
Purchase of materials and telecommunications products	4,333,050	4,337,923	4,386,627	3,889,030
Subcontracting charges	2,760,555	2,029,152	2,665,201	2,210,650
Operating lease charges and others	1,476,071	1,416,101	1,192,722	1,102,517
Cost of revenues	11,423,596	10,544,380	9,874,637	8,638,904
Gross profit	2,759,204	2,687,911	2,374,191	2,278,360
Other operating income	159,414	115,672	164,494	94,260
Selling, general and administrative expenses	(1,890,702)	(1,951,122)	(1,733,861)	(1,619,517)
Other operating expenses	(12,298)	(21,066)	(31,751)	(24,715)
Deficit on revaluation of property, plant and equipment	(105,299)	—	—	—
Net financing income	85,644	38,403	42,643	39,311
Share of profits less (losses) of associates	(30)	11,687	5,442	6,508
Negative goodwill	4,039	159,499	43,299	62,526
Profit before tax	999,972	1,040,984	864,457	836,733
Income tax	(280,712)	(260,482)	(273,960)	(262,793)
Profit for the year	719,260	780,502	590,497	573,940
Attributable to:				
Equity shareholders/owner	696,078	597,556	525,619	458,436
Minority interests	23,182	182,946	64,878	115,504
Profit for the year	719,260	780,502	590,497	573,940
Basic and diluted earnings per share (RMB)	0.172	0.151	0.133	0.116

Financial Summary

(Amounts in thousands)

At 31 December

	2006 RMB	2005 RMB	2004 RMB	2003 RMB
Financial condition				
Property, plant and equipment, net	2,232,848	2,567,336	2,617,316	2,518,819
Other non-current assets	909,477	1,650,790	1,518,084	1,583,686
Inventories	828,124	524,096	631,239	402,110
Accounts and bills receivable, net	3,351,262	2,995,507	2,393,410	2,250,221
Prepayments and other current assets	938,640	2,086,453	1,800,643	1,341,103
Cash and cash equivalents	7,071,029	3,685,916	4,516,021	5,347,013
Total assets	15,331,380	13,510,098	13,476,713	13,442,952
Interest-bearing borrowings	95,500	209,545	184,383	250,116
Accounts and bills payable	2,860,065	1,947,466	1,996,561	1,833,419
Other current liabilities	2,792,725	4,059,891	4,442,981	4,976,407
Total liabilities	5,748,290	6,216,902	6,623,925	7,059,942
Equity attributable to equity holders of the Company	9,481,309	6,772,775	6,138,601	5,380,526
Minority interests	101,781	520,421	714,187	1,002,484
Total equity	9,583,090	7,293,196	6,852,788	6,383,010
Total liabilities and equity	15,331,380	13,510,098	13,476,713	13,442,952



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