China Netcom Group CORP (Hong Kong) LTD
Form 20-F
June 12, 2006

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 20-F

(Mark One)

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

OR

|X| ANNUAL REPORT PURSUANT TO SECTION 13 OR 15 (d) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE FISCAL YEAR ENDED DECEMBER 31, 2005

OR

[ ] TRANSITION REPORT PURSUANT TO SECTION 13 OR 15 (d) OF THE SECURITIES EXCHANGE ACT OF 1934

FOR THE TRANSITION PERIOD FROM TO ---------- ----------

OR

[ ] SHELL COMPANY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

Date of event requiring this shell company report .....

For the transaction period from _____ to _____

COMMISSION FILE NUMBER 1- 32332

CHINA NETCOM GROUP CORPORATION (HONK KONG) LIMITED
(Exact name of Registrant as specified in its charter)

Hong Kong, The People's Republic of China
(Jurisdiction of incorporation or organization)

Building C, No. 156 Fuxingmennei Avenue
Xicheng District, Beijing, 100031
The People's Republic of China
(Address of principal executive offices)

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

Title of Each Class	Name of Each Exchange On Which Registered
American depositary shares, each representing 20 ordinary shares of par value US$0.04 per share	New York Stock Exchange, Inc.

Ordinary shares of par value
US$0.04 per share.....New York Stock Exchange, Inc.*

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* Not for trading, but only in connection with the registration of American depositary shares.

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

None
(Title of Class)

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

None

(Title of Class)

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

As of December 31, 2005, 6,593,529,000 ordinary shares were issued and outstanding.

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.

Yes X No__

If this report is an annual or transition report, indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934.

Yes __ No X

The Registrant is required to file reports pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934. Note - Checking the box above will not relieve any registrant required to file reports pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 from their obligations under those Sections.

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15 (d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes X No __

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer.

See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer X Accelerated filer __ Non-accelerated filer __

Indicate by check mark which financial statement item the Registrant has elected to follow.

Item 17 ___ Item 18 X

If this is an annual report, indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes __ No X

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FORWARD-LOOKING STATEMENTS

This annual report filed on Form 20-F contains certain forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995 with respect to financial condition, results of operations, cash flows, dividends, financing plans, business strategies, capital and other expenditures, competitive positions, availability of capital, growth opportunities for new and existing products, availability and deployment of new technologies, plans and objectives of management, mergers and acquisitions, and other matters.

Statements in this Form 20-F that are not historical facts are hereby

identified as "forward looking statements" for the purpose of the safe harbor provided by Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. The words "estimate," "project," "intend," "expect," "believe," "plan" and similar expressions are intended to identify forward-looking statements. Readers are cautioned not to place undue reliance on these forward-looking statements, which speak only as of the date of this document. In addition, other written or oral statements which constitute forward looking statements have been made and may in the future be made by us or on our behalf, including with respect to the matters referred to above. These forward looking statements are necessarily estimates reflecting the best judgment of senior management that rely on a number of assumptions concerning future events, many of which are outside of our control, and involve a number of risks and uncertainties that could cause actual results to differ materially from those suggested by the forward-looking statements. These forward-looking statements should, therefore, be considered in light of various important factors, including those set forth in this annual report. Important factors that could cause actual results to differ materially from estimates or projections contained in the forward-looking statements include, without limitation:

- the level of demand for telecommunications services, particularly with regard to access lines, traffic and new value-added services;
- competitive forces in more liberalized markets, including pricing pressures and our ability to retain market share in the face of competition from existing telecommunications companies and potential new market entrants;
- the effects of tariff reduction initiatives, particularly in our core fixed-line telephone business;
- changes in the regulatory policies of the Ministry of Information Industry of China and other relevant government authorities, which could affect, among other things, the granting of requisite government approvals, licenses and permits, interconnection and transmission line arrangements, tariff policies, capital investment priorities, and spectrum allocation;
- the success of new business initiatives, some of which involve start-up costs, and new systems and applications, particularly with regard to the integration of our service offerings;
- our ability to secure or renew the licenses we need to offer telecommunications services and the cost of these licenses and related network infrastructure build-outs;
- the success of our Asia-Pacific investments;
- the availability, terms and deployment of capital, and the impact of regulatory and competitive developments on capital outlays;
- changes in the assumptions upon which we have prepared our projected financial information and capital expenditure plans;
- changes in the general political, economic, legal and social conditions in China, including the PRC government's specific policies with respect to new entrants in the telecommunications industry, the entry of foreign operators into China's telecommunications market, economic growth,

foreign exchange and the availability of credit; and

- risks and uncertainties associated with doing business in many countries in the Asia-Pacific region.

CONVENTIONS

Definitions

References in this annual report to "we", "us", the "Company" or "CNC Hong Kong" mean China Netcom Group Corporation (Hong Kong) Limited and, as the context may require, its subsidiaries. References to "China Netcom Group" mean China Network Communications Group Corporation and, as the context may require, its subsidiaries, other than us and our subsidiaries.

As used in this annual report:

- references to "China" or "PRC" mean the People's Republic of China, excluding, for purposes of this annual report, Hong Kong, Macau and Taiwan, and references to the "central government" mean the central government of the PRC;
- references to "State Council" mean the State Council of the PRC, references to "Ministry of Information Industry" and "MII" mean the Ministry of Information Industry of the PRC, and references to the "National Development and Reform Commission" and the "NDRC" mean the National Development and Reform Commission of the PRC;
- references to "our northern service region" mean the ten municipalities and provinces where we operate in northern China, consisting of Beijing and Tianjin Municipalities, and Hebei, Henan, Shandong, Liaoning, Heilongjiang, Jilin, and Shanxi Provinces, and the Inner Mongolia Autonomous Region and references to "our southern service region" mean Shanghai Municipality and Guangdong Province;
- references to "HKSE", "SEHK" or "Hong Kong Stock Exchange" mean The Stock Exchange of Hong Kong Limited, and references to "NYSE" or "New York Stock Exchange" mean New York Stock Exchange, Inc;
- references to "Renminbi" or "RMB" are to the currency of the PRC, references to "U.S. dollars" or "US$" are to the currency of the United States of America, and references to "HK dollars" or "HK$" are to the currency of the Hong Kong Special Administrative Region of the PRC; and
- references to "U.S. GAAP" mean the generally accepted accounting principles in the United States, references to "HKFRS" mean Hong Kong Financial Reporting Standards issued by Hong Kong Institute of Certified Public Accountants, and references to "PRC GAAP" mean the PRC Accounting Standards for Business Enterprises and the implementing rules thereof.

Market Share Data Convention

Certain statements made in this annual report that refer to our market share or competitive position are based on statistical and other information from a number of government and private sources, including the information

published by the MII. Unless otherwise indicated, the information has not been verified by us independently and may not be consistent with the information from other sources within or outside China.

PART I

ITEM 1. IDENTITY OF DIRECTORS, SENIOR MANAGEMENT AND ADVISORS

Not applicable.

ITEM 2. OFFER STATISTICS AND EXPECTED TIMETABLE

Not applicable.

ITEM 3. KEY INFORMATION

SELECTED FINANCIAL DATA

The following tables present our selected consolidated financial data as of and for the years ended December 31, 2002, 2003, 2004 and 2005.

You should read the selected consolidated financial data below together with our consolidated financial statements, including the notes thereto, included elsewhere in this annual report, and "Item 5. Operating and Financial Review and Prospects".

We publish our financial statements in Renminbi. We have derived the selected consolidated financial data as of and for the years ended December 31, 2002, 2003, 2004 and 2005 from our consolidated financial statements. Our consolidated financial statements have been prepared in accordance with Hong Kong Financial Reporting Standards, or HKFRS, which differ in significant respects from U.S. GAAP.

Our consolidated financial statements report our results as if (1) certain assets and liabilities transferred to us from China Netcom Group in connection with our restructuring in connection with the 2004 global offering had been transferred to us as of January 1, 2001, (2) certain fixed-line telecommunications assets and liabilities transferred to us from China Netcom Group in connection with our acquisition on October 31, 2005, or our 2005 Acquisition, of China Netcom Group's fixed-line telecommunications assets and liabilities in Heilongjiang Province, Jilin Province, the Inner Mongolia Autonomous Region and Shanxi Province, or the 2005 Acquired Assets and Liabilities, had been transferred to us as of January 1, 2002, and (3) in each case we had owned those assets and liabilities and conducted those operations throughout the relevant periods. For more details, see "Item 4. Information on the Company--History and Development".

Since we and the 2005 Acquired Assets and Liabilities were under the common control of China Netcom Group, our 2005 Acquisition has been treated as a "combination of entities under common control", which was accounted for in a manner similar to pooling-of-interests. Accordingly, the 2005 Acquired Assets and Liabilities have been recognized at historical carrying amounts and our consolidated financial statements as of and for the years ended December 31, 2002, 2003 and 2004 have been restated to include the financial position and results of operations of the 2005 Acquired Assets and Liabilities on a combined basis. All data and information relating to our businesses and operations for the years ended December 31, 2002, 2003 and 2004 are presented based on those restated amounts. We have omitted consolidated financial data as of and for the year ended December 31, 2001 because providing such information would require us to incur significant expense and devote extraordinary time to derive.

Furthermore, certain amounts in our consolidated financial statements

for the year ended December 31, 2004 have been restated to reflect the changes in our accounting policies resulting from our adoption of the new and revised HKFRS in 2005. For more details, please refer to Note 3 to our consolidated financial statement included elsewhere in this annual report.

Selected Consolidated Financial Information

	For the Years Ended Decemb		
	2002	2003	2004
	RMB	RMB	RMB
	(in millions, except per share and		
Consolidated Income Statement Data:			
HKFRS			
Revenues:			
Domestic telecommunications services:			
Fixed-line telephone services(1)	61,766	66,376	69,670
Broadband and other Internet-related service	2,682	4,332	6,206
Business and data communications services(2)	4,306	4,373	3,615
Other services	1,349	1,138	1,360
International telecommunications services	572	1,379	2,643
Total	70,675	77,598	83,494
Operating expenses:			
Depreciation and amortization	(24,796)	(26,800)	(25,180)
Network, operations and support	(14,665)	(15,108)	(13,973)
Staff costs	(9,035)	(10,945)	(11,950)
Selling, general and administrative	(7,927)	(10,322)	(12,877)
Other operating expenses	(1,901)	(2,197)	(1,993)
Operating profit before interest income, dividend income and deficit on revaluation of fixed assets	12,351	12,226	17,521
Interest and dividend income	188	140	104
Deficit on revaluation of fixed assets(3)	-	(25,778)	(11,318)
Profit/(Loss) from operations	12,539	(13,412)	6,307
Financial costs	(4,131)	(4,296)	(3,930)
Share of profit/(loss) of associated companies and jointly controlled entity	(1)	(416)	(1)
Profit/(loss) before taxation	8,407	(18,124)	2,376
Taxation	(1,789)	7,217	323
Profit/(loss) after taxation	6,618	(10,907)	2,699
Minority interests	-	1	-
Profit/(loss) for the year/period	6,618	(10,906)	2,699
Basic earnings/(losses) per share(4)	1.21	(1.99)	0.48
Diluted earnings/(losses) per share(4)	1.21	(1.99)	0.48
Basic earnings/(losses) per ADS(5)	24.2	(39.8)	9.6
Diluted earnings/(losses) per share(5)	24.2	(39.8)	9.6
U.S. GAAP			
Profit for the year/period	6,572	6,365	7,932
Basic earnings /(losses) per share(4)	1.20	1.16	1.41
Diluted earnings per share(4)	1.19	1.16	1.41
Basic earnings per ADS(5)	24.00	23.20	28.20
Diluted earnings per ADS(5)	23.80	23.20	28.20
Dividend declared per share	-	-	HKD 0.037
Dividend declared per ADS	-	-	HKD 0.74

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(1) Revenues from fixed-line telephone services included local usage fees, monthly fees, upfront installation fees, domestic and international long

distance service charges, value-added service charges, interconnection fees from domestic carriers and upfront connection fees.

(2) Revenues from business and data communications services include fees charged for managed data and leased line services.

(3) See "Item. 5. Operating and Financial Review and Prospects - Critical Accounting Policies - Revaluation of fixed assets" for a discussion of this revaluation.

(4) Basic/diluted earnings/(losses) per share for the years ended December 31, 2002, 2003, 2004 and 2005 set forth above have been computed by dividing profit/(loss) for each of the year by the weighted average number of ordinary shares during the year.

(5) Basic/diluted earnings/(losses) per ADS for the years ended December 31, 2002, 2003, 2004 and 2005 set forth above have computed by multiplying basic earnings/(losses) per share for the year by 20, which is the number of ordinary shares represented by each ADS.

	As at December 31,			
	2002	2003	2004	200
	RMB	RMB	RMB	RM
	(in millions)			
Consolidated Balance Sheet Date:				
HKFRS				
Cash and bank deposits	7,899	7,430	10,633	4,89
Accounts receivable	5,896	7,518	7,174	7,40
Total current assets	20,780	20,666	24,455	14,49
Fixed assets and construction in progress	212,053	199,687	177,494	175,48
Total assets	245,281	236,081	216,417	202,84
Accounts payable	18,934	20,195	21,125	16,71
Short-term bank loans and current portion of long-term bank and other loans	56,406	67,383	56,609	54,18
Total current liabilities	97,017	118,350	106,044	98,39
Long-term bank and other loans	40,404	30,172	26,052	18,14
Deferred revenues	19,744	17,585	13,988	10,92
Total liabilities	175,510	182,419	151,822	139,83
Owner's equity	69,767	53,659	64,595	63,01
U.S. GAAP				
Fixed assets and construction in progress	212,053	222,483	204,216	197,09
Total assets	245,281	258,877	243,139	224,45
Owner's equity	67,116	66,283	82,664	77,49

	For the Years Ended December 31,			
	2002	2003	2004	2005
	RMB	RMB	RMB	RMB
	(in millions)			

Consolidated Cash Flow Statement Date: HKFRS				
Net cash inflow from operating activities	30,012	30,917	33,653	33,557
Net cash outflow from investing activities	(34,219)	(34,875)	(28,702)	(24,608)
Purchase of fixed assets and construction in progress including "repayment for leased land"	(34,186)	(36,450)	(28,256)	(27,562)
Net cash inflow/(outflow) from financing activities	3,212	3,595	(1,743)	(14,656)

EXCHANGE RATE INFORMATION

We prepare our financial statements in Renminbi. Solely for the convenience of the reader, this annual report contains translations of Renminbi and Hong Kong dollar amounts into U.S. dollars, and vice versa, at RMB 8.0702 = US$1.00 and HK$7.7533 = US$1.00, the noon buying rates on December 30, 2005 in the City of New York for cable transfers as certified for customs purposes by the Federal Reserve Bank of New York. You should not assume that Renminbi and Hong Kong dollar amounts could actually be converted into U.S. dollars at these rates or at all.

On May 31, 2006, the latest practicable date, the noon buying rates in the City of New York for cable transfers as certified for customs purposes by the Federal Reserve Bank of New York are RMB 8.0215 = US$1.00 and HK$7.7567 = US$1.00.

The following table sets forth the high and low noon buying rates between Renminbi and U.S. dollars and between Hong Kong dollars and U.S. dollars for each of the periods shown.

	Noon Buying Rate			
	RMB per US$		HK$ per US$	
	High	Low	High	Low
December 2005	8.0808	8.0702	7.7548	7.7516
January 2006	8.0702	8.0596	7.7570	7.7506
February 2006	8.0616	8.0415	7.7618	7.7564
March 2006	8.0505	8.0167	7.7620	7.7570
April 2006	8.0248	8.0004	7.7598	7.7529
May 2006	8.0300	8.0005	7.7575	7.7510

The following table sets forth the period-end noon buying rates and the average noon buying rates between Renminbi and U.S. dollars and between Hong Kong dollars and U.S. dollars for each of 2001, 2002, 2003, 2004, 2005 and 2006 (through May 31). The average noon buying rates for the periods shown are calculated by averaging the noon buying rates on the last day of each month in the period.

	Period-End Noon Buying Rate		Average(1) Noon Buying Rate	
	RMB per US$	HK$ per US$	RMB per US$	HK$ per US$
2001	8.2766	7.7980	8.2772	7.7996
2002	8.2800	7.7988	8.2772	7.7996
2003	8.2767	7.7640	8.2771	7.7864
2004	8.2765	7.7723	8.2768	7.7899
2005	8.0702	7.7533	8.1826	7.7755
2006 (May 31)	8.0215	7.7567	8.0314	7.7760

(1) Determined by averaging the rates on the last business day of each month during the relevant year, except for the average rate of the relevant periods in 2006, which is determined by averaging the daily rates during the respective periods.

CAPITALIZATION AND INDEBTEDNESS

Not applicable.

REASONS FOR THE OFFER AND USE OF PROCEEDS

Not applicable.

RISK FACTORS

Risks Relating to Our Business

Increasing competition in each of our service regions and markets may have an adverse effect on our business growth and financial condition.

The telecommunications industry in China is rapidly evolving. In recent years, the central government has implemented a number of measures to restructure, and encourage fair and orderly competition in the telecommunications industry. As a result, we face increasing competition from other licensed telecommunications operators in China, including China Telecom Group, or China Telecom; China Mobile Communications Corporation, or China Mobile; China United Telecommunications Corporation, or China Unicom; China Railway Communications Corporation Limited, or China Railcom; and China Satellite Communications Corporation, or China Satcom. We expect our competitors to further expand their network coverage and increase their sales and marketing efforts in our northern and southern service regions. We will also face competition from foreign-invested telecommunications operators as a result of China's accession into the World Trade Organization, or the WTO, and the entry of foreign telecommunications companies into the Chinese market. In addition, we face competition from other telecommunications operators in our Asia-Pacific markets. As we operate in an increasingly competitive market, we have experienced and may continue to experience pressure on operating revenues and operating margins for some of our telecommunications services.

In our northern service region, competition in fixed-line services and in broadband and data services may result in lower tariffs, a smaller customer base and lower usage for our services, thereby adversely affecting our business growth and financial condition.

We compete with other fixed-line service providers, including China Telecom, China Unicom and China Railcom, each of which has been licensed to provide fixed-line telephone services in our northern service region. We have experienced limited competition from other fixed-line service providers to date in the market for local telephone services, primarily because our competitors have not built significant local access infrastructure. However, competition for the provision of these services may increase in the future as our competitors develop their own networks, including through the use of alternative technologies. In the markets for domestic and international long distance telephone services, we face strong competition from voice over Internet protocol, or VoIP services, provided by China Telecom, China Mobile, China Unicom and China Railcom. Tariffs for VoIP services are market-based and therefore not subject to minimum pricing restriction. In addition, we may face increasing competition from Internet phone service providers such as Skype and Vonage if current restrictions on the provision of these services are loosened. Increased competition from these operators may force us to lower our tariffs or may reduce the size of our customer base and the usage of our networks. Any of

these developments may materially adversely affect our business growth and financial condition.

Mobile service substitution for our fixed-line telephone services has also created considerable competition in the markets for local and long distance telephone services. Consistent with trends in global markets in recent years, an increasing proportion of total voice traffic is being carried by mobile networks. Currently, China Mobile and China Unicom are the only licensed providers of mobile communications services in China and, in recent years, some of the traffic from our fixed-line networks has been diverted to the networks of these two companies. In addition, we face pricing pressure from mobile operators, which have recently increasingly lowered tariffs through various discount programs. The usage volume of non-PHS local calls decreased to 172.9 billion pulses in 2005 from 189.0 billion pulses in 2004, at least in part due to migration of our non-PHS local traffic to mobile services.

For managed data services and broadband Internet access services, or broadband services, we primarily compete with China Unicom, China Telecom, China Railcom and other broadband Internet access services providers, such as Beijing Gehua CATV Network Co., Ltd. on the basis of pricing, the coverage and quality of networks, ability to provide end-to-end connectivity, quality of network management and customer service. While other major telecommunications operators in China have been leasing transport facilities from us to serve their customers, some of them, such as China Mobile and China Unicom, have in recent years begun to build their own long distance networks for voice services and fiber-optic networks for data services. Increased competition from these domestic telecommunications providers may result in lower revenues for us due to competitive pricing policies and increased sales and marketing costs to attract or retain subscribers. In our southern service region, if we do not compete effectively against China Telecom and other operators, we may achieve lower returns on our investments than expected and our business growth may be adversely affected.

In our southern service region, we compete primarily against China Telecom in the provision of VoIP services, broadband services and data services. China Telecom has a competitive advantage over us in our southern service region in terms of its larger customer base, broader network coverage and greater brand recognition. China Telecom controls most of the local access network, including the "last mile" access network, in our southern service region. Despite our efforts to build a local access network over the past five years, China Telecom is still the dominant service provider in our southern service region. As a result, we may not be able to compete effectively against China Telecom and realize acceptable returns on our investments and our business growth prospects may be adversely affected. In addition to China Telecom, we are faced with increased competition from other operators in our southern service region.

In the Asia-Pacific markets, continuing pricing pressure or our inability to meet the requirements of our business customers may reduce our revenues and net income derived from these markets.

The telecommunications services market for business and carrier customers in the Asia-Pacific region is highly competitive, and our success in the region will depend on our ability to compete against a variety of other telecommunications operators, including regional as well as global telecommunications operators. Some of our competitors may have competitive advantages over us, including greater name recognition in a particular market, greater resources, larger customer bases and better relationships with our current and potential customers.

Due to substantial excess transport capacity in the Asia-Pacific carrier market, we face intense competition from other providers of telecommunications services in the Asia-Pacific region, including C2C Pte. Ltd.

and the FLAG Telecom Group Limited. As a result of strong competition, prices of data and bandwidth products and services in our target markets have experienced continual declines in recent years. Competition also exists in the business customer segment, in which we face strong competition from international providers such as AT&T Corp. and local incumbent providers such as Singapore Telecommunications Limited, Japan's Nippon Telegraph & Telephone Corporation, or NTT, and KT Corp. The incumbent providers in particular tend to have better control of local networks. Any continued decrease in price or our inability to meet the requirements of business customers may have a material adverse impact on our revenues and net income derived from our international telecommunications services.

Competition from foreign-invested operators and other new entrants may further increase the competition for employees, exacerbate price competition and increase our operating expenses, thereby adversely affecting our financial condition and growth prospects.

As a result of China's accession to the WTO in December 2001, and the adoption of the Regulations on the Administration of Foreign-Invested Telecommunications Enterprises in January 2002, which implement China's commitments to the WTO, the PRC government has agreed to gradually liberalize the various segments and regions of the telecommunications market in China to foreign investors. Both the percentage of ownership of Sino-foreign joint ventures offering telecommunications services in China and the regions where those joint ventures are permitted to offer telecommunications services will be increased over several years. For example, foreign operators are permitted, subject to various ownership and licensing restrictions, to establish joint venture enterprises in the municipalities of Beijing and Shanghai and the city of Guangzhou to provide domestic and international voice, packet-switched and circuit-switched data transmission and other services. Foreign-invested operators entering China's telecommunications market as a result of this liberalization may have greater financial, managerial and technical resources and more expertise in network management and sales and marketing than we do.

Increased competition from these and other new entrants into the Chinese telecommunications market may further increase the competition for skilled and experienced employees, exacerbate price competition and increase our customer acquisition costs and other operating expenses, and thereby adversely affect our financial condition and growth prospects.

Competition from alternative technologies to our PHS business and an introduction of TD-SCDMA technology may cause our PHS services to be less competitive, and adversely affect our growth prospects and revenues.

We currently provide personal handyphone system, or PHS, services in most cities in our northern service region to reduce the impact of mobile substitution on our fixed-line operations. PHS is a telecommunications technology that allows us to offer to our customers wireless local access services with mobility within an area with the same area code. Our ability to realize acceptable returns from our investment in PHS technology will depend on continued customer adoption of this technology. However, this market may not continue to develop, since potential customers are and will be able to choose from a variety of alternative fixed-line and wireless communication technologies, including both existing technologies and new technologies to be offered in the future, such as third generation, or 3G mobile telephone services. For instance, if China Mobile or China Unicom reduces the tariffs for mobile telecommunications services, our existing and potential PHS customers may choose to use these services instead of our PHS services to take advantage of the less geographically restricted service scope and other features of mobile technology. In addition, more mobile licenses may be issued in the near future, which will increase the level of competition in the provision of mobile telephone services, which will in turn increase pricing pressure and adversely

affect the growth prospects of our PHS services. Furthermore, if we introduce 3G mobile telephone services, traffic on our PHS services may migrate to our 3G services, thereby materially and adversely affect the growth prospects of our PHS services.

Furthermore, part of the radio spectrum currently used by our PHS services may be reallocated by the PRC government to time division synchronization code division multiple access technology, or TD-SCDMA technology, which is one of the three technologies adopted by the International Telecommunications Union and is under review by the PRC government for use in providing 3G mobile telephone services. The PRC government is currently conducting tests on TD-SCDMA related products. The PRC government has not officially announced its decisions on issues such as the timing of the grant of the 3G licenses, the number of 3G licenses to be granted, any technical requirements, or any selection of preferred technologies. If TD-SCDMA technology is introduced, our ability to use the existing PHS spectrum may be restricted, thereby limiting the volume of usage we can handle and adversely affecting our revenues.

Any of the risks described above may cause our PHS services to become less competitive and thereby materially and adversely affect our growth prospects and revenues.

Because we rely on certain arrangements with other telecommunications operators, changes to the terms or availability of these arrangements may result in disruptions to our services and operations.

Our ability to provide telecommunications services depends upon certain arrangements with other telecommunications operators. In particular, interconnection is necessary to complete all calls between our subscribers and subscribers of other telecommunications operators. We, either through ourselves or through China Netcom Group, have entered into interconnection and transmission line leasing agreements with other fixed-line operators, including our parent company, China Netcom Group, mobile telephone operators and other telecommunications providers, as required to conduct our current business. Any disruption to our interconnection with the networks of those operators or other international telecommunications carriers with which we interconnect due to technical or competitive reasons may affect our operations, service quality and customer satisfaction, thus adversely affecting our business. Furthermore, we are generally not entitled to collect indirect or consequential damages resulting from disruptions in the networks to which we are interconnected. Our failure to renew our existing interconnection and leased line agreements on commercially acceptable terms may result in disruptions to our services. In addition, in our southern service region, we may need to lease local access network facilities from other operators in order to provide services to our customers. If we are unable to enter into arrangements with such operators in a timely manner or on acceptable terms, it may result in a delay in providing services to our customers and disrupt our operations, as we may need to seek alternative arrangements with other operators, which may adversely affect our financial condition and our results of operations.

Disruptions to our network or operating systems, or to those with which we interconnect, may result in customer dissatisfaction and reduced revenues from operations.

Our network infrastructure and the networks with which we interconnect are vulnerable to potential damage or interruption from floods, wind, storms, fires, power loss, severed cables, acts of terrorism and similar events. In particular, commercial fishing and other maritime activities may damage our Asia-Pacific submarine cables. Our networks and systems and the networks with which we interconnect also require regular maintenance and upgrades that may cause service disruptions. The occurrence of a natural disaster or other

unanticipated problems at our facilities or any other failure of our networks or systems, or the networks to which we are interconnected, may result in consequential interruptions in services across our telecommunications infrastructure. Network or system failures, as well as high traffic volumes, may also affect the quality of our services and cause temporary service interruptions. Although we have not experienced material disruptions or damage to our network and operating systems in the past, any such future occurrence may result in customer dissatisfaction and reduced revenues from operations.

Failure to successfully respond to technological and industry developments may hinder our revenue growth and adversely affect our competitive position.

The telecommunications sector has recently experienced rapid increases in the diversity and sophistication of the technologies and services offered. As a result, we expect that we will need to constantly upgrade our telecommunications technologies and services in order to respond to competitive industry conditions and customer requirements. For example, the next generation network has the capability of providing new value-added services and content that combine voice, data and images with increased efficiency and flexibility. Next generation networks may replace the traditional public switched telephone networks in the future. We have not experienced significant difficulties in upgrading new technologies and equipment in the past, but if we fail to smoothly upgrade or achieve a balanced transition of our existing network to the next generation network, we may lose our customers and market share, which may adversely affect our operations and financial condition. Furthermore, if the new technologies adopted by us do not perform as expected, or if we are unable to effectively deliver new services based on these technologies in a commercially viable manner, our revenue growth may decline and our competitive position may be adversely affected.

If we fail to successfully implement our business strategies, we may not achieve acceptable investment returns or manage growth in certain services and markets, and our financial condition may be adversely affected.

We may not be able to successfully implement all of our business strategies. For example, we have made substantial investments in developing our broadband network infrastructure and technology. However, the broadband market in China may not continue to expand at recent rates of growth, and we may not be able to attract enough customers and generate sufficient usage to achieve an acceptable return on our significant broadband investment. In addition, we may not be able to successfully expand our business and achieve profitable growth in our southern service region and the Asia-Pacific region or be able to successfully manage the growth in our business. Failure to successfully implement our business strategies may adversely affect our financial condition.

Our internal controls and management systems are not currently consistent with international practices in certain respects and we are in the process of improving these controls and systems to enable us to certify the effectiveness of our internal controls under the Sarbanes-Oxley Act of 2002. Our failure to timely and successfully upgrade these controls and systems could subject us to regulatory actions and harm the price of our stock.

Our primary operating subsidiary was established in the PRC, and as such our internal control and management systems were designed to meet the standards generally adopted by companies in China. These standards are different from the standards and best practices adopted by companies listed in the United States. We have identified areas in which our current internal control and management systems do not meet international standards and practices. In addition, during their recent audit, our external auditors brought to our attention a number of areas in which there are more than a remote likelihood that our current internal controls and management systems do not reduce to a relatively low level of the risk of undetected errors or fraud that are more

than inconsequential and could adversely affect our ability to accurately and timely record, process, summarize and report financial data. Pursuant to the Sarbanes-Oxley Act of 2002 and the various rules and regulations adopted pursuant thereto or in conjunction therewith, we will be required, for fiscal year 2006, to perform an evaluation of our internal controls over financial reporting and file an assessment of its effectiveness with the U.S. Securities and Exchange Commission, or the SEC. Unless we successfully upgrade our controls and systems, we will not be able to satisfactorily comply with our obligations under the Sarbanes-Oxley Act of 2002. If we fail to successfully complete the improvements we have scheduled on a timely basis or if the activities fail to raise our internal controls and management systems to the levels required by international standards or legal requirements or if we fail to implement required new or improved controls, then we may fail to meet our reporting obligations and our auditors may be unable to certify the management's assertion of the effectiveness of our internal controls as required under the Sarbanes-Oxley Act of 2002. This could subject us to regulatory scrutiny and result in a loss of public confidence in our management, which could, among other things, adversely affect our stock price.

We rely substantially on short-term borrowings and our inability to obtain sufficient funding may adversely affect our liquidity and financial condition.

Similar to many enterprises in China, a significant percentage of our funding requirements is satisfied through short-term borrowings. This has resulted in a significant increase in our net current liabilities. As of December 31, 2004 and 2005, our short-term bank loans and the current portion of our long-term bank and other loans were RMB 56,609 million and RMB 56,147 million, respectively, representing 68.5% and 68.4% of the sum of total long-term and short-term bank loans and other borrowings as of the respective dates. Although, in our experience, a substantial portion of our short-term borrowings is rolled over upon maturity and these borrowings have been, in the past, a stable source of funding, no assurances can be given that this will continue to be the case. If our lenders do not roll over our short-term borrowings, or if we are unable to secure sufficient borrowings, our liquidity position would be adversely affected, and we may be required to seek more expensive sources of short-term or long-term funding to finance our operations. In addition, implementing our strategies may require substantial capital expenditures. To the extent these expenditures exceed our cash resources, we will be required to seek additional debt or equity financing. If we are unable to obtain sufficient funding for our operations or development plans on commercially acceptable terms, or at all, our liquidity and financial condition may be adversely affected.

Our ultimate controlling shareholder, China Netcom Group, may cause us to enter into transactions or take (or fail to take) other actions or make decisions that conflict with the best interests of our other shareholders.

As of May 31, 2006, China Netcom Group beneficially owned approximately 70.39% of our outstanding shares. As a result, China Netcom Group, subject to our articles of association and applicable laws and regulations, will effectively be able to control our management, policies and business by controlling the composition of our board of directors, determining the timing and amount of our dividend payments, approving significant corporate transactions, including mergers and acquisitions, and approving our annual budgets. Therefore, China Netcom Group may cause us to enter into transactions or take (or fail to take) other actions or make decisions that conflict with the best interests of our other shareholders.

We rely on China Netcom Group to provide certain services and facilities for which we currently have limited alternative sources of supply. Changes in the availability, pricing or quality of these services or facilities may have a material adverse effect on our business and profitability.

Pursuant to various agreements and arrangements, China Netcom Group provides us with services and facilities necessary for our business activities, including but not limited to, the use of fiber-optic networks in our northern and southern service regions, submarine cables in the Asia-Pacific region, international gateways, leases for properties located in our northern and southern service regions and the Asia-Pacific region.

The interests of China Netcom Group as provider of these services and facilities may conflict with our interests. We currently have limited alternative sources of supply for these services and facilities and, as a result, may have limited ability to negotiate with China Netcom Group regarding the terms for providing these services and facilities. Changes in the availability, pricing or quality of these services or facilities may have a material adverse effect on our business and profitability.

Failure by China Netcom Group to fulfill its obligations under certain existing arrangements may have a material adverse effect on our business operations, growth prospects and profitability.

China Netcom Group has committed to certain arrangements to support our existing operations and future development, including through a letter of undertakings, a non-competition agreement and a restructuring agreement. In the letter of undertakings, China Netcom Group agreed to, among other things, extend its full support to our current operations and future developments. China Netcom Group has also entered into a non-competition agreement whereby China Netcom Group has agreed not to compete with us in our service regions and our international markets without our consent. In addition, under a restructuring agreement, China Netcom Group agreed to indemnify CNC China and us for losses arising from certain matters. Failure by China Netcom Group to fulfill its obligations under any of these arrangements may have a material adverse effect on our business operations, growth prospects and profitability.

The PRC National Audit Office and other governmental or third parties may audit or investigate our ultimate controlling shareholder and us from time to time. The outcome of these governmental or third party investigations may adversely affect our corporate image, the reputation and credibility of our management, our business and financial condition and the prices of our shares and ADSs.

PRC's National Audit Office, or the NAO, from time to time performs audits on state-owned companies, such as China Netcom Group, our ultimate controlling shareholder. If, as a result of an NAO audit, material irregularities are found within China Netcom Group or China Netcom Group becomes the target of any negative publicity, there would be a material adverse effect on our corporate image, the reputation and credibility of our management, our business and financial condition and the prices of our shares and ADSs. In addition, we may be the subject of other governmental or third party investigations or similar events that, depending on their outcome, could have a material adverse effect on our business and financial condition and the prices of our shares and ADSs.

Risks Relating to the PRC Telecommunications Industry

Extensive government regulation of the telecommunications industry in China may restrict our ability to respond to market conditions or competition, and may have a material adverse effect on our operations, business and financial condition.

As a telecommunications operator in China, we are subject to extensive regulation by and under the supervision of the MII, which is the primary telecommunications industry regulator in China. The MII is responsible for formulating policies and regulations for the telecommunications industry,

granting telecommunications licenses, allocating frequency spectrum and numbers, formulating interconnection and settlement arrangements between telecommunications operators, and enforcing industry regulations. Other PRC governmental authorities also regulate tariff policies, capital investment and foreign investment in the telecommunications industry. See "Item 4. Information on the Company -- Regulation". The regulatory framework within which we operate may constrain our ability to implement our business strategies and limit our ability to respond to market conditions or to changes in our cost structure. Moreover, we operate our businesses pursuant to approvals granted by the State Council and under licenses granted by the MII. If these approvals or licenses were revoked or suspended, our business and operations would be materially and adversely affected. In addition, we are subject to various regulatory requirements as to service quality, pricing and other actions, and failure to comply with such requirements may subject us to mandatory penalties or other punitive measures, any of which could have a material adverse effect on our operations and financial condition.

In addition, some of our competitors, such as China Unicom and China Railcom, enjoy preferential treatment from the PRC government with respect to tariff setting. These companies are currently permitted to set their respective tariffs for certain services, such as long distance calls over the public switched telephone network, or the traditional network, at price levels above or below the government fixed tariffs on a long-term basis, subject to filings with, and approvals from, the relevant regulatory authorities. This preferential treatment is not available to us. Our competitors who enjoy this preferential treatment may be able to provide certain services at prices that are more competitive than our prices, and our business and financial condition may be adversely affected as a result.

Future changes to the regulations and policies governing the telecommunications industry in China, including possible future industry restructurings, may have a material adverse effect on our businesses.

Possible future changes to regulations and policies governing the telecommunications industry in China may have a material adverse effect on our businesses and operations. As part of the comprehensive plan to restructure the telecommunications industry in China, as approved by the State Council in 2001, the central government stated its intention to further adjust and improve its regulatory oversight of the telecommunications industry, including gradual further deregulation of telecommunications tariffs.

The Ministry of Information Industry, or the MII, under the direction of the State Council, is currently preparing a telecommunications law to provide a uniform regulatory framework for the telecommunications industry. If and when the telecommunications law is adopted by the National People's Congress, it will provide a new framework for telecommunications regulations in China. The proposed nature and scope of the telecommunications law have not yet been announced by the PRC government. The telecommunications law and other new telecommunications regulations or rules, or future changes thereto, such as enforcement of existing regulations and policies, may materially and adversely affect our business and financial condition.

Issues may also arise regarding the interpretation and enforcement of China's WTO commitments regarding telecommunications services, which may affect telecommunications regulations and the telecommunications industry in China. Any future regulatory changes, such as those relating to the issuance of additional telecommunications licenses, tariff setting, interconnection and settlement arrangements, changes in technical and service standards, universal service obligations and spectrum and number allocations, may have a material adverse effect on our business and operations.

The PRC government may issue additional mobile telecommunications

licenses in the future. The timing of issuance and terms of these licenses, if any, have not yet been announced. We cannot assure you that we will be able to obtain a mobile license. In addition, if we do obtain a mobile license, we may not be able to effectively establish mobile operations or that our mobile operations will generate satisfactory returns for our shareholders. The issuance of additional licenses would also increase the competition we face.

The PRC telecommunications industry has been extensively restructured in recent years and may be subject to further restructuring. Such further industry restructuring may materially affect the operations of all telecommunications operators in China, including us. Accordingly, we cannot predict the scope and effect of any further restructuring on our operations.

New regulations, regulatory changes or changes in enforcement policies relating to telecommunications tariffs may adversely affect our competitiveness, business and profitability.

Tariffs are the prices we charge our customers for our telecommunications services. We are subject to extensive government regulations on tariffs, especially those relating to our basic telecommunications services, such as local and long distance fixed-line telephone services, managed data services, leased line services and interconnection agreements. The relevant provincial telecommunications administrations and provincial price bureaus currently determine the monthly fees and usage fees for our fixed-line local telephone services based on a fixed tariff set by the MII in consultation with the National Development and Reform Commission, or NDRC. The MII and the NDRC jointly set tariffs for all long distance services using the traditional network, leased lines and data services. We derive a substantial portion of our revenues from services that are subject to tariffs determined by the PRC government. In the past, our revenues have been adversely affected by reductions in tariffs mandated by the PRC government.

In 2002, the MII indicated in writing that it did not intend to initiate any adjustment to tariffs for local fixed-line telephone services during the three to five years commencing in September 2002. However, we cannot predict with accuracy the timing, likelihood or magnitude of tariff adjustments or the extent or potential impact on our business of future tariff adjustments. If the government substantially lowers the tariffs for local fixed-line telephone services, our business and profitability may be adversely affected.

In addition, the tariffs for some of our services in certain locations have been set at levels above or below the levels mandated by the government. The MII may order us to adjust these tariffs and may impose fines on us for repeated failures to comply with the mandated tariff levels for these services, or even suspend our business where the situation becomes serious, as determined at the discretion of the MII. According to a regulatory circular issued by the MII, the MII reaffirmed its intention to strictly enforce these minimum tariff levels. In addition, such enforcement may be undertaken in a selective manner. The enforcement of such tariff levels and the imposition of fines or other penalties, whether done on a selective or industry-wide basis, may materially and adversely affect our competitiveness and, consequently, our business and profitability.

The PRC government may require major operators, including us, to provide universal services with specified obligations, and we may not be compensated adequately for providing such services.

Under the Telecommunications Regulations, as promulgated by the State Council on September 25, 2000, telecommunications operators in China are required to fulfill universal service obligations in accordance with relevant regulations to be promulgated by the PRC government, and the MII has the

authority to delineate the scope of universal service obligations. The MII, together with governmental finance and pricing authorities, is also responsible for formulating administrative rules relating to the establishment of a universal service fund and compensation schemes for universal services. These rules have not yet been promulgated, and there are currently no specific regulatory requirements relating to the provision of universal services in China.

While the scope of specific universal services obligations is not yet clear, we believe that such services may include mandatory provision of basic telecommunications services in less economically developed areas in China. We may not be adequately compensated by the government or be able to realize an adequate return on investments for expanding networks to, and providing telecommunications services in, those less economically developed areas due to potentially higher capital expenditure requirements, lower usage by customers and lack of flexibility in setting our tariffs.

The MII requires China Telecom, China Netcom Group, China Mobile, China Unicom, China Railcom and China Satcom to participate in a project to provide telephone services in a number of remote villages in China as transitional measures prior to the formalization of a universal service obligation framework. In order to fulfill such obligations under these transitional measures, China Netcom Group has agreed with us that it will assume the responsibility for investing in and constructing the necessary network facilities. If we operate and maintain such network facilities in our northern and southern service regions, China Netcom Group has agreed to compensate us for the related expenses based on their fair market value. However, China Netcom Group may fail to fulfill its obligations under this project, and we may not be adequately compensated by China Netcom Group for the cost and expenses resulting from our operation and maintenance of any such network. Either of these events may adversely affect our financial condition.

We face regulatory uncertainties associated with our Asia-Pacific operations that may disrupt our operations.

Our Asia-Pacific telecommunications operations are subject to extensive government regulation, which may limit our flexibility to respond to market conditions, competition, new technologies or changes in our cost structure. In most countries and regions, we are required to obtain one or more telecommunications authorizations for our telecommunications networks and services and are subject to a variety of regulatory obligations. In most of the countries in which we have or plan to have operations, the telecommunications regulations are still evolving. In some countries and regions, the range of services that we are legally permitted to provide is limited. In other countries and regions, telecommunications legislation may be applied in an unequal or discriminatory fashion. Any changes in law, regulations or government and regulatory policies could have a material adverse effect on our business and results of operations. In particular, decisions or actions by regulators concerning economic or business interests or goals that are inconsistent with our interests may have a material adverse effect on our financial condition and results of operations. Failure to meet these regulatory requirements may result in fines or other sanctions, including revocation of our licenses. We may also be required to obtain new licenses to expand into new areas of business. We may fail to obtain these licenses and our existing licenses may not be renewed. Any of these events may disrupt our operations in the Asia-Pacific region.

Risks Relating to China and Asia

Our operations may be adversely affected by China's economic, political and social conditions.

Most of our assets are located in China and most of our revenues are

derived from our operations in China. Accordingly, our results of operations and prospects are subject, to a significant extent, to economic, political and social developments in China. In particular, our operating results may be adversely affected by:

- changes in China's political, economic and social conditions;
- changes in policies of the government or changes in laws and regulations, or the interpretation of laws and regulations;
- changes in foreign exchange regulations;
- measures that may be introduced to control inflation, such as interest rate increases; and
- changes in the rate or method of taxation.

The Chinese economy has historically been a planned economy. The majority of productive assets in China is still owned by various levels of the PRC government. In recent years the government has implemented economic reform measures emphasizing decentralization, utilization of market forces in the development of the economy and a high level of management autonomy. Such economic reform measures may be inconsistent or ineffectual, and we may not benefit from all such reforms. Furthermore, these measures may be adjusted or modified, possibly resulting in such economic liberalization measures being applied inconsistently from industry to industry, or across different regions of the country.

In the past twenty years, China has been one of the world's fastest growing economies in gross domestic product, or GDP. We cannot assure you that such growth will be sustained in the future. Moreover, a slowdown in the economies of the United States, the European Union and certain Asian countries may adversely affect economic growth in China. Our financial condition and results of operations, as well as our future prospects, would be materially and adversely affected by an economic downturn in China.

Economic growth in China has also historically been accompanied by periods of high inflation. The government has implemented various policies from time to time to control the rate of economic growth, limit inflation and otherwise regulate economic expansion. Some of these measures benefit the overall economy of China, but may also have a negative effect on us. For example, our operating results and financial condition may be adversely affected by government control over capital investments or by changes in the tax regulations applicable to us.

Political and economic conditions in the Asia-Pacific region are unpredictable and our operations may be disrupted if these conditions become unfavorable to our business.

A key element of our international business strategy involves the expansion of our operations in the Asia-Pacific region. Substantially all of our business activities outside China are concentrated in the Asia-Pacific region. Changes in political or economic conditions in the region are difficult to predict and may adversely affect our operations or cause this region to become less attractive to businesses, which may reduce our revenues. For example, the recession that many Asia-Pacific countries and regions experienced in 1998 and early 1999 was characterized by currency fluctuations, liquidity shortages and an overall economic decline. Declining economic growth rates in the future may reduce our revenues and cause us to lower our expenditures on our network infrastructure and operations, which may negatively impact our business and our profitability over time.

Our Asia-Pacific operations also expose us to additional risks inherent in international operations, including:

- difficulties in enforcing agreements and collecting receivables through some Asian legal systems;
- fluctuations in foreign currency exchange rates, which may adversely affect our results of operations and the value of our Asian assets and investments;
- implementation of foreign exchange controls or other restrictions; and
- difficulties in obtaining licenses or interconnection arrangements on acceptable terms, or at all.

Any of the above risks may adversely affect our financial condition and results of operations.

Further, some of the countries in the Asia-Pacific region in which we operate and have investments have experienced or continue to experience political instability. The continuation or re-emergence of such political instability may have a material adverse effect on economic or social conditions in those countries and may result in outbreaks of civil unrest in the affected areas, any of which may have a material adverse effect on our financial condition and results of operations or on the ownership, control and condition of our assets in those areas.

The PRC legal system has inherent uncertainties that may limit the legal protections available to you as an investor or to us in the event of any claims or disputes with third parties.

The Chinese legal system is based on written statutes. Prior court decisions may be cited for reference but have limited precedential value. Since 1979, the central government has promulgated laws and regulations dealing with economic matters such as foreign investment, corporate organization and governance, commerce, taxation and trade. In particular, legislation over the past twenty-six years has significantly enhanced the protections afforded to various forms of foreign investment in China. CNC China, our primary operating subsidiary, was incorporated in China as a "wholly foreign-owned enterprise". Although we are the sole shareholder of, and therefore have full control over, CNC China, the exercise of our shareholder rights in CNC China are subject to its articles of association and PRC laws applicable to foreign investment enterprises in China, which may be different from the laws of the United States. For example, unlike in the United States, under PRC laws, shareholders do not have the right to sue the directors or officers for misconduct on our behalf if we fail to commence such a lawsuit ourselves. As Chinese foreign investment laws and regulations are relatively new and the Chinese legal system is still evolving, the interpretations of many laws, regulations and rules are not always uniform and enforcement of these laws, regulations and rules involve uncertainties, which may limit the remedies available to you as an investor and to us in the event of any claims or disputes with third parties. In addition, any litigation in China may be protracted and result in substantial costs and diversion of resources and management attention.

Since we are a Hong Kong company, you will not have certain investor rights as our shareholder, such as the right to bring legal action against other shareholders on behalf of the company.

We were incorporated in Hong Kong. Under the Company Ordinance of Hong Kong, any of our shareholders, including our controlling shareholder China Netcom Group Corporation (BVI) Limited, or CNC BVI, do not have the right to

bring legal action against any other shareholder on our behalf to enforce any claim against such party or parties if we fail to enforce such claim ourselves.

You may experience difficulties in effecting service of legal process and enforcing judgments against us and our management.

Most of our current operations are conducted in China and most of our assets are located in China. In addition, most of our directors and executive officers reside within China, and substantially all of the assets of these persons are located within China. As a result, it may not be possible to effect service of process within the United States or elsewhere outside China upon these directors or executive officers, including with respect to matters arising under U.S. federal securities laws or applicable state securities laws. Moreover, our PRC counsel, Haiwen & Partners, has advised us that China does not have treaties with the United States or many other countries providing for the reciprocal recognition and enforcement of court judgments. Our Hong Kong counsel, Linklaters, has also advised us that Hong Kong has no arrangement for the reciprocal enforcement of judgments with the United States. As a result, recognition and enforcement in China of judgments of a court of the United States or any other jurisdiction, including judgments against us or our directors, executive officers, underwriters or experts, may be difficult or impossible.

Government control of currency conversion may adversely affect our operations and financial results.

We receive substantially all of our revenues in Renminbi, which is not a freely convertible currency. A portion of such revenues will need to be converted into other currencies to meet our foreign currency obligations. Our foreign currency requirements primarily include:

- debt service on foreign currency-denominated debt;
- purchases of imported equipment; and
- payment of any dividends declared in respect of our shares.

Our primary operating subsidiary will be permitted to undertake current account foreign exchange transactions by producing commercial documents evidencing such transactions, provided that they are processed through certain banks in China. However, foreign exchange transactions under the capital account, including principal payments with respect to foreign currency-denominated obligations, will be subject to limitations of the State Administration of Foreign Exchange. These limitations may affect our ability to obtain foreign exchange through debt or equity financing, or to obtain foreign exchange for capital expenditures.

In the future, we expect to derive an increasing proportion of our revenues from our Asia-Pacific operations. The governments of some of the Asian countries in which we operate have in the past imposed various forms of foreign exchange controls. We cannot assure you that foreign exchange controls will not be imposed again in the future. If imposed, these restrictions may adversely affect our ability to meet our foreign currency obligations.

Fluctuations in exchange rates may adversely affect our financial condition and results of operations and the prices of our shares and ADSs or any dividends payable on our shares and ADSs in foreign currency terms.

We conduct our business primarily in Renminbi, which is also our functional and reporting currency. The Renminbi is not a fully convertible currency. From 1994 to July 20, 2005, the official exchange rate for the conversion of Renminbi to U.S. dollars was generally stable. On July 21, 2005,

the PRC government introduced a managed floating exchange rate system to allow the value of the Renminbi to fluctuate within a regulated band based on market supply and demand and by reference to a basket of currencies. On the same day, the value of the Renminbi appreciated by 2% against the U.S. dollar. The PRC government has since made and in the future may make further adjustments to the exchange rate system. Substantially all of our revenues are denominated in Renminbi, while a portion of our capital expenditures are denominated in foreign currencies, such as U.S. dollars and Hong Kong dollars. Future movements in the exchange rate of Renminbi and other currencies may have an adverse effect on our financial condition and results of operations, particularly our international long distance services and Asia-Pacific telecommunications services. In addition, any revaluation of the Renminbi may adversely affect the prices of our shares and ADSs or any dividends payable on our shares and ADSs in foreign currency terms.

Our corporate structure may restrict our ability to receive dividends from, and transfer funds to, our Chinese operating subsidiary, which may restrict our ability to act in response to changing market conditions.

Substantially all of our operations are conducted through our Chinese operating subsidiary, China Netcom (Group) Company Limited, or CNC China. The ability of our Chinese subsidiary to make dividend and other payments to us may be restricted by factors that include changes in applicable foreign exchange and other laws and regulations. As a wholly foreign-owned enterprise in China, CNC China is required to provide for a reserve fund and a staff and workers' bonus and welfare fund, each of which is appropriated from net profit after taxation but before dividend distribution according to the prevailing accounting rules and regulations in the PRC. CNC China is required to allocate at least 10% of its net profit to the reserve fund until the balance of this fund has reached 50% of its registered capital. In addition, the profit available for distribution from our Chinese subsidiary is determined in accordance with generally accepted accounting principles in China. This calculation may differ from one performed in accordance with either HKFRS or U.S. GAAP. As a result, we may not receive sufficient distributions from our Chinese subsidiary to enable us to make dividend distributions to our shareholders in the future, even if our HKFRS or U.S. GAAP financial statements indicate that our operations have been profitable.

Distributions by our Chinese subsidiary to us other than as dividends may be subject to governmental approval and taxation. Any transfer of funds from our company to our Chinese subsidiary, either as a shareholder loan or as an increase in registered capital, is subject to registration or approval with or by Chinese governmental authorities, including the relevant administration of foreign exchange and/or other relevant examining and approval authorities. These limitations on the free flow of funds between us and our Chinese subsidiary may restrict our ability to act in response to changing market conditions.

Risk relating to our ADSs

Holders of our ADSs will not have the same voting rights as the holders of our shares and may not receive voting materials in time to be able to exercise their right to vote.

Except as described in this document and in the deposit agreement, holders of our ADSs will not be able to exercise voting rights attaching to the shares evidenced by our ADSs on an individual basis. Holders of our ADSs will receive proxy materials with respect to matters to be voted on at a meeting of shareholders through the depositary and may only exercise voting rights by appointing the depositary or its nominee as their representative to exercise the voting rights attaching to the shares represented by the ADSs. Consequently, if the materials are slow to be forwarded to holders of ADSs by the depositary or are otherwise delayed or if the depositary sets deadlines by which holders of

ADSs must give their instructions regarding how to vote that fall too soon after mailing of the proxy materials, you may not receive voting materials in time to instruct the depositary to vote. Thus, it is possible that you, or persons who hold their ADSs through brokers, dealers or other third parties, may not have the opportunity to exercise a right to vote.

ITEM 4. INFORMATION ON THE COMPANY

HISTORY AND DEVELOPMENT

Our legal and commercial name is China Netcom Group Corporation (Hong Kong) Limited. Our principal executive offices are located at Building C, No. 156 Fuxingmennei Avenue, Xicheng District, Beijing, PRC 100031. Our telephone number is (86-10) 6642-6655. Our registered offices are located at 6701, 67/F, The Center, 99 Queen's Road Central, Hong Kong. We have appointed CT Corporation System, 111 Eighth Avenue, 13th Floor, New York, New York 10011, United States of America, with telephone number 1-212-894-8940, as our agent for service of processes for actions brought under the U.S. securities laws.

Our current principal operating subsidiary, CNC China, was incorporated as a PRC limited liability company in August 1999 by its four founders and shareholders, the Academy of Sciences, INC-SARFT, CRTC and Shanghai Alliance, as a facilities-based telecommunications operator in China. We were established on October 22, 1999 to facilitate investments by foreign investors, including CNC Fund, L.P., in CNC China. Shortly thereafter, the four founders, using their respective equity interests in CNC China as capital contributions, established China Netcom (Holdings) Company Limited, or China Netcom Holdings, which in turn contributed its entire interests in CNC China through CNC BVI to us. CNC Fund, L.P. purchased from us 30,967,127 Series A preferred shares of par value US$0.01 each in February 2001 for a cash consideration of US$325,000,000.

We, through China Netcom Corporation International Limited, established Asia Netcom in 2002. Asia Netcom remained inactive until it acquired substantially all the assets, including cash, and most of the subsidiaries, of the former Asia Global Crossing Ltd., or AGC, in March 2003. The transaction was consummated under Section 363 of the U.S. Bankruptcy Code. The transaction consisted of the assumption of certain contracts and liabilities, including selected customer contracts and vendor liabilities, and the payment of cash to AGC. The assets included submarine cable and network assets connecting Japan, Korea, Taiwan, Hong Kong, the Philippines, Singapore and Australia, as well as sales operations in these countries and regions. We held a 51% equity interest in Asia Netcom after the acquisition of AGC. In December 2003, we acquired the remaining 49% interest in Asia Netcom for cash consideration of US$61 million.

Formation of the China Netcom Group

Pursuant to a PRC government-issued directive in 2001 to restructure the PRC fixed-line telecommunications industry, which has been in operation for decades, China Telecom Group, the then incumbent fixed-line carrier, in May 2002, divided its operations between:

- China Telecom Group, which retained:
  - the principal fixed-line networks that were located in 21 southern and western provinces and municipalities of China; and
  - assets constituting 70% of the bandwidth of the nationwide inter-provincial fiber-optic network that were owned by the former China Telecom Group; and
- China Netcom Group, which was established with:

- the principal fixed-line networks that were located in the Beijing and Tianjin Municipalities and the provinces of Hebei, Henan, Shandong, Liaoning, Shanxi, Jilin and Heilongjiang and the Inner Mongolia Autonomous Region; and

- assets constituting 30% of the bandwidth of the nationwide inter-provincial fiber-optic network that were owned by the former China Telecom Group.

Pursuant to the same directive, China Netcom Group purchased the entire equity interest in Jitong Communications Company Limited on May 28, 2003. In April 2004, the shareholders of China Netcom Holdings agreed to transfer their respective interests in China Netcom Holdings to China Netcom Group, as described below.

Restructuring in Anticipation of the November 2004 Global Offering

The asset and liability transfers

In anticipation of our Global Offering in November 2004, we entered into certain transactions, including a series of transfers of assets and liabilities between us and China Netcom Group. Following our restructuring, we provide:

- telecommunications businesses in our northern and southern service regions; and

- international telecommunications services in the Asia-Pacific region.

China Netcom Group continues to:

- provide telecommunications services in provinces, autonomous regions and municipalities outside our northern and southern service regions; and

- own non-core businesses.

Our subsidiaries

We own the entire equity interest of CNC China, a company registered in China and, through China Netcom Corporation International Limited, the entire issued share capital of Asia Netcom, a company registered in Bermuda. In addition, in connection with our 2005 Acquisition, we acquired the entire equity interests of China Netcom Group New Horizon Communications Limited, or CNC New Horizon, from CNC BVI, which we currently hold through China Netcom Group New Horizon Communications Corporation (BVI) Limited. See "-- Our 2005 Acquisition". CNC China and CNC New Horizon are our operating subsidiaries in China. All businesses in our northern and southern service regions are operated through their local branch offices. Asia Netcom operates either directly or through its subsidiaries in Hong Kong and other key business centers in the Asia-Pacific region.

Change of our financial year end

In order to conform our financial year end, which was March 31 previously, to the financial year end of the businesses that were transferred to us in connection with the restructuring, we changed our financial year end from March 31 to December 31 beginning on April 1, 2003.

Name changes

We were incorporated in Hong Kong under the Companies Ordinance as a private limited liability company on October 22, 1999 under the name of Target Strong Limited.

- We changed our name from Target Strong Limited to China Netcom (Hong Kong) Corporation Limited on December 9, 1999.

- We changed our name from China Netcom (Hong Kong) Corporation Limited to China Netcom Corporation (Hong Kong) Limited on August 4, 2000.

In connection with our restructuring in anticipation of the November 2004 global offering:

- We changed our company name from China Netcom Corporation (Hong Kong) Limited to China Netcom Group Corporation (Hong Kong) Limited on July 23, 2004;

- CNC China's company name was changed from China Netcom Corporation Limited to China Netcom (Group) Company Limited on September 10, 2004; and

- CNC BVI's company name was changed from China Netcom Holdings (BVI) Limited to China Netcom Group Corporation (BVI) Limited on August 31, 2004.

Our Initial Public Offering in November 2004

In November 2004, we successfully completed our initial public offering of shares, or IPO, raising approximately RMB 8,944 million in aggregate net proceeds for us, after deduction of fees and expenses. Our shares are listed and traded on the Hong Kong Stock Exchange and ADSs representing our shares are listed and traded on the New York Stock Exchange.

Our 2005 Acquisition

On September 12, 2005, we, CNC BVI and China Netcom Group entered into a conditional sale and purchase agreement whereby we agreed to acquire the entire equity interests of China Netcom Group New Horizon Communications Corporation (BVI) Limited from CNC BVI for a consideration of RMB 12,800 million, RMB 3,000 million of which was paid out to China Netcom Group on October 31, 2005 at the consummation of our 2005 Acquisition.

Our 2005 Acquisition resulted in the transfer from China Netcom Group to us its fixed-line telecommunications assets and related liabilities in Heilongjiang Province, Jilin Province, the Inner Mongolia Autonomous Region and Shanxi Province, or the 2005 Acquired Assets and Liabilities.

Recent Development-Sale of Asia Netcom

On June 2, 2006, we agreed to sell our equity interest to a group of investors for US$168.84 million. Asia Netcom is a wholly owned subsidiary through which we provide international telecommunications services in the Asia-Pacific region. The sale of Asia Netcom is in line with our strategy to focus on development of telecommunications services in China. We expect this transaction to be completed by early August 2006. Upon completion of the transaction, we expect to continue our buisness relationship with Asia Netcom in connection with our remaining international operations, including the purchase of capacity from Asia Netcom.

BUSINESS OVERVIEW

Unless otherwise indicated, all data and information relating to our businesses and operations for years ended December 31, 2003 and 2004 include the data and information relating to the 2005 Acquired Assets and Liabilities.

Our Services

We are the dominant provider of fixed-line telephone services, broadband and other Internet-related services and business and data communications services in our northern service region in China. We also provide voice, broadband and data services using new technologies in our southern service region and international voice and data services throughout the Asia-Pacific region.

Tariffs for our services are regulated by the government, including the MII, the NDRC, and provincial telecommunications administrations and price bureaus in China. We describe, in this "Item 4. Information on the Company -- Business Overview" section, tariffs for services for which we have sole discretion in setting the market-based tariff levels, including VoIP and broadband Internet services. For a discussion of government-fixed tariffs and guidance tariffs, such as those for fixed-line telephone services, see "-- Regulation -- Tariff Setting". Prices for some of our services may be subject to promotional discounts.

Fixed-line telephone services (including PHS)

We are the dominant provider of fixed-line telephone services in our northern service region, with a market share of 92.3% as of December 31, 2005, based on the number of fixed-line subscribers.

Our fixed-line telephone services consist of local telephone, domestic long distance, international long distance, value-added and interconnection services. The number of our fixed-line subscribers in our northern service region has increased from 93.8 million as of December 31, 2003 to 114.7 million as of December 31, 2005. Of the total number of fixed-line subscribers in our northern service region, as of December 31, 2005, approximately 61.3% were residential customers, 9.4% were business customers, 5.5% were public telephones and 23.8% were PHS subscribers. Fixed-line telephone services represent our principal business activity.

We have selectively built wireless local access networks based on PHS technology to offer PHS services as a cost-effective alternative to mobile services. Our PHS services have been introduced in most cities in our northern service region, where we have rolled out our PHS networks as an extension to our existing fixed-line network.

PHS services are wireless telephone services that have features similar to traditional mobile telephone services. For example, both types of services offer voice services over handsets as well as short messaging functions. However, as PHS services have smaller cellular coverage than traditional mobile networks, PHS networks require more cellular sites for the same area coverage. In addition, due to regulatory constraints in China, users of PHS services are only permitted to roam within an area with the same area code while traditional mobile telephone services offer nationwide or international roaming capabilities. Tariffs for PHS services are similar to those for traditional fixed-line services, which are generally lower than those for traditional mobile services. Furthermore, incoming calls are free when using PHS services but are charged on a per minute basis when using traditional mobile services.

Our PHS services are designed to provide our subscribers that require mobility within an area with the same area code with a more cost-effective tariff plan than traditional mobile services and access to value-added data

services. We believe that our PHS services have contributed to the growth in our customer base, overall call volumes and revenues, and have also mitigated the substitution effect of mobile services. Our PHS services are provided in regions covering more than 100 area codes in our northern service region and the number of our PHS subscribers has grown rapidly since we began offering this service. We had 5.2 million new subscribers to our PHS services in 2005. As of December 31, 2005, we had 27.3 million PHS subscribers in our northern service region, compared to approximately 11.8 million at the end of 2003.

We also operate a network of approximately 6.3 million public telephones located in our northern service region in China. We provide local, domestic long distance and international long distance call services and Internet services through our public telephones. An important contributing factor to the demand for public telephones services is China's large and growing migrant population.

We are seeking to stimulate continued growth in fixed-line traffic through the introduction of value-added services, such as caller identification, telephone information services, teleconferencing and PHS short messaging service.

In addition to our northern service region, we also selectively provide fixed-line telephone services, mainly IP-based domestic and international long distance services, in our southern service region.

The following table summarizes key information regarding our local telephone services in our service regions in China as of the dates indicated:

	As of December 31,		
	2003	2004	2005
	(in thousands, except percentages)		
Total number of fixed-line subscribers(1)	94,073	108,079	115,328
Northern service region			
Number of fixed-line subscribers			
Residential	68,957	70,638	70,273
Business	8,671	9,251	10,725
PHS	11,796	22,124	27,329
Public telephones	4,416	5,558	6,331
Total	93,840	107,571	114,658
Market share(2)	95.6%	93.5%	92.3%
Southern service region			
Number of fixed-line subscribers	233	508	670

(1) Fixed-line subscribers consist of all access lines in service as well as PHS subscribers. We calculate PHS subscribers based on number of active telephone numbers for our PHS services. In cases where a PHS subscriber uses the same telephone number as an access line in service, the designation as a PHS subscriber or access line in service depends on which service is first activated. We increase our total number of fixed-line subscribers as soon as practicable after activation of the service. We remove a fixed-line subscriber from the total number of fixed-line subscribers as soon as practicable after the fixed-line subscriber deactivates the service voluntarily or three months after the date on which the fixed-line subscriber's bill becomes overdue. Prepaid and postpaid telephone card customers are not counted toward our fixed-line subscribers.

(2) Calculated by dividing the number of our fixed-line subscribers by the total number of fixed-line subscribers in our northern service region published by the provincial telecommunications administrations or the MII, as the case may be, as of each of December 31, 2003, 2004 and 2005.

Local telephone services

Our local telephone services have grown steadily in recent years and continue to represent the largest portion of our fixed-line telephone services in terms of revenues.

Service usage

The following table sets forth information regarding usage of our local telephone services provided in our northern service region for the periods indicated:

	For the Years Ended December 31,		
	2003	2004	2005
Total usage (pulses in millions)(1)	240,998	234,661	228,436
Internet dial-up usage (pulses in millions) (1)	38,943	17,226	8,552

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(1) Pulses are the billing units for calculating local telephone usage fees. See "-- Regulation -- Tariff Setting -- Local telephone services" for a discussion of pulses.

The decrease in total usage in our local telephone services from 2004 to 2005 was primarily due to a decrease in Internet dial-up usage, reflecting the continuing migration to broadband services.

Domestic long distance services

We offer long distance services through our traditional networks and VoIP long distance services in our northern service region, and primarily through VoIP in our southern service region.

The usage of our VoIP domestic long distance services in our northern and southern service regions as a percentage of the total usage of our domestic long distance services increased from 42.2% for the year ended December 31, 2003 to 48.4% for the year ended December 31, 2005, primarily because the usage of our lower-priced VoIP long distance services increased at a higher rate than the usage of our long distance services using our traditional networks over this period. At the end of 2001, we launched our "IP Direct" service to allow customers direct access to our VoIP network by dialing a 5-digit access code from any fixed-line telephone terminal, without having to purchase prepaid phone cards. We believe our "IP Direct" service has contributed to the increase of our market share in the VoIP segment and partially offset the decline in our effective tariffs, since our "IP Direct" services are subject to less discounts than our VoIP cards.

Service usage

The following table shows the total minutes of domestic long distance calls carried through our long distance network and the market share of our domestic long distance services for the periods indicated:

	For the Years Ended December		
	2003	2004	2005
Total minutes of domestic long distance calls (in millions)(1)(2)			
Traditional	15,220	15,546	15,97
VoIP	11,110	13,820	14,99
Total	26,330	29,366	30,97
Northern service region			
Total minutes of usage (in millions)(2)	15,190	15,087	15,65
Traditional			
VoIP	9,104	11,960	12,12
Sub-total	24,294	27,047	27,77
Southern service region			
Total minutes of usage (in millions)	2,036	2,319	3,20

(1) Includes usage provided over traditional networks in our southern service region.

(2) Includes calls originated by prepaid phone cards users and VoIP subscribers that are carried over our long distance networks.

The increase in minutes of usage in our domestic long distance services in recent years is mainly due to economic development, declining effective tariffs, increased cross-regional business activities, growth in our customer base and new service offerings. The increase in competition has, however, negatively affected our market shares and may affect the future growth rate of our domestic long distance services.

Tariffs

In 2001, the PRC government abolished regulatory controls on tariffs for VoIP long distance calls and allowed operators to set their own rates. We currently charge RMB 0.30 per minute in addition to a local usage fee for our VoIP domestic long distance services.

International long distance services

We are the leading provider of international long distance services in our northern service region, with a 48.7% market share for the overall international long distance service in that region for the year ended December 31, 2005, as compared to 54.3% for the year ended December 31, 2004. This decrease was primarily due to increasing competitions.

In 1999, we began to offer VoIP international long distance services in our northern and southern service regions. The usage of our VoIP international long distance services as a percentage of the total usage of our international long distance services increased from 59.2% as of December 31, 2003 to 70.7% as of December 31, 2005, as price-sensitive customers increasingly elected to use lower-priced VoIP international long distance services.

Service usage

The following table sets forth certain information related to the usage

and market share of our international long distance services for the periods indicated:

	For the Years Ended December 31,		
	2003	2004	2005
International long distance outbound call minutes (in millions)(1)(2)			
Traditional	187	158	173
VoIP	271	313	418
Total	458	471	591
Northern service region			
Total minutes of usage (in millions)(2)			
Traditional	186	148	156
VoIP	179	191	196
Sub-total	365	339	352
Southern service region			
Total minutes of usage (in millions)	92	132	239

(1) Includes usage provided over traditional networks in our southern service region.

(2) Includes calls originated by prepaid phone cards users and VoIP subscribers that are carried over our international long distance networks.

Our principal outgoing international long distance calls are to Hong Kong, Taiwan, the United States, Japan and South Korea. The increase in minutes of usage in our international long distance services in recent years is mainly due to China's economic development, declining effective tariffs, increasing interaction between China and other countries and regions, the growth in our customer base and new service offerings.

Tariffs

The following table sets forth our current VoIP international long distance tariffs:

	Tariff
	(RMB per minute)
VoIP services to:	
Hong Kong, Macau and Taiwan	1.50
United States and Canada	2.40
Asia-Pacific and certain European countries(1)	3.60
All other international destinations	4.60

(1) Includes the United Kingdom, France, Italy, Germany, Australia, New Zealand, Japan, South Korea, Singapore, Malaysia, Thailand, the Philippines and Indonesia.

We offer international long distance services through international gateways that we lease from China Netcom Group, and pay for the use of networks of operators in foreign jurisdictions for outgoing international calls.

Currently, China Netcom Group negotiates bilateral settlement arrangements and rates based on international settlement standards in the telecommunications industry. We have agreed with China Netcom Group that the costs and benefits of its international interconnection agreements will be for our account. These agreements are also currently in the process of being assigned or transferred to us.

Value-added services

In addition to basic telephone services, we offer a range of value-added services, including caller identification, PHS short messaging and "personalized ring" services. Personalized ring service enables our PHS telephone to emit a distinctive ring for incoming calls designated numbers. Our value-added services increase total usage on our network and average revenues per fixed-line subscriber, thus contributing to our revenues. As of December 31, 2003, 2004 and 2005, 52.2%, 60.4% and 65.9%, respectively, of our subscribers subscribed to our caller identification service in our service regions. In 2003, 6.8 billion PHS short messages were sent from our network, representing an increase of 240.9% from 2.0 billion in 2004. The number of subscribers to our "personalized ring" services reached 6.8 million as of December 31, 2005, as compared to 630,000 as of December 31, 2004. In addition, we provide telephone information, teleconferencing, video conferencing, voice mail services. Value-added services are still in a relatively early stage of development in China, and we believe that there is significant growth potential in this area.

Tariffs

We charge RMB 3.00 to RMB 6.00 per month, depending on the region, for our caller identification service. We charge RMB 0.08 to RMB 0.10 per message for PHS messages sent within our own network or to the network of China Telecom, and RMB 0.10 to RMB 0.15 per message for messages sent outside our own network or the network of China Telecom. We charge RMB 2.00 to RMB 10.00 per month for using our "personalized ring" and charge separately for downloading "rings tones"

Interconnection

We earn interconnection fees for terminating or transiting calls that originate from other domestic operators' networks and pay interconnection fees to other operators in respect of calls originating from our networks that are terminated on their networks. We earn and pay such fees in respect of local and domestic and international long distance calls and Internet service.

All interconnection and settlement arrangements among domestic operators in China are governed by the Telecommunications Regulations and the rules on interconnection arrangements and settlement promulgated by the MII. Most of the agreements pursuant to which we interconnect with other domestic operators were entered into by China Netcom Group prior to our restructuring. We have entered into an agreement with China Netcom Group pursuant to which we have agreed with China Netcom Group that the costs and benefits arising under these agreements, as they relate to our operations, will be for our account. We have also entered into an interconnection settlement agreement with China Netcom Group to interconnect with networks owned by China Netcom Group outside of our northern and southern service regions.

For information about our domestic and international telecommunications arrangements, see "--Regulation -- Tariff Setting -- Interconnection" and "Item 7. Major Shareholders and Related Party Transactions -- Related Party Transactions -- Continuing connected transactions relating to CNC China -- Interconnection Settlement Agreement".

Broadband and other Internet-related services

We are the leading provider of broadband and other Internet-related services in our northern service region, and one of the major providers in our southern service region. Broadband services represent one of our fastest growing businesses. This growth has been driven by the increasing affordability and rising use of personal computers and other Internet access devices, reduced tariffs and the proliferation of content and applications, such as online games and video-on-demand.

The following table sets forth selected information regarding our broadband, dial-up and dedicated Internet access services.

	As of and For the Years Ended December 31,		
	2003	2004	2005
Broadband services:(1)			
DSL subscribers (in thousands)	2,708.9	5,956.2	8,568.4
LAN subscribers (in thousands)	636.6	2,533.2	2,904.2
Others (in thousands)	0.7	3.0	2.6
Subtotal	3,346.2	8,492.4	11,475.2
Northern service region			
DSL subscribers (in thousands)	2,708.9	5,939.2	8,529.2
LAN subscribers (in thousands)	603.8	2,207.2	2,507.0
Others (in thousands)	0.7	0	0
Subtotal	3,313.4	8,146.4	11,036.2
Market share(2)	91.0%	93.5%	87.6%
Southern service region			
DSL subscribers (in thousands)	0	17.1	39.2
LAN subscribers (in thousands) (3)	33	326.3	397.2
Subtotal	33	346	439
Dial-up and dedicated Internet access services:			
Dial-up online usage (minutes in millions)	32,292.7	15,134.2	6,657.5
Dedicated Internet access lines in service (in thousands)	6.6	2.7	2.0
Northern service region			
Dial-up online usage (minutes in millions)	32,273.3	15,129.8	6,645.6
Dedicated Internet access lines in service (in thousands)	6.1	2.7	2.0
Southern service region			
Dial-up online usage (minutes in millions)	19.4	4.4	12.0

(1) We calculate DSL subscribers based on the number of active accounts. LAN subscribers consist of end-users and dedicated line users. We calculate LAN end-users based on the number of ports subscribed for. The number of LAN dedicated line users equals total monthly fees paid by such users divided by set average revenue per unit. The current set revenue per unit is RMB 90. We consider an account active or a service subscribed for as soon as practicable after activations of the applicable service. We remove a subscriber from the total number of subscribers as soon as practicable after that subscriber deactivates the service voluntarily or three months after the date on which that subscriber's bill becomes overdue.

(2) Calculated by dividing the number of our own broadband subscribers by the total number of broadband subscribers in our northern service region, as published by the provincial telecommunications administrations or the MII, as the case may be, as of each of December 31, 2003, 2004 and 2005.

(3) Amounts as of December 31, 2004 and 2005 include dedicated Internet access lines.

Broadband services

We are leveraging our extensive fixed-line network, large customer base, experienced sales force and established brand to achieve a leading position in the fast growing market for broadband services in China. We offer broadband services both in our northern and southern service regions. As of December 31, 2005, we had 11.47 million broadband subscribers, having averaged net additional subscribers of approximately 250,000 per month in 2005. In our southern service region, we target communications- intensive cities such as Shanghai, Guangzhou and Shenzhen, where we provide LAN-based broadband services.

We increase the speed at which content may be accessed by relocating and storing broadband content closer to the end users. In addition, we offer a range of services to our corporate customers designed to help them capture the full benefits of broadband services. We offer broadband services through a range of devices, including computers and television set-top boxes. In 2005, we successfully launched China's first IPTV services in the city of Harbin, Heilongjiang Province.

DSL services

We promote DSL services as the primary broadband service means for residential customers and small and medium-sized enterprise customers in our northern service region. We provide DSL services by upgrading our existing copper-based local switching network. DSL technology allows us to roll out our broadband network at lower incremental costs than other types of broadband networks. In our northern service region, where we are the dominant fixed-line operator, the number of subscribers to our DSL services has grown steadily in recent years, with approximately 8.5 million DSL subscribers as of December 31, 2005, compared with approximately 2.7 million subscribers as of the end of 2003. As of December 31, 2005, our DSL subscribers accounted for 74.7% of our total number of broadband subscribers in our northern and southern service regions.

LAN services

In addition to DSL technology, we also use Ethernet technology-based local-area networks, or LANs, to provide our customers with broadband services. We have selectively rolled out LANs in high density residential and office buildings in both our northern and southern service regions, where customers demand a large bandwidth and high-speed Internet access. LAN uses fiber-optic technology and Ethernet protocol to connect our users to a telecommunications network and greatly expands capacity of the access network. As of December 31, 2005, we had 2.9 million subscribers of our LAN services, representing 25.3% of our total broadband subscribers.

Internet application-related services

We have entered into cooperation arrangements with content and applications providers in the businesses of live webcasting, virtual theater, video conferencing, IPTV, online education, and broadband games. In addition to basic services such as games, video and portals, we have also launched a series of dedicated services catering to the specific needs of local markets and industry subscribers, namely, an integrated tax payment services platform, digital libraries and digital photo-finishing. In 2005, we successfully launched

China's first IPTV services in the city of Harbin, Heilongjiang Province.

We also operate Internet data centers, which provide co-location and website hosting services to business customers that lease servers, routers and other network components for Internet-related solutions. Internet data centers are facilities used to house, protect and maintain network service computers that store and deliver Internet and other network content, such as web pages, applications and data. These services are used primarily by business customers seeking to outsource the infrastructure needed to utilize the Internet effectively.

Tariffs

We charge an upfront installation fee to both DSL and LAN subscribers. DSL subscribers may choose a monthly package for unlimited usage, or a monthly package with limited usage, with additional fees charged for overtime usage. For customers connected through LANs, we offer a monthly package with unlimited usage.

Dial-up and dedicated Internet access

We are also one of the largest providers of dial-up Internet access services in our northern service regions in terms of number of subscribers. Total usage by our dial-up Internet subscribers decreased significantly in 2005. We believe that the decrease was primarily attributable to the migration of some high-usage customers from dial-up Internet services to broadband services.

We offer high speed Internet access through dedicated lines to our business customers, particularly communications-intensive corporate customers. As of December 31, 2005, we had a total of approximately 2,000 dedicated Internet access subscribers in our northern service region. We bundle this service with voice and data services to provide integrated communications solutions to our business customers. We also offer dedicated Internet access lines in our southern service region.

Tariffs

Dial-up Internet access

We offer dial-up Internet access on both a postpaid and prepaid basis. We charge a network usage fee ranging from RMB 1.00 to RMB 3.00 per hour. In addition, a communication fee of RMB 0.02 per minute is charged and recorded as fixed-line telephone services revenues. Postpaid customers are billed for this service together with their monthly telephone service bills. Prepaid customers must purchase stored value cards that enable them to access the Internet. The network usage fee is charged against the stored value card, while the communication fee is billed to the telephone number from which the Internet connection is made.

Dedicated Internet access

We charge a subscription fee of RMB 100 and a monthly network usage fee ranging from RMB 2,400 to RMB 5,400, depending on bandwidth, for our dedicated Internet access. Where the dedicated Internet access is provided through DDN, frame relay, ATM or digital circuits access, their respective tariffs apply in addition to the subscription fee and network usage fee. For a more detailed description of the tariffs for DDN, frame relay, ATM or digital circuits, please see "-- Regulation -- Tariff Setting".

Business and data communications services

We are the leading provider of business and data communications

services in our northern service region and a leading provider of these services in our southern service region. Managed data services represent a growing area in China's telecommunications industry. We bundle the data communications services together with fixed-line telephone services and broadband services to attract communications-intensive corporate customers. We are responding to increasing market demand in this area by leveraging our network platforms for data transmission and by offering a broad portfolio of services and customized solutions.

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

Managed data services

We provide a variety of managed data services to our business customers, including DDN, frame relay, ATM and IP-VPN services. We anticipate that demand for data communications services will be fueled by growth in the emerging services segment, which includes e-commerce, broadband content, network applications and IP-VPN services. The following table sets forth selected information regarding our managed data services.

	As of December 31,		
	2003	2004	2005
Number of ports			
DDN			
Frame relay	36,683	43,078	43,519
ATM	1,239	4,816	4,212
Leased bandwidth			
DDN (x64kbps)	319,812	319,323	205,064
Frame relay (x128kbps)	47,123	82,395	177,016
ATM (x2Mbps)	10,010	23,262	12,316

DDN services

DDN systems, composed of fiber-optic cables, digital transmission paths and digital nodes, are capable of providing high-quality private circuits and other services at various speeds to satisfy the multimedia communications needs of customers. Our DDN services provide high quality and reliable transmission at speeds ranging from 9.6kbps to 2Mbps to meet the increasing demand for low- to medium-speed transmission capacity from business customers and government agencies.

Frame relay and ATM services

We offer advanced high-speed data communications services based on frame relay and ATM technologies to major business customers, including multinational corporations, government agencies and financial institutions. These services enable flexible and cost-effective use of bandwidth resources. Our frame relay service provides high-speed, cost-effective data transmission services linking different business sites for high volume data traffic. ATM is a data transmission service using high bandwidth and multiplexing technology intended to handle high bandwidth, integrated voice, text, data, video and Internet traffic. Many of our customers are increasingly using frame relay and ATM services to form VPNs to link their local area networks in different

locations. VPNs enable large companies to link multiple sites and offices through a single network that uses existing switched lines to reduce cost but has capabilities comparable to a dedicated private circuit.

IP-VPN

Our IP-VPN service targets business customers that require direct IP connections between multiple sites. These customers are provided with private networks connected to our Internet backbone network and intended for secure data transmission.

Leased line services

We are a major provider of dedicated leased line services to businesses, government agencies and other telecommunications operators in our northern service region. These leased lines allow point-to-point connection for voice and data traffic. Leased lines are used by business customers to assemble their own private networks and by telecommunications operators to establish their service networks. We lease network elements, including digital circuits, digital trunk lines and optical fibers, to business and government customers as well as other telecommunications operators.

As of December 31, 2005, we leased circuits totaled 129,989 (x2Mbps) in bandwidth, including 100,387 (x2Mbps) in bandwidth to business customers. An increasing percentage of our leased circuits are of higher speed as well as capacity. Revenues generated from our leased line services have grown steadily in recent years. The following table sets forth the respective amounts of bandwidth of our leased line services provided to our business customers and carrier customers as of the dates indicated.

	As of December 31,		
	2003	2004	2005
Bandwidth of leased circuits (x2Mbps)			
Business customers	39,942	56,363	100,387
Carrier customers	44,196	34,740	29,602
Total	84,138	91,103	129,989

International telecommunications services

We are a leading provider of international telecommunications services to small and medium-sized enterprises, multinational business customers, Internet service providers and telecommunications carriers in the Asia-Pacific region. We provide international voice services, including termination, refile and bilateral services for international inbound calls destined for or transit through China and other Asia-Pacific countries. We also provide international gateway services for China outbound international long distance voice and inbound voice termination for international carriers, as well as managed data, leased line, Internet-related and other value-added data services.

Managed data, leased line and Internet-related services

Through our international branches in China and Asia Netcom, our wholly owned subsidiary, we have become a leading provider of an array of data telecommunications services, including ATM, frame relay, IP- VPN, leased line

services such as international private line circuits, indefeasible rights of use, or IRUs, and Internet services, such as dedicated Internet access and IP-transit, in key markets in the Asia-Pacific region.

International voice services

By forming partnerships with international carriers principally in the Asia-Pacific region, we are able to deliver voice services that terminate or originate in China. We purchase termination services from foreign carriers for our outbound international voice traffic. In addition, we provide interconnection services to domestic carriers for their outgoing international calls, and provide international carriers transit services for calls originating outside China that are rerouted through our network for termination in a third country. We also provide international carriers and enterprise customers teleconferencing, voice-VPN, international toll free services and other value-added services.

For the international voice service, we pay for the use of networks of international carriers for outgoing international calls and receive payments from international carriers for the use of our network for incoming international calls. Traditionally, these payments have been made pursuant to settlement arrangements under the recommended regulatory terms of the International Telecommunications Union.

Infrastructure for our international operations

We provide our regional services through a regional fiber-optic submarine cable system owned by our parent, China Netcom Group, connecting Japan, South Korea, Taiwan, Hong Kong, Singapore and the Philippines. This cable system also connects to the west coast of the United States, and to Australia, New Zealand, India, Malaysia, Thailand, Indonesia and Europe through additional circuits that we have purchased or leased. In addition, we operate an international network with an aggregate capacity of 250 Gbps in 24 international submarine cables, ten international terrestrial cables and other leased international circuits that connect to major cities around the world.

Recent Development-Sale of Asia Netcom

On June 2, 2006, we agreed to sell our equity interest in Asia Netcom to a group of investors for US$168.84 million. The sale of Asia Netcom is in line with our strategy to focus on development of telecommunications services in China. Upon completion of the transaction, we expect to continue our business relationship with Asia Netcom in connection with our remaining interenational operations, including the purchase of capacity from Asia Netcom. See "--History and Development-Recent Development-Sale of Asia Netcom".

Marketing, Sales, Distribution and Customer Services

In 2005, we revamped our marketing and sales channels in our northern service region by establishing a new community manager system. We established a cross-marketing system based on major account managers, community managers, sales outlets, 10060 telephone marketing, online marketing, and third party partners.

Over 40,000 community managers conducted direct marketing through on-site cold-calling, which significantly enhanced our product sales and service quality. To ensure the effectiveness of the community manager marketing strategy, we set key performance indicators for community managers on certain criteria such as sales revenue, sales growth, service and maintenance.

We improved our system of chief representatives for key accounts and provide one-stop global services to major customers. We began to offer options

for either centralized or separate settlement based on the clients' needs. In response to a growing demand from our business customers for communications, networking and IT services, we heavily marketed a wide range of customized value-added applications and integrated solution packages, through road shows targeting specific groups of customers and other promotional activities.

In 2005, for the fourth consecutive year, we ranked number one in a customer satisfaction survey conducted by the Ministry of Information Industry.

Trademarks

We market our services under the "CNC" brand name and logo, which are registered trademarks in China owned by our parent company, China Netcom Group. China Netcom Group has also registered the "CNC Connected" brand name as a trademark for our broadband services targeted at business customers. On October 8, 2004, we entered into a new trademark licensing agreement with China Netcom Group for our use of, among other things, the "CNC" brand name and logo, and "CNC Connected" brand name. Under this agreement, China Netcom Group has agreed to grant to us and our subsidiaries the right to use these trademarks on a royalty-free basis for ten years, which is automatically renewable at our option. Substantially all of our trademarks registered in China by China Netcom Group expire after 2010.

Billing services and credit control

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

We charge a late payment fee on subscriber accounts that are not paid by the monthly due date. We generally deactivate services for subscribers whose accounts are more than 30 days overdue. These subscribers whose services have been deactivated must pay all overdue amounts, including applicable late payment fees, to reactivate their services. We will terminate a subscriber's service and will remove him or her from the subscriber list if his or her account is overdue for more than three months. We have implemented subscriber registration procedures, including credit and background checking for PHS customers to strengthen credit control. We also actively promote our prepaid telephone services, available in our northern and southern service regions, as a means of controlling bad debts.

Network Infrastructure

We operate a network which provides extensive coverage in China and connectivity to over ten countries and regions in the Asia-Pacific region. This network is technologically advanced and conducive to the introduction of the next generation network and 3G technology. This network supports a wide range of end-to-end fixed-line telecommunications services and enables customized products to be delivered to meet a variety of telecommunications needs in "real-time".

The network which we operate consists of transport networks, service networks and support and information systems. The transport networks are primarily fiber-optic based networks covering our northern and southern service regions and the Asia-Pacific countries and regions in which we operate, supplemented by satellite transmission and digital microwave links. The service networks, which support our basic and value-added telecommunications services,

consist of our local access networks, including PHS networks, fixed-line telephone switch networks, Internet and data service networks and intelligent networks. The support and information systems include an operation support system and a business support system to support the reliable and effective operation of our networks. In addition, we are building an information technology network and management support system which is designed to ensure the speed and accuracy of our internal information flow.

Transport networks

We operate an advanced, high-speed, large capacity, secure and reliable fiber-optic transport network throughout our northern and southern service regions and in the Asia-Pacific countries and regions in which we operate. The inter-provincial fiber-optic cables in our northern and southern service regions and the Asia-Pacific fiber-optic cables, both of which are owned by our parent, China Netcom Group, and operated by us, are integrated with our own intra-provincial transport network. This fiber-optic network is supplemented by satellite transmissions and microwave links. The integrated transport network links the major economic centers in China, Japan, South Korea, Taiwan, Hong Kong, Singapore and the Philippines and connects to networks worldwide. The fiber-optic transport network that we operate allows us to more easily manage networks with enhanced reliability. In addition, we offer a series of advanced protection technologies to customers with varying service level requirements.

Service networks

Local access networks

We have extensive local access network coverage in our northern service region. Our local access network covers most cities, counties and villages in our northern service region. With our comprehensive local access networks, we are able to provide customized solutions to our customers. In addition, as of December 31, 2005, our PHS network had a capacity for 41.4 million lines.

We continue to upgrade our existing copper line local access networks using DSL technology. We have selectively connected additional large office buildings and business centers with broadband services using LAN. As of December 31, 2005, the total capacity of our DSL access ports reached 12.3 million lines.

Fixed-line telephone switch networks

A substantial portion of our fixed-line telephone networks has been built in the last decade. All of our switches are digital. The network consists of 131 local switch networks and a long distance switch network. As of December 31, 2005, the total capacity of local switches reached 113.9 million lines, and the capacity of long distance switches reached 1.94 million lines. In addition, China Netcom Group owns international gateways in Beijing, Shanghai and Guangzhou with a total capacity of approximately 161,910 lines as of December 31, 2005, and we utilize these international gateways for our international long distance telephone services. We intend to adopt advanced technology to ensure network reliability and to improve the utilization rate of our network. We have substantially completed the implementation of centralized control for our local switch networks, and have implemented centralized control for approximately 37% of the long distance switch networks we operate.

Internet and data service networks

We have developed large capacity, high quality and reliable Internet and data networks in our northern and southern service regions. Our Internet networks primarily rely on switch routers with high bandwidths. They are structured with two layers, the backbone network layer and the application layer. Our backbone networks are meshed to achieve maximum reliability and

stability. A majority of the main routes in this layer has transmission capacity at 10 Gbps, or at 2.5 Gbps. As of December 31, 2005, we also had a backbone IP network with a total bandwidth of 603,532 Mbps and international outbound bandwidth of 39,830 Mbps. In addition, this network also allows us to provide services such as IP-VPN, Internet data center, e-commerce and video-on-demand services. Our data network system includes a digital data network and a frame relay and ATM network. These networks cover all cities and counties in our northern service region and substantially all cities and counties in our southern service region. In particular, our ATM network allows us to provide various access services, flexible broadband management capability and quality end-to-end services.

Support and information systems

In 2005, we formulated a "Tri-Integration" development strategy for our corporate information system. We believe this strategy will enable gradual integration and standardization of our three major systems - application systems, the data center and the transport network carrying the application systems. The strategy, as a key part of our preparation for strategic transformation, aims to enhance management transparency and our ability to support integrated businesses and respond to the market.

In 2005, we also launched a "2+1" project as part of the implementation of the "Tri-Integration" strategy. The project involved the full-scale deployment of enterprise resource planning, or ERP, system and the centralization of billing systems at the provincial level, and, based on the needs of these two systems, optimization and integration of the DCN network for data carrying and transmission. This project is expected to be completed in 2006. Upon completion, we expect our back office information system to improve substantially in terms of management efficiency and minimized maintenance costs. The "2+1" project is expected to enhance market responsiveness and business support capability, by facilitating quick decision-making for our management and operations, control of operating risks and improvement of internal controls.

Suppliers

We make most of our purchases through competitive bidding primarily based on product and service quality, system compatibility and price.

Research and Development

Our research and development requirements are primarily fulfilled by China Netcom Group in return for a service fee that is negotiated on a case-by-case basis. These research and development activities are focused primarily on operational planning and development of value-added services. China Netcom Group has established a centralized research and development center.

Strategic Alliance with Telefonica

In November 2005, we entered into a strategic alliance agreement with Telefonica Internacional S.A., or Telefonica, pursuant to which we and Telefonica identified a number of areas in the telecommunications business for potential cooperation. We believe that our strategic cooperation with Telefonica will bring new expertise to our operations and management.

Competition

We compete with other telecommunications providers in virtually all aspects of our business, including our fixed-line telephone services, broadband and other Internet-related services, business and data communications services and international telecommunications services. All of our principal competitors in China are telecommunications carriers wholly or majority-owned by the PRC

government, including three fixed-line service providers and two licensed mobile service providers. We also face intense competition from foreign telecommunications service providers in our Asia-Pacific service region, where we serve both business and carrier customers.

Fixed-line telephone services

In our northern service region, we are the dominant provider of fixed-line telephone services, including local telephone services, domestic and international long distance services and value-added services. We currently compete with China Telecom, China Unicom and China Railcom, each of which has been licensed to provide fixed-line telephone services in our northern service region. In the markets for domestic and international long distance telephone services, we face stronger competition from lower-priced VoIP services provided by China Telecom, China Unicom, China Railcom and China Mobile. Mobile service substitution for our fixed-line telephone services has also created considerable competition for our local and long-distance telephone services. Currently, China Mobile and China Unicom are the only licensed providers of mobile communications services in China and, in recent years, some of the traffic from our fixed-line networks has been diverted to these two companies. Our PHS services provide an alternative for many of our existing and potential customers who would otherwise choose mobile services instead of fixed-line services. In our southern service region, we compete primarily against China Telecom, which holds a dominant market position as the incumbent operator, in the fixed-line telephone services markets in southern China. We also compete with China Mobile, China Unicom and China Railcom in the provision of telephone services in our southern service region.

Internet-related access services; business and data communications services

For Internet-related access services and business and data communications services, we compete with China Telecom, China Unicom, China Railcom and other Internet service providers on the basis of pricing, coverage and quality of networks, ability to provide end-to-end connectivity, quality of network management and customer service.

Our international telecommunications services

The telecommunications services market for business and data services in Asia is highly competitive, and our success in the Asia-Pacific region will depend on our ability to compete against a variety of other telecommunications providers, including local incumbent operators as well as global telecommunications operators. In the business segment, we face strong competition from international operators, such as AT&T Corp., and local incumbent operators, including NTT, Singapore Telecom and Korea Telecom. In the carrier market, we also face intense competition from other providers of telecommunications services in the Asia-Pacific region, including FLAG Telecom Group Limited and C2C Pte. Ltd.

Potential competition from foreign operators

As a result of China's accession to the World Trade Organization, the PRC government has agreed to open up over several years various segments and regions of the telecommunications market in China to foreign investors. Foreign operators entering into China's telecommunications market may have greater financial, managerial and technical resources, and more expertise in network management, sales and marketing than we do. See "Item 3. Key Information--Risk Factors -- Risks Relating to Our Business -- Increasing competition in each of our service regions and markets may have an adverse effect on our business growth and financial condition -- Competition from foreign-invested operators and other new entrants may further increase the competition for employees, exacerbate price competition and increase our operating expenses, thereby

adversely affecting our financial condition and growth prospects". In order to address the competition we face from foreign operators, we have formed strategic alliances with some of our potential competitors, including Equant and Singtel.

REGULATION

Overview of Regulation of the Telecommunications Industry in China

The telecommunications industry in China is subject to extensive government regulation. Under the State Council, a number of central government authorities have regulatory responsibilities for various aspects of the telecommunications industry. These authorities primarily include:

- The Ministry of Information Industry, or the MII, which is responsible for, among other things:

  formulating and enforcing telecommunications industry policies and regulations as well as technical standards;

  granting telecommunications service licenses;

  supervising the operations and quality of service of telecommunications operators;

  allocating and administering telecommunications resources, such as spectrum and numbers;

  together with other relevant government regulatory authorities, formulating tariff standards;

  formulating interconnection and settlement policies between telecommunications networks; and

  maintaining fair and orderly market competition among operators;

- Provincial telecommunications administrations under the MII, which oversee the implementation of the MII's regulations and exercise regulatory authority delegated by the MII within their respective provinces, autonomous regions and municipalities; and

- The National Development and Reform Commission, or the NDRC, which, together with the MII, sets government fixed tariffs and government guidance tariffs for certain telecommunications services. See "-- Tariff Setting" below. It also approves investment projects within the restricted sectors specified in the annually adjusted catalogue released by the State Council.

The PRC government is in the process of drafting a telecommunications law. We expect that, if and when the telecommunications law is adopted by the National People's Congress or its standing committee, it will become the basic telecommunications statute and provide a regulatory framework for the telecommunications industry in China.

Telecommunications Regulations

The Telecommunications Regulations, effective as of September 25, 2000, were promulgated by the State Council, and provide the primary regulatory framework for China's telecommunications industry in the interim period prior to the finalization and adoption of the telecommunications law. The stated goals of the Telecommunications Regulations are to develop a transparent and fair regulatory environment to encourage fair and orderly competition and the development in the telecommunications industry. The key aspects which the

Telecommunications Regulations address include entry into the telecommunications industry, network interconnection, telecommunications resource allocation, tariffs and service standards.

Licensing

The Telecommunications Regulations distinguish between basic and value-added telecommunications services, which are subject to different licensing requirements. According to the Catalog of Telecommunications Services, as promulgated by the MII and effective as of April 1, 2003:

- basic telecommunications services include, among other things, fixed-line local and domestic long distance telephone services, international telecommunications services, IP telephone services, mobile communications services (such as 900/1800MHz GSM, 800MHz CDMA and 3G mobile communications services), satellite communications services, paging services, data communications services (such as Internet data transmission services, international data communications services), network access services and the domestic and international telecommunications facility services; and

- value-added telecommunications services include, among other things, IP-VPN services, call center, voice mail and video conferencing call services, Internet data center and Internet access services, electronic data interchange services and information services.

Under the Telecommunications Regulations, all telecommunications operators in China must obtain a telecommunications service operating license from the MII or from the provincial telecommunications administrations. Providers of value-added services within a single province are required to obtain licenses from provincial telecommunications administrations. Providers of basic telecommunications services and providers of value-added services in two or more provinces, autonomous regions and municipalities are required to obtain licenses from the MII. TD-SCDMA technology is one of the three technologies adopted by the International Telecommunications Union and under review by the PRC government for use in providing 3G mobile telephone services. The MII is currently conducting tests on TD-SCDMA related products. The PRC government has not publicly announced its decisions on issues such as the timing of the grant of the 3G licenses, the number of 3G licenses to be granted, any technical requirements, or any selection of preferred technologies. In accordance with the approval of the MII, CNC China, our principal operating subsidiary in China, as an indirect subsidiary of China Netcom Group, has the right to operate our telecommunications business in eight provinces and municipalities under the authorization of China Netcom Group, which holds the license required for operating our telecommunications businesses in China.

Tariff Setting

Overview

Our current tariffs are subject to regulation by various government authorities, including the MII, the NDRC and, at the local level, the relevant provincial telecommunications administrations and price bureaus. Under the Telecommunications Regulations, telecommunications tariffs are categorized into government-fixed tariffs, government guidance tariffs and market-based tariffs.

The monthly fee and usage fee for local telephone service and tariffs for all domestic and international, Hong Kong, Macau and Taiwan long distance services using traditional networks are regulated as fixed tariffs, which are fixed jointly by the MII and the NDRC. Leased line and data services (other than

ATM service) are charged at government-guidance tariffs, which are determined jointly by the MII and the NDRC. We derive a substantial portion (in excess of 80%) of our revenues from services that are subject to government guidance tariffs and government-fixed tariffs.

The Notice on Implementation of Market-Based Tariffs for Certain Telecommunications Services, promulgated jointly by the MII and the NDRC in 2002, specifies the telecommunications businesses to which market-based tariffs are applicable, including VoIP, Internet access services, and certain value-added services provided over fixed-line telephone networks, such as telephone information, caller identification and voice mail. Market-based tariffs shall be applicable to those telecommunications services for which effective competition exists in the market. The tariffs of such telecommunications services are determined at the sole discretion of the operators, and will be implemented after filing with the MII or provincial telecommunications administrations, as applicable. There is uncertainty regarding how the MII determines the existence of effective competition, as the MII has not publicly disclosed the criteria it uses for determining whether a certain type of service should be subject to market-based tariffs. Under the Telecommunications Regulations, cost is the primary basis for tariff setting, but the tariff levels also take into account social and economic development, the development of the telecommunications industry and the purchasing power of the customers. The MII has not provided a timetable for tariff deregulation or indicated that operators will eventually be permitted to freely set all tariffs. We expect that increased flexibility in setting certain tariffs will allow us to better respond to changes in market demand and competitive conditions.

In December 2000, the PRC government issued a notice of tariff adjustments. The tariff adjustments changed the tariff levels for various telecommunications services, including local and long distance telephone, data and leased line services. In general, these adjustments have stimulated the overall usage of our telecommunications services. In July 2001, the government eliminated the upfront connection fee for fixed-line telephone services. For a discussion of the impact of these adjustments on our financial condition and results of operations, see "Item 5. Operating and Financial Review and Prospects".

The PRC government retains the ultimate authority to adopt changes to tariffs. However, the Telecommunications Regulations require the government to hold public hearings before setting or changing a fixed or guidance tariff, which should be attended by, among others, telecommunications operators and consumers. In 2002, the MII indicated in writing that it did not intend to initiate any adjustment to tariffs for fixed-line local telephone services during the three to five years commencing in September 2002. Our average realized tariffs may vary from levels set forth below. See "Item 3. Key Information--Risk Factors -- Risks Relating to the PRC Telecommunications Industry -- New regulations, regulatory changes or changes in enforcement policies relating to telecommunications tariffs may adversely affect our competitiveness, business and profitability".

Tariffs

The following tables set forth the tariff rates of certain services provided by us, where government fixed tariffs or government guidance tariffs are applicable.

Local telephone services

For our local telephone services, we charge a registration fee for initial installation that varies depending on whether the subscriber is a residential or a business customer, a fixed monthly fee, local call usage fees based on call duration and fees for certain value-added services. The following

table sets forth our current tariffs for local telephone services provided on our traditional and PHS network:

	Tariff (in RMB)
Monthly fee:	
Residential subscribers in:	
Provincial capitals	20.00 to 25.00
Other cities and counties	12.00 to 18.00
Rural areas	10.00 to 15.00
Business subscribers	25.00 to 35.00
Usage fee:	
Intra-district	0.18 to 0.22 for the first two pulses (first three minutes or less) and 0.09 to 0.11 for each additional pulse (one minute intervals)
Inter-district	0.30 to 0.50 per pulse (one minute intervals)
Communication fee:	
Internet dial-up	0.02 per pulse (one minute intervals)

Domestic long distance services

Our revenues from domestic long distance services consist of charges based on the duration, time of day and day of the week a call is placed. The following table sets forth the current tariffs for our domestic long distance telephone services using our traditional network:

	Tariff (RMB)
Domestic long distance services on our traditional Network	0.07 per six seconds(1)

(1) Subject to filing with the provincial telecommunications administrations, our provincial level headquarters may apply a 10% to 50% discount rate to calls made during off-peak hours.

International long distance services

International long distance service is a government-fixed tariff. The following table sets forth our current international long distance tariffs:

	Tariff (RMB)
International long distance services on our traditional network(1):	
To Hong Kong, Macau and Taiwan	0.20 per six seconds
To all international destinations	0.80 per six seconds

(1) Subject to filing with the provincial telecommunications administrations, our provincial level headquarters may apply a 10% to 50% discount rate to calls made during off-peak hours.

Managed data services

The PRC government publishes guidance tariffs for certain managed data services, including DDN and frame relay services, provided by operators in China. Interim tariffs for our ATM services are determined at our discretion, subject to approval by the MII. An initial fee is generally charged for installation and testing for our data services, as well as a fixed monthly fee

for each of the services.

DDN services

The following table sets forth the monthly fees for DDN services at the bandwidths of 64kbps, 128kbps, 512kbps and 1Mbps:

	Monthly Fee			
	64kbps	128kbps	512kbps	1Mbps
	(RMB)			
Intra-district.....	1,500	2,000	3,800	5,000
Inter-district.....	2,000	2,500	5,200	7,500
Domestic long distance..	3,500	5,000	7,000	9,000

Frame relay services

The following tables set forth the monthly fees for frame relay services, which include monthly fees for port access and permanent virtual circuits, or PVCs(1):

	Monthly Fee			
	64kbps	128kbps	512kbps	1Mbps
Port Access	(RMB)			
Monthly fees.....	260	400	500	1,000
PVC				
Intra-district.....	550	800	1,000	1,500
Inter-district.....	800	1,150	1,450	2,200
Domestic long distance...	1,700	2,200	2,500	4,000

(1) One-way tariff for PVCs frame relay services.

Leased line services

We charge monthly fees for subscribers to our leased line services based on guidance tariffs set by the PRC government, which vary based on bandwidth and whether the leased line is local or long distance. Leased line tariffs have generally decreased in recent years.

The following table sets forth the tariffs for 2Mbps, 8Mbps, 34Mbps and 155Mbps digital circuits:

	Monthly Fee			
	2Mbps	8Mbps	34Mbps	155Mbps
	(RMB)			
Intra-district.....	2,000	6,000	16,000	44,000
Inter-district.....	4,000	11,000	31,000	88,000
Domestic long distance(1).....	6,000	17,000	47,000	132,000

(1) Does not include the tariffs for local digital circuits and access lines.

Interconnection

According to the Telecommunications Regulations and the Administrative Rules on Interconnection between the Public Telecommunications Networks, as promulgated by the MII in May 2001, major telecommunications operators in China may not refuse a request from another operator to interconnect with its network. Upon such a request, the relevant operator shall enter into an interconnection

agreement with the other operator, and file such agreement with the MII. In addition, interconnection agreements may not be terminated unilaterally without an approval from the MII.

The Telecommunications Regulations further provides that the MII shall establish rules relating to technical standards and settlement procedures of interconnection. Accordingly, the MII promulgated the Measures on Settlement of Usage Fees between Telecommunications Networks in March 2001, which specify the methods for revenue sharing and settlement between telecommunications operators. China Netcom Group has entered into agreements on interconnection with other telecommunications operators, including China Telecom, China Mobile, China Unicom, China Railcom and China Satcom.

In December 2003, the MII revised the rules on interconnection technical standards and settlement procedures for public telecommunications networks by promulgating the Measures on Settlement of Interconnection between Public Telecommunications Networks and Sharing of Relaying Fees.

The following table sets forth selected current major interconnection revenue sharing and settlement arrangements for local calls, as established in the 2003 rules:

Operator from whose Network Calls are Originated	Operator at whose Network Calls are Terminated	Settlement Arrangeme
Mobile operator	Local fixed-line operator	(1) Mobile operator co the cellular usage fee its subscribers. (2) Mobile operator pa 0.06 per minute to loc fixed-line operator.
Local fixed-line operator	Mobile operator	No revenue sharing or settlement.
Local fixed-line operator A	Local fixed-line operator B	(1) Operator A collect usage fees from its subscribers. (2) In the case of (i) intra-district calls, operator A pays operat B 50% of the intra-district usage fees; o (ii) inter-district calls (x) where operat A does not use the inter-district transmission facilitie of operator B, operato A pays operator B 50% the intra-district usa fees; or (y) where operator A uses operat B's inter-district transmission facilitie operator A pays operat

		B 90% of the inter-district usage fees.

The following table sets forth selected current major main interconnection revenue sharing and settlement arrangements for domestic long distance calls:

Operator from whose Network Calls are Originated	Operator at whose Network Calls are Terminated	Settlement Arrangeme
Local fixed-line or mobile operator A	Local fixed-line or mobile operator B, through the long distance network of operator C	RMB 0.06 per minute to operator A, RMB 0.06 p minute to operator B, balance for operator C

The following table sets forth selected current major main interconnection revenue sharing and settlement arrangements for international long distance calls, including calls originated from and terminated in Hong Kong, Macau and Taiwan:

Operator from whose Network Calls are Originated	Operator at whose Network Calls are Terminated	Settlement Arrangeme
Domestic fixed-line or mobile operator A	International long distance operator B, through the domestic long distance network of operator C to international gateway	RMB 0.06 per minute to operator A, no greater RMB 0.54 per minute to operator C, the balanc operator B.

The following table sets forth selected current main interconnection revenue sharing and settlement arrangements for VoIP long distance calls:

Operator from whose Network Calls are Originated	Operator at whose Network Calls are Terminated	Settlement Arrangeme
Fixed-line or mobile operator A	Fixed-line or mobile operator B through the VoIP network of operator C	(1) Operator C collect VoIP long distance usage fees from its subscribers. (2) Operator C pays RM 0.06 per minute to ope B on the terminating end. (3) No settlement betw operator C and operato A on the originating end. (4) Operator A collect local usage fees.

Effective November 1, 2002, the Ministry of Information Industry has

unified the minimum level of the termination rate for international calls, including for this purpose calls from Hong Kong, Macau and Taiwan, terminating in China. Such termination rate is required to be no less than US$0.17 per minute, but can be higher based upon negotiations between the carriers.

Technical Standards

The MII sets industry technical standards for telecommunications terminal and interconnection-related equipment used in the public telecommunications networks. A network access license from the MII and other relevant regulatory authorities is required for all such equipment. Most of the standards set by the MII conform to standards recommended by the International Telecommunications Union and other international telecommunications standards organizations.

Capital Investment

Prior to July 16, 2004, the State Council authorized the NDRC to approve any plan to construct a nationwide telecommunications network or any network construction plan involving a capital investment that totals from RMB 50 million to RMB 200 million. The State Council also authorized the MII to approve certain aspects of such investment projects. Any investment project with total capital investment in excess of RMB 200 million was required to obtain approval from the State Council.

On July 16, 2004, the State Council promulgated, effective immediately, the Decision on Reform of Investment System, or the Investment Reform Decision, which significantly modified the government approval process for major investment projects in China. The Investment Reform Decision eliminated the government approval requirements for investment projects that do not involve direct government funding unless the investment projects are in the restricted sectors specified in the annually adjusted catalogue released by the State Council. The 2004 catalogue, which was attached as an annex to the Investment Reform Decision, sets forth approval requirements for individual investment projects in restricted sectors. Within the telecommunications sector, the investment projects that require the NDRC's approval include:

- domestic backbone transmission networks (including broadcasting and television networks);
- international telecommunications transmission circuits;
- international gateways;
- international telecommunications facilities for dedicated telecommunications networks; and
- other telecommunications infrastructure projects involving information security.

Accessing International Capital Markets

Prior to accessing the international capital markets, we may be required to obtain approval from various government authorities depending on the type of international financing we intend to seek. For example, documents relating to our future public offerings of new shares must be filed with the China Securities Regulatory Commission, or the CSRC. If such offerings involve certain new acquisitions of assets or exchanges of equity interest within China, the CSRC's prior approval will be required. In addition, China Netcom Group and our other state-owned shareholders are required to obtain approval from relevant PRC government authorities prior to their participation in any future share offering by our company confirming their respective sales of shares and related

contributions to the PRC national social security fund, as required by PRC law. Furthermore, any use of the proceeds that we receive from international capital markets by CNC China, either as a shareholder loan or as a capital contribution, will be subject to registration or approval requirements under PRC law.

Telecommunications Resources

The MII is responsible for the administration and allocation of telecommunications resources in China, including spectrum frequencies and telecommunications network numbers. The use of these resources by telecommunications operators is subject to the approval of the MII or the relevant provincial telecommunications administrations or provincial radio administrations and the payment of a telecommunications resources usage fee. The provincial radio administrations have allocated the 1900-1915 MHz frequency spectrum to us for PHS services, and we have the exclusive rights to use that frequency spectrum in our northern service region. On January 1, 2005, the MII issued a regulation imposing fees for the use of telephone numbers. Under the regulation, starting from April 1, 2005, all telecommunications operators, including us, are required to pay RMB 0.01 per telephone number per month.

Quality of Service

Under the Telecommunications Regulations, the MII and the relevant provincial telecommunications administrations are responsible for supervising and monitoring the quality of services provided by telecommunications operators in China. Under the Telecommunications Regulations, customers of telecommunications operators have the right to submit their complaints to the MII and the relevant provincial telecommunications administrations or other relevant government authorities.

Universal Services Obligations

Under the Telecommunications Regulations, telecommunications operators in China are required to fulfill universal service obligations in accordance with relevant regulations to be promulgated by the PRC government, and the MII has the authority to delineate the scope of universal service obligations. The MII, together with governmental finance and pricing authorities, is also responsible for formulating administrative rules relating to the establishment of a universal service fund and compensation schemes for universal services. These rules have not yet been promulgated, and there are currently no specific regulatory requirements relating to the provision of universal services in China.

While the scope of specific universal services obligations is not yet clear, we believe that such services may include mandatory provision of basic telecommunications services in economically less developed areas in China. The MII requires China Telecom, China Netcom Group, China Mobile, China Unicom, China Railcom and China Satcom to participate in a project to provide telephone services in a number of remote villages in China as transitional measures prior to the formalization of a universal service obligation framework. In order to fulfill such obligations under those transitional measures, China Netcom Group has agreed with us that it will assume the responsibility for investing in and constructing the necessary network facilities. If we operate and maintain such network facilities in our northern and southern service regions, China Netcom Group has agreed to compensate us for the related expenses based on fair market value.

Regulation of the Telecommunications Industry in Our Asia-Pacific Region

We are required to obtain and maintain a variety of telecommunications and other licenses and authorizations in the Asia-Pacific jurisdictions in which we operate. We must also comply with a variety of regulatory obligations,

including obtaining permits to land our cables in the territories to which they are connected. In some jurisdictions in our Asia-Pacific service region, we are subject to ownership limitations with respect to the joint ventures that we form with our local partners. For example, South Korea currently limits the ownership of domestic enterprises by offshore telecommunications operators, such as us, to 49%. We hold all necessary telecommunications and other licenses that permit us to own and independently operate the non-PRC assets in key countries and regions, including Japan, Hong Kong and Singapore. We also operate in South Korea, Malaysia, Indonesia and the Philippines through joint ventures or through contractual relationships with operators that permit us to rely on the relevant telecommunications licenses. Licenses are not required in other countries in which we operate, such as Australia.

ORGANIZATIONAL STRUCTURE

Our Shareholding Structure

As of May 31, 2006, China Netcom Group Corporation (Hong Kong) Limited ("CNC Hong Kong", "we" or "us") is owned by China Netcom Group Corporation (BVI) Limited ("CNC BVI"), five PRC shareholders, Telefonica Internacional S.A. which was incorporated in Spain, and public shareholders, which hold 70.39%, 4.51%, 4.99% and 20.11% of our shares, respectively. Our five PRC shareholders, all of which are established in the PRC, are the Chinese Academy of Sciences (or the Academy of Sciences), Information and Network Center of the State Administration of Radio, Film and Television (or INC-SARFT), China Railways Telecommunications Center (or CRTC), Shanghai Alliance Investment Limited (or Shanghai Alliance), and Shandong Provincial State-owned Assets Supervision and Administration Commission (or Shandong SASAC). All of the ordinary shares owned by our five PRC shareholders are registered in the name of China Netcom Group Corporation (BVI) Limited, or CNC BVI, which holds such ordinary shares in trust for each of the five PRC shareholders. Consequently, the ownership percentages of our five PRC shareholders reflect the aggregate beneficial interests of these shareholders as held through CNC BVI. The ownership of CNC BVI as indicated above reflects CNC BVI's own beneficial ownership.

CNC BVI is owned 100% by China Network Communications Group Corporation ("China Netcom Group"), which is a wholly state-owned enterprise established in PRC. China Netcom Group is the parent of wholly owned subsidiaries that, following the restructuring, include China Netcom (Holdings) Company Limited, or China Netcom Holdings, an investment holding company, and telecommunications companies outside our northern and southern service regions. None of these subsidiary companies have any ownership interest in us, nor do we have any ownership interest in them.

CNC Hong Kong has three wholly-owned subsidiaries, which include China Netcom Group New Horizon Communications Corporation (BVI) Limited ("CNC New Horizon BVI"), China Netcom (Group) Company Limited ("CNC China") which was incorporated in PRC, and China Netcom Corporation International Limited ("CNC International") which was incorporated in Bermuda. CNC New Horizon BVI owns 100% of China Netcom Group New Horizon Communications Corporation Limited ("CNC New Horizon PRC") which was incorporated in PRC. CNC International has three wholly-owned subsidiaries, which are Asia Netcom Corporation Limited ("Asia Netcom") incorporated in Bermuda, China Netcom (USA) Operations Limited ("China Netcom (USA)"), and China Netcom (Hong Kong) Operations Limited ("China Netcom (Hong Kong)"). Each of China Netcom (USA) and China Netcom (Hong Kong) was previously wholly-owned subsidiaries of Asia Netcom and the ownership of each of these two entities was transferred to China Netcom Corporation International Limited as of March 15, 2006.

Recent Development-Sale of Asia Netcom

On June 2, 2006, we agreed to sell our equity interest in Asia Netcom to a group of investors for US$168.84 million. We expect this transaction to be completed by early August 2006. See "--History and Development--Recent Development-Sale of Asia Netcom."

PROPERTY, PLANT AND EQUIPMENT

Our principal executive offices are located in Beijing. We also maintain an executive office in Hong Kong. We own, lease or have usage rights in various properties, which consist of offices, administrative centers, staff quarters, retail outlets and technical facilities. We have certain properties transferred to us by China Netcom Group which do not have vested proper legal titles, and we have certain properties the titles for which have not been transferred to us. We believe it is unlikely that we would be denied our right to use a large number of these properties with title defects at any given time. China Netcom Group agreed to indemnify us against any loss or damage suffered or incurred by us, caused by or arising from any challenge to or interference with our title to and/or right to use properties transferred to us in respect of which we have not obtained long-term title certificates or those properties rented by us from China Netcom Group where there are title defects.

ITEM 4A. UNRESOLVED STAFF COMMENTS

None.

ITEM 5. OPERATING AND FINANCIAL REVIEW AND PROSPECTS

The following discussion and analysis should be read in conjunction with our consolidated financial statements, selected consolidated financial data and unaudited pro forma consolidated financial information, in each case together with the accompanying notes, all included elsewhere in this document.

Overview of Our Services

We are the dominant provider of fixed-line telephone services, broadband and other Internet-related services, and business and data communications services in our northern service region in China. We also provide voice, broadband and data services using new technologies in our southern service region and international voice and data services throughout the Asia-Pacific region.

Factors Affecting Our Results of Operations

Our 2005 Acquisition

On October 31, 2005, we acquired from China Netcom Group the fixed-line telecommunications assets and related liabilities in Heilongjiang Province, Jilin Province, the Inner Mongolia Autonomous Region and Shanxi Province. Since we and the 2005 Acquired Assets and Liabilities were under the common control of China Netcom Group, our 2005 Acquisition has been treated as a "combination of entities under common control", which was accounted for in a manner similar to pooling-of-interests. Accordingly, the 2005 Acquired Assets and Liabilities have been recognized at carrying amounts and our financial statements as of and for the years ended December 31, 2003 and 2004 have been restated to include the financial position and results of operations of the 2005 Acquired Assets and Liabilities on a combined basis. All data and information relating to our businesses and operations for the years ended December 31, 2003 and 2004 are presented based on those restated amounts.

The following table presents a summary of the results of operations of each of our company, as previously reported by us, and the 2005 Acquired Assets and Liabilities for the years ended December 31, 2003 and 2004 and the shareholders' equity as of December 31, 2003 and December 31, 2004, and the combined amounts presented in our consolidated financial statements included elsewhere in this annual report. For the periods presented, all significant balances and transactions between our company and China Netcom Group in relation to the 2005 Acquired Assets and Liabilities prior to our 2005 Acquisition have been eliminated.

	Our Company (as previously reported) RMB Million	2005 Acquired Assets and Liabilities RMB Million	Co M
2003			
Operating revenue	59,898	17,700	
Operating income/(loss)	(14,489)	1,077	(1
Net income/(loss)	(11,112)	205	(1
Basic earnings/(loss) per share (RMB)	(2.02)	0.03	
2004			
Operating revenue	64,878	18,616	
Operating income/(loss)	15,511	(9,204)	
Net income/(loss)	9,230	(6,531)	
Basic earnings/(loss) per share (RMB)	1.64	(1.16)	
Financial condition:			
Current assets as of December 31, 2004	17,492	3,174	
Total assets as of December 31, 2004	179,534	56,547	2
Current liabilities as of December 31, 2004	86,871	31,479	1
Total liabilities as of December 31, 2004	136,155	46,264	1
Shareholders' equity as of December 31, 2004	43,376	10,283	
Shareholders' equity as of December 31, 2003	62,213	7,554	

Revaluation of our fixed assets

As part of the reorganization of China Netcom Group and us, and as required by the relevant PRC regulations, China Enterprise Appraisal, an independent appraiser registered in China, conducted an appraisal of our fixed assets as of December 31, 2003 on a depreciated replacement cost basis. This revaluation resulted in a net reduction in the book value of the fixed assets other than land and buildings in the amount of RMB 22,796 million.

As required by the relevant PRC regulation, China Enterprise Appraisal, conducted an appraisal of 2005 Acquired Assets and Liabilities as of December 31, 2004 on a depreciated replacement cost basis. This revaluation resulted in a net reduction in the book value of the fixed assets other than land and building in the amount of RMB 7,455 million.

For the purpose of preparing our financial statements, the effect of the revaluations was reflected in our consolidated financial statements as a charge of RMB 25,778 million on our consolidated income statements in the form of a deficit on revaluation of fixed assets in 2003 and surplus of RMB 2,982 million that was credited to the revaluation reserve on December 31, 2003, and a

charge of RMB 11,318 million on our consolidated income statements in the form of a deficit on revaluation of fixed assets in 2004 and surplus of RMB 3,863 million that was credited to the revaluation reserve on December 31, 2004. This had the effect of significantly and adversely affecting our profits from operations in each of 2003 and 2004.

The revaluation also has the effect of decreasing future annual depreciation and amortization charges.

Results of Operations

The table below sets forth a breakdown of the revenues of our domestic and international telecommunications services and total operating expenses in terms of amount and as a percentage of our total revenues, as well as net cash flow, for the periods indicated. Although in 2003 we did not manage our international services separately from our domestic services, we have begun to do so in 2004 and will continue to do so in the future. Therefore, we expect in the future to continue to report our revenues in the same format as presented below.

	For the Years Ended December 31,				
	2003		2004		
	Amount	Percentage of Revenues	Amount	Percentage of Revenues	Amount
	(RMB in millions, except percentage data				
Revenues:					
Domestic Telecommunications Services:					
Fixed-line telephone services(1):					
Local:					
Local usage fees	24,685	31.8%	24,858	29.8%	24,58
Monthly fees	16,476	21.2%	17,964	21.5%	18,26
Upfront installation fees	1,267	1.6%	1,568	1.9%	1,44
Subtotal	42,428	54.7%	44,390	53.2%	44,28
Domestic long distance(2)	11,425	14.7%	11,266	13.5%	10,26
International long distance(2)(3)	1,543	2.0%	1,234	1.5%	1,18
Value-added services	2,095	2.7%	2,993	3.6%	4,00
Interconnection fees from domestic Carriers	3,763	4.8%	5,441	6.5%	6,51
Upfront connection fees(4)	5,122	6.6%	4,346	5.2%	3,40
Subtotal	66,376	85.5%	69,670	83.4%	69,64

Broadband Services other Internet-related	2,914	3.8%	5,202	6.2%	7,81
Services	1,418	1.8%	1,004	1.2%	54
Subtotal	4,332	5.6%	6,206	7.4%	8,35
Business and data communications services:					
Managed data	1,553	2.0%	1,520	1.8%	1,39
Leased line	2,820	3.6%	2,095	2.6%	2,23
Subtotal	4,373	5.6%	3,615	4.4%	3,63
Other services	1,138	1.5%	1,360	1.6%	2,34
Subtotal	76,219	98.2%	80,851	96.8%	83,97
International Telecommunications Services:					
International long distance	-	-	181	0.2%	28
Interconnection fees from international Carriers	1,217	1.6%	1,012	1.2%	1,26
Broadband and other Internet-related Services	14	-	360	0.4%	37
Managed data	64	0.1%	309	0.4%	40
Leased line	63	0.1%	456	0.6%	68
Other services	21	-	285	0.3%	23
Subtotal	1,379	1.8%	2,643	3.2%	3,25
Total	77,598	100.0%	83,494	100.0%	87,23
Operating Expenses:					
Depreciation and amortization	26,800	34.5%	25,180	30.2%	25,04
Network, operations and support	15,108	19.5%	13,973	16.7%	14,41
Staff costs	10,945	14.1%	11,950	14.3%	12,33
Selling, general and administrative	10,322	13.3%	12,877	15.4%	13,43
Other operating expenses	2,197	2.8%	1,993	2.4%	1,49
Total	65,372	84.2%	65,973	79.0%	66,72
Operating profit before interest income, dividend income and deficit on revaluation of fixed assets	12,226	15.8%	17,521	21.0%	20,50
Interest and dividend income	140	0.2%	104	0.1%	18

Deficit on revaluation of fixed Assets	(25,778)	-33.2%	(11,318)	-13.6%	
Profit/(loss) from operations	(13,412)	-17.3%	6,307	7.6%	20,69
Finance costs	(4,296)	-5.5%	(3,930)	-4.7%	(3,374
Share of profit/(loss) of associated companies and jointly controlled entity	(416)	-0.5%	(1)	0.0%	-
Profit/(loss) before taxation	(18,124)	-23.4%	2,376	2.8%	17,31
Taxation	7,217	9.3%	323	0.4%	(3,429
Profit/(loss) after taxation	(10,907)	-14.1%	2,699	3.2%	13,88
Minority interests	1	0.0%	-	0.0%	
Profit/(loss) for the year	(10,906)	-14.1%	2,699	3.2%	13,88
Net cash inflows from operating Activities	30,917	39.8%	33,653	40.3%	33,55
Net cash outflows from investing Activities	(34,875)	-44.9%	(28,702)	-34.4%	(24,608
Net cash inflows/(outflows) from financing Activities	3,595	4.6%	(1,743)	-2.1%	(14,656

(1) Includes revenues from our PHS services.

(2) Includes revenues from our long distance VoIP services.

(3) Includes revenues from calls to Hong Kong, Macau and Taiwan.

(4) Upfront connection fees for basic telephone access services were eliminated by the MII in July 2001.

Operating results for the year ended December 31, 2005 and the year ended December 31, 2004

Revenues

Our revenues consist of revenues from the provision of telecommunications services, net of business tax and government levies. Sources of our revenues consist of revenues from our domestic businesses, including fees charged for the provision of fixed-line telephone services, broadband and other Internet-related services, business and data communications services, and other services, and revenues from our international telecommunications services.

In 2005, our revenues were RMB 87,232 million, representing an increase of RMB 3,738 million, or 4.5%, from RMB 83,494 million in 2004. This increase primarily reflects increases in revenues from our domestic services, including broadband services, value-added services, interconnection fees and certain other services.

Domestic telecommunications services

Fixed-line telephone services

Local telephone services

Revenues from our local telephone services (including PHS services) comprise local usage fees, monthly fees and installation fees. They vary depending on the number of our fixed-line subscribers, average realized tariffs and the usage volume of local calls (including those made to connect to our dial-up Internet service). In 2005, revenues from our local telephone services were RMB 44,285 million, representing a decrease of RMB 105 million, or 0.2%, from RMB 44,390 million in 2004, and accounting for 50.8% of our total revenues in 2005.

This slight decrease in revenues from local telephone services reflects a combination of decreases in revenues from local usage fees and upfront installation fees and an increase in revenues from monthly fees. The decreases in revenues from local usage fees and upfront installation fees were primarily due to increasing competition in the telecommunications market and increasing mobile substitution. The increase in revenues from monthly fees was primarily due to the growth of our PHS services.

Local usage fees. Usage fees for local services include local usage fees charged for local telephone calls and VoIP long distance calls, and communications fees for dial-up Internet access.

In 2005, revenues from our local usage fees were RMB 24,582 million, representing a decrease of RMB 276 million, or 1.1%, from RMB 24,858 million in 2004. The decrease was primarily due to a decrease of 6.2 billion pulses, or 2.7%, in the usage volume of local calls to 228.4 billion pulses in 2005 from 234.6 billion in 2004. The decrease in usage volume of local calls was in turn caused by a decrease in usage volume of non-PHS calls to 172.9 billion pulses in 2005 from 189.0 billion pulses in 2004, principally reflecting the migration of our non-PHS local traffic to PHS and mobile services. Usage volume of PHS calls increased to 55.6 billion pulses in 2005 from 45.7 billion pulses in 2004.

Revenues from communications fees charged for our dial-up Internet service decreased to RMB 149 million in 2005 from RMB 256 million in 2004, which was primarily caused by a decrease of 8.674 billion pulses, or 50.4%, in usage volume of this service to 8.552 billion pulses in 2005 from 17.226 billion pulses in 2004, reflecting the migration of Internet dial-up traffic to broadband services.

Monthly fees. Monthly fees represent the fixed amount of service charges to our customers for using our fixed-line telephone services.

In 2005, our revenue from monthly fees were RMB 18,261 million, representing an increase of RMB 297 million, or 1.7%, from RMB 17,964 million in 2004, primarily due to an increase in the number of our fixed-line subscribers in our service regions.

Upfront installation fees. Installation fees represent the amortized amount of the upfront fees received for installation of non-PHS fixed-line telephone services. These upfront installation fees are deferred and recognized over the expected customer relationship period, which is currently estimated to be ten years.

Revenues from the upfront installation fees were RMB 1,442 million in 2005, representing a decrease of RMB 126 million, or 8.0%, from RMB 1,568 million in 2004. The decrease was principally attributable to upfront installation discount offered to new subscribers, coupled with a decrease in the number of new subscribers in 2005 to 2.036 million from 3.678 million in 2004.

Domestic long distance services

Revenues from our domestic long distance services consist of usage fees for domestic long distance calls originated by our fixed-line subscribers, users of our prepaid phone cards and certain other customers. In 2005, our domestic long distance revenues were RMB 10,260 million, representing a decrease of RMB 1,006 million, or 8.9%, from RMB 11,266 million in 2004. This decrease was caused by a decrease of RMB 547 million, or 7.2%, in revenues from the domestic long distance calls carried on our traditional network and a decrease of RMB 458 million, or 12.6%, in revenues from our VoIP long distance service during the 2004-2005 comparison period, which in turn was primarily attributable to declines in the average realized tariffs for both long distance calls carried on the traditional network and VoIP calls.

International long distance services

Revenues from our international long distance services consist of usage fees charged to our customers for their international long distance calls originated in our service regions, including those made to Hong Kong, Macau and Taiwan.

In 2005, this revenue was RMB 1,180 million, representing a decrease of RMB 54 million, or 4.4%, from RMB 1,234 million in 2004. The revenue decrease reflects a combination of an increase of 34.0% in the volume of international long distance calls carried on our VoIP network and a decrease of 22.0% in the average realized tariff for international long distance calls.

Value-added services

Revenues from our value-added services consist of fees that we charge our customers for the provision of caller identification, PHS short-messaging, personalized ring, telephone information services, video- and tele-conferencing and other value-added services. Revenues from our value-added services in 2005 were RMB 4,000 million, representing an increase of RMB 1,007 million, or 33.6%, from RMB 2,993 million in 2004. The increase was primarily attributable to an increase in revenues from PHS short message service to RMB 624 million in 2005 from RMB 79 million in 2004, reflecting an increase in the number of PHS short messages sent from our network to 6.8 billion in 2005 from 2.0 billion in 2004. The revenue growth was further driven by an increase in revenues from our caller identification service to RMB 2,241 million in 2005 from 2,231 million in 2004, reflecting an increase in the number of subscribers of our caller identification service, which reached a penetration rate of 65.9% of our access lines in service as of December 31, 2005 from 60.4% as of December 31, 2004.

Interconnection services

Revenues from our interconnection services represent interconnection fees charged to other domestic telecommunications carriers, principally China Mobile, China Unicom and China Telecom, for both local and long distance calls, and revenues from our interconnections with China Netcom Group.

Revenues from our interconnection services were RMB 6,517 million in 2005, representing an increase of RMB 1,076 million, or 19.8%, from RMB 5,441 million in 2004. The increase was primarily due to increases in aggregate revenues from our interconnections with China Unicom and China Mobile to RMB 4,632 million in 2005 from RMB 2,930 million in 2004. The interconnection revenue growth was further driven by an increase of RMB 270 million in revenues from interconnections with China Netcom Group, pursuant to the interconnection

service agreement.

Upfront connection fees

Upfront connection fees represent the amortized amount of the upfront fees received for the initial activation of fixed-line telephone services. As a result of the elimination of this fee on July 1, 2001, revenues from the amortized portion of upfront connection fees were RMB 3,405 million in 2005, representing a decrease of RMB 941 million, or 21.7%, from RMB 4,346 million in 2004, and will continue to decline in the coming years until the expiration of the amortization period.

Broadband access and other Internet-related services

Revenues from our broadband access and other Internet-related services consist of revenues for the provision of DSL, LAN, and other Internet-related services, as well as Internet dial-up (other than communications fees) and dedicated Internet access services.

Total revenues from our broadband services in 2005 were RMB 7,812 million, representing an increase of RMB 2,610 million, or 50.2%, from RMB 5,202 million in 2004. This increase reflects the rapid expansion of our broadband subscriber base. The total number of our DSL subscribers increased by approximately 2.6 million, or 43.3%, or to 8.6 million as of December 31, 2005 from approximately 6.0 million as of December 31, 2004. The effect of the increase in the number of subscribers on revenue growth was partially offset by declines in the average realized monthly tariffs for our broadband services, reflecting the discount and promotional packages that we offer, and the fact that increasing numbers of our new subscribers are residential users, who generally have lower usage than business users.

Revenues from other Internet-related services were RMB 540 million in 2005, representing a decrease of RMB 464 million, or 46.2%, from RMB 1,004 million in 2004. The decrease was primarily due to the continuing migration of subscribers to broadband services from Internet dial-up services.

Business and data communications services

Managed data services

Revenues from our corporate data services represent fees that we charge for our DDN, frame relay, ATM, MPLS VPN and X.25 services. Revenues from our managed data services were RMB 1,395 million in 2005, representing a decrease of RMB 125 million, or 8.2%, from RMB 1,520 million in 2004. The decrease was primarily due to decrease in average realized tariff as a result of increased market competition.

Leased line services

Revenues from our leased line services represent fees that we receive from our business and carrier customers for leasing circuit capacity to them, including the lease of digital circuits, digital trunk lines and optic fibers. Revenues from our leased line services were RMB 2,238 million in 2005, representing an increase of RMB 143 million, or 6.8%, from RMB 2,095 million in 2004. This increase was primarily due to an increase in circuit bandwidth leased to 129,989 (x2Mbps) as of December 31, 2005 from 91,103 (x2Mbps) as of December 31, 2004, which was primarily attributable to an increase in circuit bandwidth leased to business customers to 100,387 (x2Mbps) as of December 31, 2005 from 56,363 (x2Mbps) as of December 31, 2004. The effect of the increased circuit

bandwidth leased to business customers on revenue growth was partially offset by a decrease in circuit bandwidth leased to carrier customers, and a decrease in average realized tariffs for our leased line services.

Other services

Revenues from other services, including revenues from service and maintenance fees, lease payments for our non-telecommunications equipment, paging service fees, and revenues from sales of products like handsets and DSL modems, were RMB 2,345 million in 2005, representing an increase of RMB 985 million, or 72.4%, from RMB 1,360 million in 2004. The increase was primarily due to an increase in sales of PHS handsets and external modems for our DSL service.

International telecommunications services

Revenues from our international operations consist of fees charged for provision to carrier customers of wholesale voice services, including termination, refile and bilateral services for international inbound calls destined for the PRC or transit through the PRC or other Asia-Pacific countries and regions, home country direct and international toll-free services; and leased line, Internet, managed data and other telecommunications services provided to business and carrier customers located outside the PRC.

Revenues from our international telecommunications services were RMB 3,255 million in 2005, representing an increase of RMB 612 million, or 23.2%, from RMB 2,643 million in 2004. The increase was primarily due to a rapid increase in revenues from leased line services, interconnection fees and managed data services provided to our international customers.

Operating expenses

The key components of our operating expenses are depreciation and amortization expenses, network operations and support expenses, selling, general and administrative expenses, staff costs and other expenses. Our total operating expenses in 2005 were RMB 66,727 million, representing an increase of RMB 754 million, or 1.1%, from RMB 65,973 million in 2004, as compared to the 4.5% increase in our revenues during this period. The increase in our total operating expenses principally reflect the expansion of our customer base and increased selling, general and administrative expenses, which was in turn primarily caused by increasing market competition.

The following table sets forth the components of our operating expenses as percentages of our revenues for the periods indicated.

	Years Ended 31 December			
	2004		2005	
	Amount	Percentage of revenue	Amount	Per of
	(RMB in millions, except percentage data			
Depreciation and amortization expenses.....	25,180	30.2%	25,049	
Network, operations and support expenses.....	13,973	16.7%	14,417	
Selling, general and administrative expenses.....	12,877	15.4%	13,438	

Staff costs	11,950	14.3%	12,333
Other operating expenses	1,993	2.4%	1,490
Total operating expenses	65,973	79.0%	66,727

Depreciation and amortization

We depreciate our property, plant and equipment on a straight-line basis over the estimated useful lives of the assets, after taking into account their estimated residual value. For example, our telecommunication network and equipment are depreciated over periods typically ranging from five to ten years. In 2005, our depreciation and amortization expenses were RMB 25,049 million, representing a decrease of RMB 131 million, or 0.5%, from RMB 25,180 million in 2004. The decrease was primarily attributable to the revaluation deficit of our fixed assets upon our 2005 Acquisition, which resulted in a decrease in our total assets value. For more details, see "--Factors Affecting Our Results of Operations--Our 2005 Acquisition". The decrease in our depreciation and amortization expenses also reflects a decrease in our capital expenditure to RMB 27,562 million in 2005 from RMB 28,256 million in 2004.

Network, operations and support

Network, operations and support expenses primarily consist of repair and maintenance expenses incurred in connection with the operation of our telecommunications networks, interconnection expenses, utility expenses, expenses relating to the disposal of fixed assets and the installation costs for additional access lines that are put in service each year, which are amortized on a straight-line basis over ten years to the extent that such costs match the incremental revenues from new customers. In 2005, these expenses amounted to RMB 14,417 million, representing an increase of RMB 444 million, or 3.2%, from RMB 13,973 million in 2004. The increase was primarily attributable to an increase of RMB 885 million in interconnection expenses with China Netcom Group and other carriers, which was in part due to increased volume of outbound calls. The increase was partially offset by a decrease in repair and maintenance expenses by RMB 751 million, or 14.4%, to RMB 4,452 million in 2005 from RMB 5,203 million in 2004, as a result of our continued efforts to centralize the management of our network operations.

Selling, general and administrative

Selling, general and administrative expenses primarily consist of sales and marketing expenses, general and administrative expense and provision for doubtful accounts.

In 2005, our selling, general and administrative expenses were RMB 13,438 million, representing an increase of RMB 561 million, or 4.4%, from RMB 12,877 million in 2004. The increase in these expenses was primarily attributable to an increase in sales and marketing expenses to RMB 8,985 million in 2005 from RMB 8,152 million, which was partially offset by a decrease in the general and administrative expenses, particularly office and travel expenses, resulting from our continued efforts to cut costs.

Staff costs

Staff costs principally consist of expenses for salary and benefits, contributions to pension plans and a housing fund, and the payment of early retirement benefits.

In 2005, our staff costs were RMB 12,333 million, representing an increase of RMB 383 million, or 3.2%, from RMB 11,950 million in 2004, which was primarily attributable to an increase in staff salary and benefits to RMB 11,046

million in 2005 from RMB 10,076 million in 2004. In 2005, we started to implement a performance-linked compensation allocation system with an increased percentage of salaries paid to the front office employees. In addition, we implemented several employee benefit programs to better retain and motivate existing employees and to attract qualified potential employees.

Other operating expenses

Other operating expenses include printing costs for bills, invoices and other materials, charitable donations, and other miscellaneous administrative and operational expenses. In 2005, other operating expenses were RMB 1,490 million, representing a decrease of RMB 503 million, or 25.2%, from RMB 1,993 million in 2004, reflecting our efforts to reduce such expenses.

Operating profit before interest income, dividend income and deficit on revaluation of fixed assets

In 2005, our operating profit before interest income, dividend income and deficit on revaluation of fixed assets was RMB 20,505 million, representing an increase of RMB 2,984 million, or 17.0%, from RMB 17,521 million in 2004.

Profit/(loss) from operations

In 2005, our profit from operations was RMB 20,691 million, representing an increase of RMB 14,384 million, or 228.1%, from RMB 6,307 million in 2004.

Finance costs

In 2005, our finance costs were RMB 3,374 million, representing a decrease of RMB 556 million, or 14.1%, from RMB 3,930 million in 2004, which was primarily attributable to a reduction in our total borrowings and a gain in foreign exchange resulting from the appreciation of the value of Renminbi against U.S. dollars in 2005. For more details, see "Risk Factors--Risks relating to China and Asia--Fluctuations in exchange rates may adversely affect our financial condition and results of operations and the prices of our shares and ADSs or any dividends payable on our shares and ADSs in foreign currency terms".

Taxation

The statutory tax rate on most of our operations in the PRC is 33%, although some of our subsidiaries and affiliates in the PRC are subject to lower statutory tax rates or enjoy preferential tax rates.

In 2005, our taxation expense was RMB 3,429 million, representing an increase of RMB 3,752 million from a tax credit of RMB 323 million in 2004 and reflecting a higher profit from operations.

Our effective tax rate of 19.8% in 2005 was lower than the statutory tax rate, mainly because the revenues from upfront connection fees that we recognized during the period were not taxable under the PRC law. In addition, we benefited from a non-recurring tax reduction of RMB 837 million after making up the accumulated pre-restructuring losses with current profit.

Profit for the period

As a result of the foregoing, our profit for 2005 was RMB 13,888 million, representing an increase of RMB 11,189 million, or 414.6%, from RMB 2,699 million in 2004.

Profit/(Loss) for the Year Reconciled to U.S. GAAP

Our consolidated profit for 2005 determined under U.S. GAAP was RMB 10,465 million. Our profit for 2005 determined under U.S. GAAP was lower than that under HKFRS. The difference principally reflects the revaluation deficits of RMB 25,778 million in 2003 and RMB 11,318 million in 2004 taken to the carrying value of our assets under HKFRS. We expect this factor to continue to contribute to the difference in our consolidated profit under U.S. GAAP compared to our consolidated profit under HKFRS.

Operating results for the year ended December 31, 2004 and the year ended December 31, 2003

Revenues

In 2004, our revenues were RMB 83,494 million, representing an increase of RMB 5,896 million, or 7.6%, from RMB 77,598 million in 2003. This increase primarily reflects increases in revenues from our domestic services, including fixed-line services, broadband and other Internet-related services, interconnections with other domestic carriers, and value-added services and revenues from our international telecommunications services.

Domestic telecommunications services

Fixed-line telephone services

Local telephone services

In 2004, revenues from our local telephone services were RMB 44,390 million, representing an increase of RMB 1,962 million, or 4.6%, from RMB 42,428 million in 2003, and accounting for 53.2% of our total operating revenue in 2004.

The revenue growth in 2004 reflects increases in revenues from each of monthly fees, upfront installation fees and local usage fees, with monthly fee revenues accounting for the largest portion of the increase. This revenue growth was primarily attributable to continued growth in the number of our fixed-line subscribers and the usage volume of our PHS services. This revenue growth was partially offset by a decline in average usage per subscriber.

Local usage fees. In 2004, revenues from our local usage fees were RMB 24,858 million, representing an increase of RMB 173 million, or 0.7%, from RMB 24,685 million in 2003. As the average realized tariffs for local usage remained constant, this increase was attributable to an increase of 27.2 billion pulses, or 147.0%, in PHS usage volume to 45.7 billion pulses in 2004 from 18.5 billion pulses in 2003. The increase in usage volume was in turn caused by an increase of 10.3 million, or 87.3%, in the number of our PHS subscribers, to 22.1 million as of December 31, 2004 from 11.8 million as of December 31, 2003.

The effect of increased PHS usage volume on revenue growth was partially offset by a revenue decline from non-PHS calls, reflecting a decrease of 33.5 billion pulses, or 15.1%, in usage volume to 189.0 billion pulses in 2004 from 222.5 billion pulses in 2003 and principally reflecting the migration of our non-PHS local traffic to PHS and mobile services. While our number of non-PHS fixed-line subscribers increased by 3.7 million, or 4.5%, to 86.0 million as of December 31, 2004 from 82.3 million as of December 31, 2003, our monthly usage volume per subscriber declined due to the migration of non-PHS traffic to PHS and mobile networks.

Revenues from communications fees charged for our dial-up Internet service also declined in 2004 compared to 2003, which was primarily caused by a

decline of 21.7 billion pulses, or 55.8%, in usage volume of this service to 17.2 billion pulses in 2004 from 38.9 billion pulses in 2003 and reflecting the migration of Internet dial-up traffic to broadband services.

Monthly fees. In 2004, our revenues from monthly fees were RMB 17,964 million, representing an increase of RMB 1,488 million, or 9.0%, from RMB 16,476 million in 2003. The revenue growth was largely attributable to the 14.0 million, or 14.9%, increase in the number of our fixed-line subscribers during this period, which was partially offset by a decline in the average realized tariffs on a per subscriber basis, principally reflecting the increased number and scope of special promotional packages and discount schemes offered to certain subscribers of our fixed-line services.

Upfront installation fees. Revenues from the amortized amount of installation fees were RMB 1,568 million in 2004, representing an increase of RMB 301 million, or 23.8% from RMB 1,267 million in 2003. This increase principally reflects an increased number of access lines in service in our northern service region.

Domestic long distance services

In 2004, our domestic long distance revenues were RMB 11,266 million, representing a slight decrease of RMB 159 million, or 1.4%, from RMB 11,425 million in 2003. This decrease reflects a combination of:

- a decrease of RMB 864 million, or 10.2%, in revenues from the domestic long distance calls carried on our traditional network in 2004 as compared to 2003, which was in turn primarily caused by a decrease in the average realized tariffs for this service; and

- an increase of RMB 706 million, or 24.2%, in revenues from our VoIP long distance service. With the average realized tariffs for domestic VoIP long-distance calls remaining relatively constant, this increase was primarily attributable to an increase of 2.7 billion minutes, or 24.4%, in the usage volume of domestic long distance calls carried on our VoIP network.

International long distance services

In 2004, revenues from international long distance services were RMB 1,234 million, representing a decrease of RMB 309 million, or 20.0%, from RMB 1,543 million in 2003. The revenue decline principally reflects a decrease of RMB 166 million, or 22.8%, in revenues from international long distance calls carried on our traditional network, which was in turn caused by:

- decreased usage volume due to the continued migration of our international long distance traffic to VoIP networks of our own and other service providers, and

- lower average realized tariffs due to the increased usage and scope of special promotional discounts offered to our customers.

Value-Added Services

Revenues from our value-added services in 2004 were RMB 2,993 million, representing an increase of RMB 898 million, or 42.9%, from RMB 2,095 million in 2003. The increase was primarily due to the growth in the number of subscribers of our caller identification service, which reached a penetration rate of 60.4%

of our access lines in service as of December 31, 2004, and increasing usage of PHS messaging and other value-added services in our northern service region.

Interconnection Services

Revenues from our interconnection services were RMB 5,441 million in 2004, representing an increase of RMB 1,678 million, or 44.6%, from RMB 3,763 million in 2003. The increase was primarily due to increases in the revenues from our interconnections with China Mobile, China Unicom, China Telecom, and China Netcom Group.

Upfront connection fees

As a result of the elimination of the upfront connection fees on July 1, 2001, revenue from the amortized portion of upfront connection fees decreased by RMB 776 million, or 15.2%, to RMB 4,346 million in 2004, from RMB 5,122 million in 2003, and will continue to decline in the coming years.

Broadband access and other Internet-related services

Total revenues from our broadband access in 2004 were RMB 5,202 million, representing an increase of RMB 2,288 million, or 78.5%, from RMB 2,914 million in 2003. This increase reflects the rapid expansion of our broadband subscriber base. The total number of our DSL subscribers increased by approximately 3.3 million, or 122.2%, or to 6.0 million as of December 31, 2004 from approximately 2.7 million as of December 31, 2003. The effect of this subscriber increase on revenue growth was partially offset by declines in the average realized monthly tariffs for our broadband services, reflecting the discount and promotional packages that we offer, and the fact that increasing numbers of our new subscribers are residential users, who generally have lower usage than business users.

Revenues from other Internet-related services were RMB 1,004 million in 2004, representing a decrease of RMB 364 million, or 26.6%, from RMB 1,368 million in 2003. The decrease was primarily due to the continuing migration of subscribers to broadband services from Internet dial-up services.

Business and data communications services

Managed data services

Revenues from our managed data services in 2004 were RMB 1,520 million, representing a decrease of RMB 3.3 million, or 2.1%, from RMB 1,553 million in 2003. This decrease principally reflects reduced tariffs for our management data services as a result of intensified competition.

Leased line services

Revenues from our leased line services were RMB 2,095 million in 2004, representing a decrease of RMB 725 million, or 25.7%, from RMB 2,820 million in 2003. This decrease was primarily caused by a decline in revenues from the leased line services provided to our carrier customers, as both the leased bandwidth to these customers and the average realized tariffs declined. Revenues from our business customers also declined, reflecting a combination of increased leasing of bandwidth to these customers and lower average realized tariffs.

Other services

Revenues from other services, including revenues from service and maintenance fees, lease payments for our non-telecommunications equipment, paging service fees, and revenues from sales of products such as handsets and DSL modems, were RMB 1,360 million in 2004, representing an increase of RMB 222 million, or 19.5%, from RMB 1,138 million in 2003 and reflecting revenue growth from sales of DSL modems and other services.

International telecommunications services

In 2004, total revenues from our international operations were RMB 2,643 million, representing an increase of RMB 1,264 million, or 91.7%, from RMB 1,379 million in 2003. During this period, we recorded RMB 1,040 million in revenue from the operations of Asia Netcom, which accounted for 82.3% of the increase in our international revenue. Revenues generated by Asia Netcom are not reflected in the operating revenue data for 2003, as we used equity accounting for Asia Netcom during 2003. In addition to revenues from operations of Asia Netcom, increases in revenues from broadband and other Internet-related services, managed data services and leased line services provided to non-PRC customers further contributed to the overall revenue growth from our international telecommunications services.

Operating expenses

Our total operating expenses in 2004 were RMB 65,973 million, representing an increase of RMB 601 million, or 0.9%, from RMB 65,372 million in 2003, as compared to the 7.6% increase in our revenues during this period. The increase in our total operating expenses principally reflect the expansion of our customer base and increased selling, general and administrative expenses, which was in turn primarily caused by increasing market competition.

Depreciation and amortization

In 2004, our depreciation and amortization expenses were RMB 25,180 million, representing a decrease of RMB 1,620 million, or 6.0% from RMB 26,800 million in 2003. This decrease principally reflects:

- the revaluation of our fixed assets in 2003 and 2004, which resulted in decreased depreciation expenses; and
- a decrease in the amounts spent in purchasing and constructing telecommunications network and equipment during this period.

Network, operations and support

In 2004, these expenses amounted to RMB 13,973 million, representing a decrease of RMB 1,135 million, or 7.5%, from RMB 15,108 million in 2003.

The decrease was primarily reflects a combination of:

- a decrease of RMB 1,544 million, or 91.4%, in the loss from disposal of fixed assets, reflecting improved asset quality upon the consummation of our restructuring in 2003;
- a decrease of RMB 712 million, or 15.7%, in maintenance and repair costs due to increasingly centralized management of our network operations;
- an increase of RMB 930 million, or 143.1%, in costs of leasing digital circuits and other network elements from other carriers; and

- an increase of RMB 537 million, or 28.6%, in interconnection expenses with China Netcom Group and other carriers, which was in part due to increased volume of outbound calls.

Selling, general and administrative

In 2004, our selling, general and administrative expenses were RMB 12,877 million, representing an increase of RMB 2,555 million, or 24.8%, from RMB 10,322 million in 2003. These expenses increased more rapidly than revenues, principally as a result of:

- an increase of RMB 2,708 million, or 193.3%, in customer acquisition costs principally relating to subsidized handsets provided to some of our PHS subscribers, which are amortized based on the types of service packages for which they subscribe and their usage patterns.

- an increase of RMB 213 million, or 34.4%, in provisions for doubtful accounts, primarily due to increased delinquency rates among our subscribers, reflecting the increasing percentage of lower income customers, which in turn was a result of our lower installation costs and the elimination of upfront connection fees in July 2001.

Staff costs

In 2004, our staff costs were RMB 11,950 million, representing an increase of RMB 1,005 million, or 9.2%, from RMB 10,945 million in 2003. This increase principally reflects a combination of:

- an increase of RMB 357 million, or 106.25%, in early retirement expenses incurred;

- an increase of RMB 204 million, or 53.4%, in insurance expenses, reflecting increased scope of participation in national health insurance plans by our branches;

- an increase of RMB 114 million, or 23.5%, in welfare expenses; and

- a decrease of 78 million, or 1.53%, in salaries and wages expense, due to a reduction in the number of our temporary employees in connection with our restructuring.

Other operating expenses

In 2004, other operating expenses were RMB 1,993 million, representing a decrease of RMB 204 million, or 9.3%, from RMB 2,197 million in 2003.

Operating profit before interest income, dividend income and deficit on revaluation of fixed assets

In 2004, our operating profit before interest income, dividend income and deficit on revaluation of fixed assets was RMB 17,521 million, representing an increase of RMB 5,295 million, or 43.3%, from RMB 12,226 million in 2003.

Profit/(loss) from operations

In 2004, our profit from operations was RMB 6,307 million, representing an increase of RMB 19,719 million, from a loss of RMB 13,412 million in 2003.

Finance costs

In 2004, our finance costs were RMB 3,930 million, representing a decrease of RMB 366 million from RMB 4,296 million in 2003, which was primarily attributable to the reduction in our total borrowings.

Share of profit/(losses) of a jointly controlled entity

No deficit from our share of losses of our jointly controlled entity was recorded in 2004, as revenues and expenses associated with Asia Netcom's operations were consolidated into our results beginning on January 1, 2004.

Taxation

In 2004, we received a tax credit of RMB 323 million, representing a decrease of RMB 6,894 million from a tax credit of RMB 7,217 million in 2003 and reflecting a higher profit from operations.

The effective tax rates deviated from the weighted average statutory tax rate mainly because the upfront connection fee revenues that we recognized were not taxable under the PRC law.

Profit for the period

As a result of the foregoing, our net income for 2004 was RMB 2,699 million, representing an increase of RMB 13,605 million from a net loss of RMB 10,906 million for 2003.

Profit/(Loss) for the Year Reconciled to U.S. GAAP

Our consolidated profit as determined pursuant to U.S. GAAP for 2004 was RMB 7,932 million, as compared to RMB 2,699 million as determined pursuant to HKFRS. The principal difference reflects the effect of the revaluation of our fixed assets in 2003 and 2004. The lower depreciation charges we record under HKFRS are a result of the lower carrying value of our asset base under HKFRS.

Liquidity and Capital Resources

Overview

Our primary source of funding for both our working capital and our longer-term funding needs have been cash provided by operating activities and short-term bank loans and our primary uses of funds have been capital expenditures, repayment of bank loans and, for the year ended December 31, 2005, our 2005 Acquisition.

The following table summarizes our cash flows for the periods indicated:

	For the Years Ended December 31,		
	2003	2004	2005
	(RMB in millions)		
Net cash inflow from operating activities..	30,917	33,653	33,557
Net cash outflow for investing activities..	(34,875)	(28,702)	(24,608)
Net cash inflow/(outflow) from financing activities.....	3,595	(1,743)	(14,656)

Increase/(decrease) in cash and cash equivalents	(363)	3,208	(5,707)

Our net cash outflow in 2005 was RMB 5,707 million, representing a decrease in cash inflow of RMB 8,915 million from the net cash inflow of RMB 3,208 million in 2004, which in turn increased from a net cash outflow of RMB 363 million in 2003. The decrease from 2004 to 2005 and the increase from 2003 to 2004 in net cash inflows were primarily attributable to our global offering in the fourth quarter in 2004, which resulted in a significant increase in our cash and cash equivalents as of December 31, 2004.

Taking into account cash generated from operating activities, short-term and long-term bank loans, we believe that we have access to sufficient working capital for the next 12 months.

Net cash inflow from operating activities

Our net cash inflow from operating activities in 2005 was RMB 33,557 million, representing a decrease of RMB 96 million, or 0.3%, from RMB 33,653 million in 2004. The decrease principally reflects a combination of:

- a cash outflow for profit tax paid in the amount of RMB 4,065 million for 2005 compared to RMB 7 million in 2004, as a result of the utilization in 2005 of our provision for profit tax for 2004 pursuant to relevant PRC regulations; and
- an increase of RMB 3,298 million, or 8.8%, in our net cash inflow generated from operations to RMB 40,732 million in 2005 from RMB 37,434 million in 2004.

Our net cash inflow from operating activities was RMB 33,653 million in 2004, representing a slight increase of RMB 2,736 million, or 8.8%, from RMB 30,917 million in 2003, primarily reflecting:

- an increase of RMB 1,907 million in our net cash flow generated from operations; and
- a decrease of RMB 924 million in the profit tax paid.

For more details, see Note 34(a) to our consolidated financial statements included elsewhere in this annual report.

Set out below is a breakdown of our net cash inflow from operating activities for the periods indicated:

	Years Ended December 31,		
	2003	2004	200
	(RMB in millions)		
Net cash inflows generated from operations	35,527	37,434	40
Interest received	95	86	
Dividends received	45	17	
Interest paid	(3,819)	(3,877)	(3
profits tax paid	(931)	(7)	(4

Net cash inflow from operating activities.....	30,917	33,653	33

All of our operations in the PRC are conducted through our wholly foreign-owned subsidiaries, CNC China and CNC New Horizon. Our telecommunications businesses outside of the PRC are primarily owned and conducted by China Netcom (USA) Operations Limited and China Netcom (Hong Kong) Operations Limited, our wholly owned subsidiaries incorporated in the U.S. and Hong Kong, respectively. Accordingly, our future cash flow will consist principally of dividends from our subsidiaries. Our ability to pay dividends depends substantially on the payment of dividends to us by CNC China and CNC New Horizon. CNC China and CNC New Horizon must follow the laws and regulations of the PRC and their respective articles of association in declaring and paying dividends to us. As wholly foreign-owned enterprises in China, each of CNC China and CNC New Horizon is required to provide for a reserve fund and staff and workers' bonus and welfare fund, each of which is allocated from net profit after taxation but before dividend distribution according to the prevailing accounting rules and regulations in the PRC. Each of CNC China and CNC New Horizon is required to allocate at least 10% of its net profit to the reserve fund until the balance of this fund has reached 50% of its registered capital. Appropriations to the staff and workers' bonus and welfare fund, which are determined at the discretion of the respective directors of CNC China and CNC New Horizon, are charged as expenses on a when-incurred basis in the consolidated financial statements. During 2003, neither CNC China nor CNC New Horizon made any contributions into these statutory funds as both of them, on a stand-alone basis, incurred a net loss in this year. In 2004 and 2005, CNC China and CNC New Horizon contributed approximately RMB 723 million and RMB 1,040 million, respectively, to these statutory funds. None of the contributions by CNC China or CNC New Horizon to these statutory funds may be used for dividend purposes. For more details, see "Item 8. Financial Information -- Dividend Policy".

Net cash outflow for investing activities

Our net cash outflow from investing activities in 2005 was RMB 24,608 million, representing a decrease of RMB 4,094 million, or 14.3%, from RMB 28,702 million in 2004. This decrease was primarily attributable to (i) a decrease in our capital expenditures to RMB 27,562 million in 2005 from RMB 28,256 million in 2004; and (ii) RMB 2,874 million that we realized in 2005 in investments from the sale of short-term securities acquired in 2004. For more details, see "-- Capital expenditures" below.

Our net cash used in investing activities was RMB 28,702 million in 2004 and RMB 34,875 million in 2003. Our cash outlays for capital expenditures amounted to RMB 28,256 million in 2004 and RMB 36,450 million in 2003. In 2004, we realized RMB 1,528 million in investments of from the sale of a portion of investments we had made primarily in 2001 and 2002 in short-term securities. In 2003 we realized RMB 1,195 million from the sale of a portion of investments we had made primarily in 2001 and 2002 in short-term securities, as well as RMB 756million from the disposal of fixed assets.

We must obtain approvals from the NDRC and the MII, and in some cases, the State Council for any government-funded project involving significant capital investment in our operations. In addition, approvals from the NDRC and the MII are required for investment projects concerning national security, such as the construction of domestic backbone transmission networks, international gateways, and other telecommunications infrastructure projects. For a more detailed description, see "Item 4. Information on the Company -- Regulation -- Capital Investment".

Net cash inflow/(outflow) from financing activities

Our net cash outflow from financing activities in 2005 was RMB 14,656 million, representing an increase of RMB 12,913 million, or 740.8%, from RMB 1,743 million in 2004. This increase was primarily attributable to:

- cash inflow from our global offering in 2004 in the amount of RMB 8,944 million;
- a net amount of RMB 3,995 million in loans from China Netcom Group in 2004;
- a payment of distribution to China Netcom Group of RMB 1,566 million in 2005, compared to RMB 7,310 million in 2004; and
- a payment to China Netcom Group in the amount of RMB 3,000 million in 2005 in connection with our 2005 Acquisition.

Our net cash outflow from financing activities was RMB 1,743 million in 2004, compared to an inflow of RMB 3,595 million in 2003. The decrease in cash inflow primarily reflects:

- net proceeds of RMB 8,944 million from the global offering, less related expenses of RMB 689 million;
- a payment of distribution to China Netcom Group of RMB 7,310 million;
- new bank loans amounting to RMB 64,664 million;
- repayment of bank loans amounting to RMB 70,051 million; and
- equity distribution to CNC BVI of RMB 1,021 million, upon assignment of loan prior to the global offering.

Working capital

As of December 31, 2005, our working capital(calculated as current liabilities less current assets), or net current liabilities, was RMB 83,900 million, representing an increase of RMB 2,311 million, or 2.8%, from RMB 81,589 million as of December 31, 2004. The increase in net current liabilities was primarily attributable to reduced levels of cash and cash equivalents and bank loans as of December 31, 2005 compared to the amounts as of December 31, 2004 as a result of our efforts to reduce working capital.

Indebtedness

In May 2006, we submitted an application to the PBOC for approval to issue RMB 20.0 billion in short-term debentures with terms less than one year. We expect to complete the issuance within one year from receiving each approval.

Our indebtedness as of the dates indicated was as follows:

	Years Ended Decem	
	2003	2004
	(RMB in milli	
Short-term loans	47,991	44,882

Long-term bank loans and other loans, current portion.....	19,392	11,727
Long-term bank loans and other loans, excluding current portion.....	30,172	26,052
Deferred consideration, current portion.....	-	-
Deferred consideration, excluding current portion.....	-	-
Total.....	97,555	82,661

As of December 31, 2005, our total indebtedness were RMB 82,130 million, which included deferred consideration of RMB 9,800 million in relation to the 2005 Acquired Assets and Liabilities. Our outstanding loans as of December 31, 2005 amounted to RMB 72,330 million, representing a decrease of RMB 10,331 million, or 12.5%, from RMB 82,661 million as of December 31, 2004, reflecting a reduced level of our borrowings as we continued to repay some of our loans with the cash inflow from operating activities.

As of December 31, 2005, our short-term loan represented 68.4% of our total indebtedness, compared to 68.5% as of December 31, 2004. As of December 31, 2005, our debt-to-capital ratio was 50.1%, calculated as the ratio of total indebtedness to the sum of total indebtedness, owner's equity and the balance of deferred revenues.

Our total indebtedness as of December 31, 2004 amounted to RMB 82,661 million, representing a decrease of RMB 14,894 million, or 15.3%, from RMB 97,555 million as of December 31, 2003. As a result, our interest expenses were reduced during this period.

Our secured long-term loans were RMB 320 million as of December 31, 2005. These loans were secured by:

- RMB 245 million in corporate guarantee granted by third parties; and
- RMB 75 million in corporate guarantees granted by China Netcom Group.

As of December 31, 2005, our available and unused credit facilities amounted to RMB 104,731 million.

Contractual obligations and commitments, including off-balance sheet arrangements

The following table sets forth information regarding our aggregate payment obligations in future years of the contractual obligations and commercial commitments that we had as of December 31, 2005.

	Payments Due in the Period						
	Total	2006	2007	2008	2009	2010	T
	(RMB in millions)						
Short-term debt(1).....	48,200	48,200	-	-	-	-	
Short-term capacity purchase payable.....	-	-	-	-	-	-	
Long-term debt(1).....	28,652	7,874	9,461	6,124	249	246	
Operating lease commitments.....	4,066	994	434	333	308	298	
Capital commitments.....	1,854	1,678	170	6	-	-	
Deferred payment(2).....	11,133	2,433	2,330	2,227	2,123	2,020	

Total contractual cash obligations	93,905	61,179	12,395	8,690	2,680	2,564
Guarantees	-	-	-	-	-	-
Total commercial commitments	93,905	61,179	12,395	8,690	2,680	2,564

(1) The amounts shown include interest charged for each year.
(2) The amounts shown include interest payable on the deferred consideration.

We have entered into certain foreign currency exchange forward contracts with banks, which are non-speculative and used as hedges of certain of our borrowings that are denominated in foreign currencies. The foreign currency exchange forward contracts and respective payable balances are included in other non-current liabilities and disclosed in the section entitled "-- Market Risk and Risk Management -- Foreign exchange rate risk".

Capital expenditures

The following table sets forth our actual and planned total capital expenditure requirements for the periods indicated:

	Capital Expenditures
	(RMB in millions)
2003	36,450
2004	28,256
2005	27,562
2006 (Planned)	27,300

Historically, most of our capital expenditures were budgeted for the improvement of our networks and related equipment. In particular, capital expenditures related to our local access, switching, data and transport networks each accounted for a significant percentage of our total capital expenditures. Expenditures for other projects were mainly related to investments in facilities to house our telecommunications equipment and other facilities. Our total capital expenditure in 2003, 2004 and 2005 were substantially lower than those in 2003 as we focused on controlling our capital expenditure levels by improving our network efficiency and developing new products and services to better utilize our existing networks.

In 2005, our capital expenditures were RMB 27,562 million, representing a decrease of RMB 694million, or 2.5%, from RMB 28,256 million in 2004, which was primarily attributable to our efforts to improve the utilization rate of our existing network equipment, the implementation of an efficiency-based capital expenditure policy. In 2005, we continued to increase investments to RMB 2,909 million in 2005 from RMB 2,166 million in 2004 in operation and supporting systems in an effort to enhance network, billing and sales services for our customers. In addition, we increased investments to RMB 7,272 million in 2005 from RMB 6,642 million in 2004 in broadband and content services in an effort to improve the quality of our broadband services and expanding our broadband network coverage. We reduced investments to RMB 5,582 million in 2005 from RMB 8,102 million in 2004 in the PHS segment as we increased our focus on enhancing the utilization of our existing PHS network.

Our capital expenditure estimates are subject to uncertainty, and actual capital expenditures in future periods may differ significantly from these estimates. The timing, amount and nature of capital expenditures are subject to various factors, including the general economic environment, customer

demand, technological advances and other relevant factors.

Capital resources

We expect to fund our capital expenditure needs with a combination of cash generated from operating activities, short-term and long-term bank loans and net proceeds from the global offering. We believe that we will have sufficient capital resources to satisfy our capital expenditure requirements in the foreseeable future periods.

Reconciliation of HKFRS and U.S. GAAP

Our consolidated financial statements have been prepared in accordance with HKFRS, which differs significantly in certain respects from U.S. GAAP. Differences between HKFRS and U.S. GAAP may have significant impact on our consolidated net profit/(loss) and shareholders' equity. For example, U.S. GAAP requires fixed assets to be recorded at cost less impairment while HKFRS allows as providing an appropriate basis for restating the depreciable asset base revaluation of the fixed assets other than impairment situation. Consequently, under U.S. GAAP there was no charge to income in 2003 or 2004 resulting from the revaluation of our fixed assets in the amount of RMB 25,778 million in 2003 or RMB 11,318 million in 2004, as the case may be. Thus, in future periods we expect our depreciation and amortization expense as reported in accordance with U.S. GAAP to be significantly higher than as reported in our financial statements prepared in accordance with HKFRS.

We have summarized these differences and their effect on our shareholders' equity as of December 31, 2003, 2004 and 2005 and the results of our operations for each of the years ended December 31, 2003, 2004 and 2005 in Note 41 to our consolidated financial statements included elsewhere in this document. These differences relate primarily to the treatment of the revaluation of fixed assets, and deferred tax.

The effect on net profit/(loss) of differences between HKFRS and U.S. GAAP for the years ended December 31, 2003, 2004 and 2005 is as set forth in the following table.

	For the Years Ended December 3		
	2003	2004	
	(RMB in millions)		
Net profit/(loss) under HKFRS.....	(10,906)	2,699	1
U.S. GAAP adjustments.....	17,271	5,233	(
Net profit under U.S. GAAP.....	6,365	7,932	1

The effect on shareholders' equity of differences between HKFRS and U.S. GAAP as of December 31, 2002, 2003 and 2004 is as set forth in the following table.

	As of December 31,		
	2003	2004	
	(RMB in millions)		
Owners' equity under HKFRS.....	53,659	64,595	6
U.S. GAAP adjustments.....	12,624	18,069	1

Owners' equity under U.S. GAAP.....	66,283	82,664	7

Critical Accounting Policies

We have prepared the consolidated financial statements in accordance with HKFRS issued by the Hong Kong Institute of Certified Public Accountants. HKFRS require us to adopt accounting policies and make estimates and assumptions in the preparation of these financial statements. When we make these estimates and assumptions, we base our estimates on historical experience and are required to make judgments about matters that are inherently uncertain. Accordingly, the reported financial position and results of operations are sensitive to these estimates and assumptions, and actual results may differ from those estimates as facts, circumstances and conditions change. Our principal accounting policies are set out in detail in Note4 to our consolidated financial statements included elsewhere in this document. The following sections discuss the accounting policies which involve the most significant estimates and judgments made in the preparation of our consolidated financial statements.

Depreciation of fixed assets

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

Revaluation of fixed assets

In connection with our restructuring in anticipation of our global offering in 2004, our property, plant and equipment were revalued as of December 31, 2003 on a depreciated replacement cost basis. The property, plant and equipment acquired as part of our 2005 Acquisition were revaluated as of December 31, 2004 on a depreciated cost basis. In preparation for our 2005 Acquisition, apart from lease prepayment for land and buildings, which are carried at cost, other property, plant and equipment are carried at the revalued amounts, being the fair value at the date of revaluation, less subsequent accumulated depreciation and impairment losses. Revaluations are performed with sufficient regular intervals by independent valuers and, in each of the intervening years, valuations are undertaken by our executives. If the revalued amounts differ significantly from the carrying amounts of the property, plant and equipment in the future, the carrying amounts will be adjusted to the revalued amounts. This will have an impact on our future results, since any subsequent decreases in valuation are first set off against increases on earlier valuations in respect of the same item and thereafter are charged as expense to the income statement and any subsequent increases are credited as income to the income statement up to the amount previously charged. In addition, the depreciation expense in future periods will change as the carrying amounts of the fixed assets change as a result of the revaluation.

Impairment of non-current assets

At each balance sheet date, we consider both internal and external sources of information to assess where there is any indication that non-current assets, including property, plant and equipment are impaired. If any such

indication exists, the recoverable amount of the asset is estimated and an impairment loss is recognized to reduce the carrying amount of the asset to its recoverable amount. The recoverable amount is the higher of value in use or net selling price. Estimated recoverable amounts are determined based on estimated discounted future cash flows of the cash-generating unit at the lowest level to which the asset belongs. Key assumptions made to determine the estimated discounted cash flows include the estimated growth rate and our estimated weighted cost of capital. Such impairment losses are recognized in the income statement, except where the asset is carried at valuation and the impairment loss does not exceed the revaluation surplus for that same asset, in which case the impairment loss is treated as a revaluation decrease and charged to the revaluation reserve. Accordingly, there will be an impact to our future results if there is a significant change of the recoverable amounts of our non-current assets.

Revenue recognition for upfront connection and installation fees

We defer the recognition of upfront customer connection and installation fees and amortize them over the expected customer relationship period of ten years. The related direct incremental installation costs are deferred and amortized over the same expected customer relationship period of ten years, except when the direct incremental costs exceed the corresponding installation fees. The excess of the direct incremental costs over the corresponding installation fees, if any, are immediately amortized as expenses to the income statement. We estimate the expected customer relationship period based on our historical customer retention experience and other factoring in the expected level of future competition, the risk of technological or functional obsolescence to our services, technological innovation, and the expected changes in the regulatory and social environment. If our estimate of the expected customer relationship period changes as a result of increased competition, changes in telecommunications technology or other factors, the amount and timing of recognition of our deferred revenues may change for future periods.

Recognition of revenues and costs under PHS bundled service contracts

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

Provision for doubtful debts

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

Fair value

We estimates the fair value of our financial assets and financial liabilities including the accounts receivable, prepayments, other receivables and other current assets, accounts payable, and bank and other loans for disclosure purposes by discounting its future contractual cash flows at the estimated current market interest rate that is available to us for similar financial instruments. The future disclosed values will change if there are changes in the estimated market interest rate.

Accounting for business combinations under common control

We completed our 2005 Acquisition on October 31, 2005. Our 2005 Acquisition is treated as a business combination under common control. Under HKFRS, we can choose to adopt either acquisition accounting or merger accounting to record our 2005 Acquisition. We adopted merger accounting to account for the business combinations under common control as we believe that the financial statements prepared under merger accounting are more relevant to those transactions.

Inflation

According to China's National Bureau of Statistics, China's overall national inflation rate, as represented by the general consumer price index, was approximately 1.2% in 2003, 3.9% in 2004, and 1.8% in 2005. Inflation or deflation has not had a significant impact on our results of operations in recent years.

Market Risk and Risk Management

Market risk is the risk of loss related to adverse changes in market prices, including interest rates and foreign exchange rates, of financial instruments we hold or have issued, all of which were for purposes other than trading purposes. In the normal course of business, we are routinely subject to a variety of risks, including market risk associated with interest rate movements and currency rate movements on non-Renminbi denominated assets and liabilities.

Foreign exchange rate risk

We conduct our business primarily in Renminbi, which is also our functional and reporting currency. The Renminbi is not a fully convertible currency. From 1994 to July 20, 2005, the official exchange rate for the conversion of Renminbi to U.S. dollars was generally stable. On July 21, 2005, the RPC government introduced a managed floating exchange rate system to allow the value of the Renminbi to fluctuate within a regulated band based on market supply and demand and by reference to a basket of currencies. On the same day, the value of the Renminbi appreciated by 2% against the U.S. dollar. The PRC government has since made and in the future may make further adjustments to the exchange rate system. Fluctuations in exchange rates may adversely affect the value, translated or converted into United States dollars or Hong Kong dollars (which are pegged to the U.S. dollar), of our net assets, earnings and any declared dividends. For a detailed description of the unitary managed floating rate system used by the PRC government to set foreign exchange rates, see "Item 3. Key Information -- Selected Financial Data -- Exchange Rate Information".

We are exposed to foreign currency risk primarily as a result of our foreign currency borrowings for past purchases of telecommunications equipment from overseas suppliers. In addition, we receive some of our revenues from our international operations and pay related expenses in foreign currencies. As a result, our foreign currency exposure relates to our foreign currency-denominated debt and, to a limited extent, cash and cash equivalents denominated in foreign currencies.

We have, in the past, entered into currency swap agreements and foreign exchange forward contracts designed to mitigate our exposure to foreign currency risks and may continue to do so in the future.

The following table provides information regarding our foreign currency-sensitive financial instruments, which consist of cash and cash equivalents, short-term and long-term debt obligations and capital commitments as of December 31, 2005 and the expected maturity profile of these debt obligations and capital commitments.

	Expected Maturity					
	2006	2007	2008	2009	2010	Thereafter
	(RMB equivalent in millions, except interest ra					
Assets:						
Cash and cash equivalents						
U.S. dollars.....	512	-	-	-	-	-
HK dollars.....	506	-	-	-	-	-
Taiwan dollars.....						
Liabilities:						
U.S. dollar-denominated loans						
Fixed rate.....	137	43	30	30	28	556
Average rate.....	3.91%	2.59%	1.29%	1.26%	0.92%	0.50%
Variable rate.....	114	303	-	-	-	-
Average rate(1).....	3.67%	5.10%	-	-	-	-
Euro-denominated loans						
Fixed rate.....	31	30	29	27	27	286
Average rate.....	2.86%	2.69%	2.52%	2.32%	2.32%	2.25%
Variable rate.....	-	-	-	-	-	-
Average rate(1).....	-	-	-	-	-	-
Japanese yen-denominated loans						
Fixed rate.....	-	-	-	-	-	-
Average rate.....	-	-	-	-	-	-
Variable rate.....	39	39	39	39	39	132
Average rate(1).....	2.12%	2.12%	2.12%	2.12%	2.12%	2.12%

(1) The average interest rates for variable rate loans are calculated based on the rates reported as of December 31, 2005.

Interest Rate Risk

The People's Bank of China has the sole authority in China to establish the official interest rates for Renminbi-denominated loans. Financial institutions in China set their effective interest rates within the range

established by the People's Bank of China. Interest rates and payment methods on loans denominated in foreign currencies are set by financial institutions based on interest rate changes in the international financial market, cost of funds, risk levels and other factors.

We are subject to market risks due to fluctuations in interest rates on our debt. The majority of our debt is in the form of bank loans from banks in China. Increases in interest rates will increase the cost of new borrowing and the interest expense with respect to outstanding variable rate debt. Accordingly, fluctuations in interest rates can lead to significant fluctuations in the fair value of these debt instruments.

The following table provides information regarding our interest rate-sensitive financial instruments, which consist of short-term and long-term debt obligations as well as the expected maturity profile of such obligations.

	Expected Maturity						
	2006	2007	2008	2009	2010	Thereafter	Tota
	(RMB equivalent in millions, except interest rates)						
Liabilities:							
RMB-denominated loans							
Fixed rate.....	36,148	2,320	2,350	-	-	-	40,81
Average rate.....	4.86%	5.20%	5.24%	-	-	-	4.9
Variable rate.....	1,115	5,040	3,250	-	-	2,518	27,15
Average rate.....	5.00%	5.18%	5.18%	-	-	5.47%	4.98
U.S. dollar-denominated loans							
Fixed rate.....	137	43	30	30	28	556	82
Average rate.....	3.91%	2.59%	1.29%	1.26%	0.92%	0.50%	1.24
Variable rate.....	114	303	-	-	-	-	41
Average rate.....	3.67%	5.10%	-	-	-	-	4.71
Euro-denominated loans							
Fixed rate.....	31	30	29	27	27	286	43
Average rate.....	2.86%	2.69%	2.52%	2.32%	2.32%	2.25%	2.35
Variable rate.....	-	-	-	-	-	-	
Average rate.....	-	-	-	-	-	-	
Japanese yen-denominated loans							
Fixed rate.....	-	-	-	-	-	-	
Average rate.....	-	-	-	-	-	-	
Variable rate.....	39	39	39	39	39	132	32
Average rate.....	2.12%	2.12%	2.12%	2.12%	2.12%	2.12%	2.12

(1) The average interest rates for variable rate loans are calculated based on the rates reported as of December 31, 2005.

ITEM 6. DIRECTORS, SENIOR MANAGEMENT AND EMPLOYEES

DIRECTORS AND SENIOR MANAGEMENT

In accordance with Hong Kong law and our articles of association,

members of our board of directors are elected by our shareholders. Our board of directors consists of 13 members, including five independent non-executive directors.

The following table sets forth certain information about our directors, each of whom were duly elected and will retire from office at an annual general meeting by rotation every three years (but will be eligible for re-election at such annual general meeting), executive officers and joint company secretaries.

Name	Age	Positions
Zhang Chunjiang	47	Chairman and Executive Director
Edward Tian Suning(1)	42	Vice Chairman, Non-Executive Director
Zuo Xunsheng(2)	55	Executive Director and Chief Executive O
Zhang Xiaotie	53	Executive Director
Miao Jianhua	54	Executive Director and Joint Company Sec
Jiang Weiping(3)	54	Executive Director
Li Liming	55	Non-Executive Director
Keith Rupert Murdoch(4)	75	Non-Executive Director
Yan Yixun	67	Non-Executive Director
Jose Maria Alvarez-Pallete(5)	42	Non-Executive Director
John Lawson Thornton	52	Independent Non-Executive Director
Victor Cha Mou Zing	56	Independent Non-Executive Director
Qian Yingyi	49	Independent Non-Executive Director
Hou Ziqiang	68	Independent Non-Executive Director
Timpson Chung Shui Ming	54	Independent Non-Executive Director
Mauricio Sartorius(6)	46	Alternate Director
Pei Aihua	55	Senior Vice President
Zhang Changsheng	58	Senior Vice President
Zhao Jidong	55	Senior Vice President
Li Fushen	43	Chief Financial Officer
Mok Kam Wan	43	Joint Company Secretary

(1) Resigned as Chief Executive officer and Executive Director effective May 17, 2006.
(2) Appointed effective May 17, 2006.
(3) Re-designated as an Executive Director on December 7, 2005. Resigned as a Director effective May 17, 2006.
(4) Resigned as a Director effective September 12, 2005.
(5) Appointed effective September 12, 2005.
(6) Alternate Director to Jose Maria Alvarez-Pallete; appointed effective September 12, 2005.

Directors, Executive Officers and Joint Company Secretaries

Directors

Zhang Chunjiang, 47, Chairman and Executive Director, has served as a Director since June 2004. He has been the Chairman of China Netcom (Group) Company Limited since September 2004 and President of China Netcom Group since May 2003. He joined PCCW Limited as a Non-executive Director since April 2005. Prior to joining China Netcom Group, Mr. Zhang served as Deputy Minister of the

Ministry of Information Industry (MII) and was one of the most senior regulatory officials in the PRC telecommunications industry from December 1999 to May 2003. From August 1993 to December 1999, Mr. Zhang held a series of senior positions at the former Liaoning Provincial Posts and Telecommunications Bureau, the former Ministry of Posts and Telecommunications (MPT) and the MII, including serving as the Deputy Director of the former Liaoning Provincial Posts and Telecommunications Administration, Director of Mobile Telecommunications Administration of the MPT and Director of Telecommunications Administration of the MII. Mr. Zhang is a senior engineer of professor level and has extensive experience in telecommunications management, operations and technology. Mr. Zhang graduated from the Beijing University of Posts and Telecommunications in 1982 with a bachelor's degree in telecommunications.

Dr. Edward Tian Suning, 42, Vice Chairman and Non-Executive Director, has served as a Director since 2000. He has also served as Vice President of China Netcom Group from April 2002 to May 2006. From 1999 to May 2006, he has served as Chief Executive Officer of China Netcom (Holdings) Company Limited and the Company. He has been a Director of China Netcom (Group) Company Limited from 2001 and May 2006. He has also served as Vice Chairman and a Non-executive Director of PCCW Limited since April 2005. Dr. Tian is also an Independent Director of AsiaInfo Holdings Inc., a Nasdaq-listed company. Dr. Tian is a member of the Advisory Committee to Harvard Business School of the US and the International Business Council of the World Economic Forum. Prior to joining China Netcom (Holdings) Company Limited, Dr. Tian was the co-founder and Chief Executive Officer of AsiaInfo Holdings Inc., a Nasdaq-listed company providing software and networking solutions in China. Dr. Tian has extensive experience and knowledge in the management and financing fields of the telecommunications and information industry. Dr. Tian received a Ph.D. in natural resources management from Texas Tech University in 1992, a master's degree in ecology from the Graduate School of the Chinese Academy of Sciences in 1988, and a bachelor's degree in environmental biology from Liaoning University in 1985.

Zuo Xunsheng, 55, has served as Executive Director and Chief Executive Officer since May 2006 , overseeing general operations of the Company. Mr. Zuo has served as Chief Operating Officer and from December 2005 to May 2006.He has served as Senior Vice President from July 2004 to May 2006. He has also served as Vice President of China Netcom Group since April 2002. Before joining China Netcom Group, Mr. Zuo was President of the former Shandong Telecommunications Company from May 2000 to April 2002. From October 1997 to May 2000, Mr. Zuo served as Director of the former Posts and Telecommunications Bureau of Shandong Province. From 1988 to 1997, Mr. Zuo served as Director of the former Bureau of Telecommunications of Jinan City. Mr. Zuo graduated from Guanghua School of Management of Peking University with an EMBA degree in 2004. Mr. Zuo was appointed as an Executive Director and Chief Executive Director effective May 17, 2006.

Zhang Xiaotie, 53, Executive Director, has served as a Director since October 2004. He has served as Vice President of China Netcom Group since July 2003. From June 2002 to July 2003, Mr. Zhang also served as Assistant to President and General Manager of Planning and Finance Department of China Netcom Group. Before joining China Netcom Group, Mr. Zhang served as Vice Director and Director of the Economic Regulation and Communications Settlement Bureau of the MII and held a series of senior positions at the former MPT and the former Beijing Administration of Telecommunications. Mr. Zhang graduated from the School of Economics and Management of Tsinghua University with a master's degree.

Miao Jianhua, 54, Executive Director and Joint Company Secretary, has served as a Director since October 2004. He has also served as Assistant to President of China Netcom Group since September 2003 to November 2005. From June 2002 to November 2005, Mr. Miao served as the General Manager of the Human Resources Department of China Netcom Group and the Company. Before joining China

Netcom Group, Mr. Miao served as Director of the Inspection Bureau of the former MPT and the MII from 1997 to early 2002, and held senior positions at the former Jilin Provincial Administration of Posts and Telecommunications prior to June 1997. He graduated from the Australian National University with a master's degree in management.

Jiang Weiping, 54, Executive Director, has served as a Director from October 2004 to May 2006. He has also served as Assistant to the President of China Netcom Group since July 2004. Mr. Jiang became the General Manager of Human Resources Department of the Company since November 2005. From May 2000 to July 2004, he served as General Manager in the former Liaoning Telecommunications Company and Liaoning Communications Company. From August 1984 to May 2000, he held a series of senior positions in the former Liaoning Provincial Administration of Posts and Telecommunications, including Deputy Director and Director from August 1993 to May 2000. Mr. Jiang graduated from the Harbin Institute of Technology with a bachelor's degree in radio communications.

Li Liming, 55, Non-Executive Director, has served as a Director since October 2004. She also served as General Manager of Human Resource Department of the China Netcom Group since March 2005. From July 2003 to August 2004, she served as Deputy General Manager of Human Resources Department of China Netcom Group. Before joining China Netcom Group, Ms. Li held a series of senior positions at Jitong Network Communications Company Limited from November 1994 to July 2003. Ms. Li graduated from the Radio Department of Tsinghua University with a bachelor's degree in semiconductor devices.

Keith Rupert Murdoch, 75, Non-Executive Director, previously served as a Director from 2001 to June 30, 2004 and from October 2004 to September 2005. He is Chairman and Chief Officer of News Corporation, a diversified international media and entertainment company. Mr. Murdoch received on M.A. in economics from Oxford University in 1953.

Yan Yixun, 67, Non-Executive Director, has served as a Director since 2001. He is a member of the Standing Committee of the Tenth National People's Congress and Vice Chairman of the Financial and Economic Committee of the National People's Congress. He was a member of the Standing Committee of the Eighth and Ninth National People's Congress and a member of the Education, Science, Culture and Health Committee of the Ninth National People's Congress. From December 1992 to November 2000, he served as Vice Chairman of the Chinese Academy of Sciences, prior to that he served as Director of Shanghai Technical Physics Research Institute. He was a first-term Board Director of Legend Holdings Limited and now serves as Chairman of the Board of NewMargin Venture Capital Co., Ltd and Director of Chinese Academy of Sciences Holdings Co., Ltd. Mr. Yan received a master's degree from the Institute of Electronics of the Chinese Academy of Sciences in 1966 and graduated from the Department of Radio Electronics at Tsinghua University in 1962.

Jose Maria Alvarez-Pallete, 42, Non-Executive Director, has served as a Director since September 2005. He joined Telefonica Internacional in February 1999 as General Manager for Finance. In September of the same year, he became Chief Financial Officer of Telefonica, S.A. In July 2002, he was appointed as Chairman and Chief Executive Officer of Telefonica Internacional, S.A. and a member of the senior management committee of the company. Telefonica Internacional, S.A. has 5% interest in the issued share capital of the Company. Mr. Alvarez-Pallete is a Director on the boards of Telecomunicacoes de Sao Paulo, S.A. (listed on the Stock Exchanges of Sao Paulo and New York), Compania de Telecomunicaciones de Chile, S.A. (listed on the Stock Exchanges of Santiago de Chile and New York), Telefonica de Espana, Telefonica Moviles S.A. (listed on the Stock Exchanges of Madrid and New York), Telefonica Moviles Espana, Telefonica Data, Telefonica Internacional, Telefonica de Argentina (listed on the Stock Exchanges of Buenos Aires and New York), Telefonica CTC Chile, Telefonica de Peru S.A.A. (listed on the Stock Exchange of Lima), Compania de

Telefonos de Chile Transmisiones Regionales, Telefonica Larga Distancia de Puerto Rico, Telesp and Cointel. In addition, he is a member of the Supervisory Board of Cesky Telecom (a company listed on the Stock Exchange of Prague). Mr. Alvarez-Pallete received a bachelor's degree in economics from the Universidad Complutense of Madrid. Mr. Alvarez-Pallete was appointed as a Director effective September 12, 2005.

John Lawson Thornton, 52, Independent Non-Executive Director, has served as a Director since October 2004. Mr. Thornton is Professor and Director of Global Leadership Project at Tsinghua University in Beijing. He was President and a Director of The Goldman Sachs Group, Inc. until July 2003. Mr. Thornton is also a Director of Ford Motor Company (listed on the New York Stock Exchange), Industrial and Commercial Bank of China, Intel Corporation (listed on NASDAQ Stock Exchange) and News Corporation, Inc. (listed on the New York Stock Exchange and the Australian Stock Exchange). He is also Chairman of the Brookings Institution Board of Trustees, a member of the Council on Foreign Relations, a trustee or advisory board member of the Asia Society, China Institute, China Securities Regulatory Commission, the Eisenhower Fellowships, Financial Services Volunteer Corps, The Hotchkiss School, International Advisory Committee of the China Reform Forum, Morehouse College, National Committee on US-China Relations, Nelson Mandela Legacy Foundation (US), Tsinghua University School of Economics and Management (Beijing) and the Yale School of Management. Mr. Thornton received an A.B. in history from Harvard College in 1976, a B.A. and M.A. in jurisprudence from Oxford University in 1978 and a M.P.P.M. from the Yale School of Management in 1980.

Victor Cha Mou Zing, 56, Independent Non-Executive Director, has served as a Director since October 2004. Mr. Cha is the Managing Director of HKR International Limited and Alternate Independent Non-executive Director of New World Development Company Limited (both companies being listed on the Hong Kong Stock Exchange). He is also a member of the Chinese People's Political Consultative Committee of Zhejiang Province and a council member of the Hong Kong Polytechnic University and the Hong Kong Institute of Education. Mr. Cha graduated from Stanford University with a MBA degree and University of Wisconsin with a B.S degree.

Dr. Qian Yingyi, 49, Independent Non-Executive Director, has served as a Director since October 2004. He is Professor of Economics at the University of California, Berkeley. Since 2005, Dr. Qian has also been the First Associate Dean of the School of Economics and Management at Tsinghua University, and served as Independent Director of the Industrial and Commercial Bank of China. Before joining the Berkeley faculty in 2001, Dr. Qian taught in the Department of Economics at Stanford University and the University of Maryland. In 1990, Dr. Qian received his Ph.D. in Economics from Harvard University, after receiving an M. Phil. in Management Science/Operations Research from Yale University and an M.A. in Statistics from Columbia University. In 1981, Dr. Qian graduated from Tsinghua University with a B.S. degree in Mathematics.

Hou Ziqiang, 68, Independent Non-Executive Director, has served as a Director since October 2004. He was also Chairman of China Kejian Company Limited. Mr. Hou founded China Kejian Company Limited in 1984. From 1993 to 1997, Mr. Hou was Director of the Institute of Acoustics of the Chinese Academy of Sciences. From 1988 to 1993, Mr. Hou was Secretary General of the Chinese Academy of Sciences. Mr. Hou graduated from Peking University in 1958 with a bachelor's degree in physics.

Timpson Chung Shui Ming, G.B.S., J.P., 54, Independent Non-Executive Director, has served as a Director since October 2004. He is a fellow member of the Hong Kong Institute of Certified Public Accountants and the Association of Chartered Certified Accountants. He is an Independent Non-executive Director of Hantec Investment Holdings Limited, Tai Shing International (Holdings) Limited, Glorious Sun Enterprises Limited, The Miramar Hotel & Investment Co. Limited and

Nine Dragons Paper (Holdings) Limited. In addition, Mr. Chung is a member of the National Committee of the 10th Chinese People's Political Consultative Conference, the Vice Chairman of the Council of the City University of Hong Kong, a member of the Hong Kong Housing Authority and a Court Member of the University of Hong Kong. Formerly, he was an Executive Director of Shimao China Holdings Limited, a Director of Stockmartnet Holdings Ltd, Extrawell Pharmaceutical Holdings Limited and China Rich Holdings Limited. He was also the Chairman of the Hong Kong Housing Society, a member of the Executive Council of the Hong Kong Special Administrative Region, the Vice Chairman of the Hong Kong Special Administrative Region Government Land Fund Advisory Committee, a member of the Managing Board of the Kowloon-Canton Railway Corporation and a member of the Disaster Relief Fund Advisory Committee. Mr. Chung holds a Bachelor of Science Degree from the University of Hong Kong and a master's degree of Business Administration from the Chinese University of Hong Kong.

Mauricio Sartorius, 46, Alternate Director to Mr. Jose Maria Alvarez-Pallete. He began his career with Banco del Progreso. In 1983, Mr. Sartorius joined E. F. Hutton & Co. Inc. as a Registered Commodity Representative. In 1985, he joined Credit Suisse First Boston as Vice President of Corporate Finance for the Latin America region based in New York. Mr. Sartorius joined Telefonica in 1 January 1997 in the Corporate Finance Department as a Deputy Managing Director. In 1998, he was appointed Director of Human Resources for Telefonica Internacional. He became the Chief Representative Officer of Asia of Telefonica Internacional, S.A. on 1 January 2005 and since then resided in Beijing. Mr. Sartorius holds a degree in economics from the Universidad Complutense of Madrid and a MBA degree from New York University. Mr. Sartorius is the Alternate Director to Mr. Alvarez-Pallete and was appointed effective September 12, 2005.

Executive Officers

Zuo Xunsheng, 55, Executive Director and Chief Executive Officer.

Pei Aihua, 55, has served as Senior Vice President since July 2004 overseeing new technology and network planning and construction, and network operation and maintenance. He has also served as Vice President of China Netcom Group since April 2002. Before joining China Netcom Group, he was Deputy General Manager of the former Beijing Telecommunications Company from July 2001 to April 2002, General Manager of Sichuan Provincial Telecommunications Company from July 2000 to July 2001, and Deputy Director of the former China General Bureau of Posts and Telecommunications from June 1997 to May 2000. He graduated with a master's degree in information and communication management jointly sponsored by the Management School of Fudan University and the Norway Management School. He graduated from Changchun Optical Precision Machinery College with a master's degree in electrical engineering in 1993 and Beijing School of Post and Telecommunications in microwave technology in 1976.

Zhang Changsheng, 58, has served as Senior Vice President since July 2004 overseeing regulatory and legal matters, value-added services and broadband contents. He has also served as Vice President of China Netcom Group since February 2003. Before joining China Netcom Group, Mr. Zhang served as Assistant to Governor and Secretary General of Jiangsu Provincial Government from October 1995 to February 2003. From July 1988 to October 1995, he held several senior positions in the Ministry of Personnel. He graduated from the Military School of the People's Liberation Army in 1981.

Zhao Jidong, 55, has served as Senior Vice President since July 2004, and is responsible for international affairs, Asian Netcom Corporation Limited, Beijing Municipal Branch Company and the Olympics-related telecommunications projects. Since November 2005, he has served as the Executive Chairman of Asian Netcom Corporation Limited. He has also served as Vice President of China Netcom Group since July 2003. Before joining China Netcom Group, Mr. Zhao served as

General Manager of Beijing Communications Company from July 2002 to July 2003 and General Manager of former Beijing Telecommunications Company from May 2000 to July 2002. From November 1994 to May 2000, Mr. Zhao served as Vice Director and Director in the former Beijing Telecommunications Bureau. Mr. Zhao holds a master's degree in information and communication management jointly sponsored by the Management School of Fudan University and the Norway Management School. He graduated from Fudan University with a B.A. degree in English in 1975.

Li Fushen, 43, has served as Chief Financial Officer since September 2005. He became Financial Controller in July 2004. Since October 2003, he has served as General Manager of the Finance Department of China Netcom Group. From November 2001 to October 2003, he served as Deputy General Manager of the former Jilin Provincial Telecommunications Company and Jilin Communications Company. He graduated from the Australian National University with a master's degree in management and from the Jilin Engineering Institute with a degree in engineering management in June 1988.

Joint Company Secretaries

Miao Jianhua, 54, Executive Director and Joint Company Secretary.

Mok Kam Wan, 43, Joint Company Secretary. Ms. Mok joined the Company in October 2005. She holds a bachelor's degree of laws from The University of London and a master's degree in business administration from The Hong Kong Polytechnic University. Ms. Mok is an associate member of The Institute of Chartered Secretaries and Administrators in the United Kingdom and The Hong Kong Institute of Chartered Secretaries.

COMPENSATION

Our executive directors and executive officers receive compensation in the form of salaries, housing allowances, other allowances and benefits in kind, including our contribution to the pension plans for our directors and executive officers. We have entered into service agreements with our executive directors.

Each of our directors is entitled to an annual director's fee of HK$250,000 as proposed by the board of directors and approved by our shareholders. Director's fees are payable on a time pro-rata basis for any non full year's service. Mr. Zhang Chunjiang will receive annual base salary and performance-based bonus and any discretionary award of share options as may be determined by the board of directors. In addition, Dr. Edward Tian Suning is entitled to an additional annual fee of HK$50,000 as a member of the Corporate Governance Committee, Mr. John Lawson Thornton is entitled to an additional annual fee of HK$120,000 as the chairman of the Corporate Governance Committee and a member of the compensation and Nomination committee. Mr. Victor Cha Mou Zing is entitled to an additional annual fee of HK$100,000 as a member of the Audit Committee and the Compensation and Nomination Committee, and Mr. Jose Maria Alvarez-Pallete is entitled to an additional annual fee of HK$50,000 as a member of the Strategic Planning Committee. Dr. Edward Tian Suning, Mr. John Lawson Thornton, Mr. Victor Cha Mou Zing and Mr. Jose Maria Alvarez-Pallette is entitled to an additional fee of HK$50,000 for each committee meeting they attend.

The following table sets out the emoluments paid to our directors in 2005.

	Basic salaries, housing allowances,

	Fees	other allowances and benefits in kind	Bonus	share option benefit amortized	Contrib to reti s
			RMB		
Zhang Chunjiang.....	260,715	324,168	753,234	563,883	1
Edward Tian Suning.....	260,715	675,983	567,609	563,883	
Zhang Xiaotie.....	260,715	395,738	-	490,333	1
Miao Jianhua.....	260,715	310,470	311,079	429,041	1
Jiang Weiping(1).....	309,370	303,387	307,138	429,041	1
Li Liming.....	312,858	282,651	282,235	429,041	1
Keith Rupert Murdoch((2)).....	218,858	-	-	361,621	
Yan Yixun.....	260,715	-	-	361,621	
John Lawson Thornton.....	365,002	-	-	-	
Victor Mou Zing Cha.....	360,656	-	-	-	
Qian Yingyi.....	417,145	-	-	-	
Hou Ziqiang.....	412,799	-	-	-	
Timpson Chung Shui Ming.....	332,668	-	-	-	
Jose Maria alvarez-Pallete (3)...	94,500	-	-	-	
Total.....	4,127,431	2,292,397	2,221,295	3,628,464	8

(1) Resigned on May 17, 2006.
(2) Resigned on September 12, 2005.
(3) Appointed on September 12, 2005.

The five individuals whose emoluments were the highest for the years ended December 31, 2005 include two directors whose emoluments are reflected in the analysis presented above. The emoluments payable to the remaining individuals are as follows:

	Year ended Decem
	RMB
Basic salaries, housing allowances, bonus, share option benefit amortized, other allowances and benefits in kind.....	5,92
Contributions to retirement schemes.....	3
Total.....	5,96

The aggregate compensation to which our executive directors and senior management members were entitled (including amounts paid and accrued) in 2005 was RMB 19.4 million, including directors' fees, basic salaries, bonus, share option benefit amortized, housing allowances, other allowances and benefits in kind, as well as contributions to retirement schemes.

BOARD PRACTICE

Our company has entered into service contracts with each of our executive directors. The directors are subject to rotation under our articles of association. The service contracts of executive directors are subject to

termination at least sixty days' written notice. Pursuant to our articles of association, the remuneration of our directors is determined by our shareholders in a general shareholders' meeting. None of these service contracts will provide benefits to our directors upon termination.

Except as disclosed in this annual report, none of our directors has or is proposed to have a service contract with us (excluding contracts expiring or determinable by the employer within one year without payment of compensation (other than statutory compensation)).

Board Committees

Audit Committee

We have established an audit committee in compliance with the Code on Corporate Governance Practices as set out in Appendix 14 to the Listing Rules of the Hong Kong Stock Exchange. All members of the audit committee are appointed by the board. The audit committee currently consists of four independent non-executive directors, Mr. Timpson Chung Shui Ming who serves as its chairman, Dr. Qian Yingyi, Mr. Victor Cha Mou Zing and Mr. Hou Ziqiang. The primary responsibilities of the audit committee include supervising and managing our financial reporting system, reviewing the auditors' appointment, and supervising the work of the internal audit department.

Compensation and Nomination Committee

Our compensation committee has been renamed as the compensation and nomination Committee effective September 12, 2005. The duties of this committee include nominating new board members, reviewing the compensation of our directors and our management and making recommendations to the board. The members of the Committee are Mr. Qian, Yingyi, who serves as its chairman, Mr. Zhang Chunjiang, Mr. Zuo Xunsheng, Mr. John Lawson Thornton, Mr. Victor Cha Mou Zing and Mr. Hou Ziqiang.

Strategic Planning Committee

We have also established a strategic planning committee. The strategic planning committee is responsible for reviewing our development strategies, supervising their implementation and analyzing major investment projects. The members of this committee are Mr. Zhang Chunjiang, who serves as its chairman, Mr. Zuo Xunsheng, Mr. Zhang Xiaotie, Ms. Li Liming, Mr. Jose Maria Alvarez-Pallete, Dr. Qian Yingyi and Mr. Hou Ziqiang.

Corporate Governance Committee

We have also established a corporate governance committee. The duties of the corporate governance committee are to supervise implementation of our corporate governance polices, supervise the efficiency and legal compliance of our board of directors and make recommendations to the board in order to enhance our corporate governance structure. The chairman of this committee is Mr. John Lawson Thornton and its members include Dr. Tian Suning, Mr. Miao Jianhua, Dr. Qian Yingyi and Mr. Timpson Chung Shui Ming.

Summary Corporate Governance Differences

There are significant differences between our corporate governance practices and those of U.S. issuers listed on the New York Stock Exchange. Pursuant to Section 303A.11 of the NYSE Listing Manual, we have disclosed certain of these differences on our website at www.china-netcom.com.

EMPLOYEES

As of December 31, 2005, we had 138,440 full time employees. Substantially all of our employees are located in China. The following table sets forth the number of our employees serving in the capacities and for the periods indicated:

	As of December 31,					
	2002		2003		2004	
	Number of Employees	Percentage of Total Employees	Number of Employees	Percentage of Total Employees	Number of Employees	Percentage of Total Employees
Management, finance and Administrative	30,662	21.7	33,341	23.3	22,814	15.8
Sales and marketing	31,707	22.5	29,401	20.6	66,564	46.3
Operations and maintenance	71,530	50.6	72,418	50.6	47,322	32.9
Others(1)	7,395	5.2	7,803	5.5	7,262	5.0
Total	141,294	100.0	142,963	100.0	143,962	100.0

(1) Includes research and development employees.

As of December 31, 2005 we also employed approximately 60,521 temporary employees.

We participate in defined contribution retirement plans for our employees. We are required to contribute a portion of our employees' total wages to the PRC government's pension plan in accordance with relevant local government regulation. Our contributions were approximately RMB 1,051 million in 2003, RMB 1,181 million in 2004 and RMB 1,285 million in 2005. We also implement an early retirement scheme whereby employees approaching retirement age may opt for early retirement in exchange for certain early retirement benefits. The amount expensed as early retirement benefits was approximately RMB 336 million in 2003, RMB 693 million in 2004 and RMB 2 million in 2005.

We have implemented a short-term and long-term combined incentive remuneration scheme. The primary components of an employee's remuneration are a basic salary, a performance-based bonus and a stock option scheme for certain employees. In addition, we emphasize the importance of employee training and seek to improve the skills of our employees.

In 2005, we did not experience any strikes or other labor disturbances that interfered with our operations, and we believe that the relationship between our management and our labor union was good.

SHARE OWNERSHIP

Ownership of our shares by our directors and executive officers

Certain of our directors and executive officers have a beneficial interest in our shares through their ownership of options as further discussed in "-- Share Option Scheme".

Share option scheme

The shareholders of our company passed a resolution on September 30, 2004 to approve and adopt the share option scheme (the "Share Option Scheme").

Having considered the changes following the completion of our 2005 Acquisition and for the purpose of clarifying the relevant scope of the Share Option Scheme, the Board convened meetings on December 6, 2005 and April 28, 2006, and made minor amendments to the Share Option Scheme.

The main contents of the amended Share Option Scheme are as follows:

Purpose of the Share Option Scheme

The purpose of the Share Option Scheme is to provide our company with a means to incentivize its senior management, to attract and retain talent and to encourage other eligible participants to enhance the value of the Company.

Participants of the Share Option Scheme

The directors may invite any person belonging to any of the following classes of participants to take up options to subscribe for the ordinary shares of the Company:

(i) the directors (including executive and non-executive directors, but excluding independent Non-executive directors);

(ii) members of the middle-to-senior management; and

(iii) such class of "specialized professionals" as may be designated by the Compensation and Nomination Committee.

For the purpose of sub-paragraph (iii) above, "specialized professionals" means such professionals that are important to the development of the Group's business and the management, technical and business development personnel that occupy key positions in the Group. The Compensation and Nomination Committee has the authority to interpret the meaning of "specialized professionals".

Maximum number of shares and effective options

(i) The maximum number of shares which may be allotted and issued upon the exercise of all outstanding options granted and yet to be exercised under the Share Option Scheme and any other share option scheme must not in aggregate exceed 30 per cent. of the relevant class of securities of our company in issue from time to time.

(ii) The total number of shares which may be allotted and issued upon the exercise of all options to be granted under the Share Option Scheme must not in aggregate exceed 10 per cent. of the shares in issue immediately after the completion of the global offering of shares (and American depositary shares) of our company in November 2004 (the "General Scheme Limit").

(iii) Subject to (i) above, our company may seek approval of the shareholders in general meeting to refresh the General Scheme Limit and may seek separate approval of the shareholders in general meeting to grant options beyond the General Scheme Limit.

(iv) "Effective options" means the share options granted under the Share Option Scheme, irrespective of whether such options are exercisable in accordance with the relevant vesting schedule; and "vesting schedule" means the arrangement whereby options can be exercised by batch in accordance with the timetable pre-determined by the Share Option Scheme.

As of the date of this annual report, the total number of securities available for issue under the Share Option Scheme is 236,023,000, representing 3.6% of the issued share capital of our company as of the date of this annual

report.

Maximum entitlement of each participant

Unless otherwise approved by the shareholders in general meeting, the total number of shares issued and which may fall to be issued upon the exercise of the options granted under the Share Option Scheme (including both exercised or outstanding options) to any participant in any 12-month period shall not exceed 0.2 per cent. of the issued share capital of our company on the date of grant.

Minimum period for which an option must be held before it can be exercised

With respect to the share options granted prior to the listing of the Company's shares on the Stock Exchange, there is a minimum period of 18 months from the later of the date of grant or the date of the listing of the shares on the Stock Exchange before an option can be exercised; with respect to the share options granted after the listing of the Company's shares on the Stock Exchange, there is a minimum period of 24 months from the later of the date of grant or the date of the listing of the shares on the Stock Exchange before an option can be exercised.

Period within which the shares must be taken up under an option

Any option shall lapse if not exercised within 6 years from the later of the date of grant or the date of the listing and commencement of trading of the shares on the Stock Exchange.

The basis of determining the exercise price for shares

The exercise price is a price determined by the directors but shall not be less than the highest of: (i) the closing price of the shares on the Stock Exchange on the date of grant; (ii) the average closing price of shares on the Stock Exchange for the five trading days immediately preceding the date of grant; and (iii) the nominal value of the shares.

Consideration

No consideration is payable on acceptance of the grant of an option.

The remaining life of the Share Option Scheme

Unless otherwise terminated by the Board of Directors in exercise of its power in accordance with the rules governing the Share Option Scheme, the Share Option Scheme will remain in force for a period of 10 years commencing on the date on which the Share Option Scheme is adopted.

Amendment to and termination of the Share Option Scheme

(i) The Board of our company may amend any of the provisions of the Share Options Scheme and the terms of the options at any time, but not so as to prejudice the rights of the grantees of options.

(ii) Any alterations to the matters set out in the Listing Rules and alterations which are to the advantage of existing or future grantees of options shall only be made with the approval of shareholders at general meeting.

(iii) Any alterations to the terms and conditions of the Share Option Scheme which are of a material nature shall be approved by the shareholders of our company at general meeting, except where the alterations take effect automatically under the existing terms of the Share Option Scheme.

(iv) Any change to the authority of the Board in relation to alteration of the terms of the Share Option Scheme shall be approved by shareholders of our company at general meeting. The amended Share Option Scheme or the terms thereof shall comply with the relevant requirements of the Listing Rules.

(v) During the effective term of the Share Option Scheme, the Board may at any time terminate the Share Option Scheme or decide not to grant any options under the Share Option Scheme, and in such event the options granted under this Scheme (to the extent not already exercised) may still be exercisable pursuant to the rules of the Share Option Scheme or may be cancelled by the Board pursuant to rules thereof.

(vi) The Share Option Scheme will be terminated upon the expiry of its effective term and any new share option scheme to be adopted by the Board shall be approved by the shareholders of our company at general meeting.

Exercise of Options and Proceeds

(1) The Exercise Price for the initial grant of Options shall be the initial public offering price. The Exercise Price of Options granted subsequently shall be the higher of the par value of the shares, the closing price of the shares on the Options Grant Date and the average closing price of the shares in the five trading days prior to the Options Grant Date.

(2) Share Options shall be effective for a period of six years. Any Options not exercised after the expiry of six years from the Options Effective Date shall lapse automatically.

(i) The initial exercise of the Share Options which are granted prior to the listing of the Company on the Hong Kong Stock Exchange is subject to an Options Restricted Period of 1.5 years and such Share Options shall only be exercised in batches in accordance with the Vesting Schedule below. The maximum number of Options that can be exercised at each tier shall not exceed the limits set out below:

- 40% of the Options granted may be exercised 18 months after the Options Effective Date (the "First Tier");
- another 20% of the Options granted may be exercised 30 months after the Options Effective Date (the "Second Tier");
- another 20% of the Options granted may be exercised 42 months after the Options Effective Date (the "Third Tier"); and
- the remaining 20% of the Options granted may be exercised 54 months after the Options Effective Date (the "Fourth Tier").

(ii) The initial exercise of the Share Options which are granted after the listing of the Company on the Hong Kong Stock Exchange is subject to an Options Restricted Period of 2 years and such Share Options shall only be exercised in batches in accordance with the Vesting Schedule below. The maximum number of Options that can be exercised at each tier shall not exceed the limits set out below:

- 40% of the Options granted may be exercised 24 months after the Options Effective Date (the "First Tier");

- another 20% of the Options granted may be exercised 36 months after the Options Effective Date (the "Second Tier");

- another 20% of the Options granted may be exercised 48 months after the Options Effective Date (the "Third Tier"); and

- the remaining 20% of the Options granted may be exercised 60 months after the Options Effective Date (the "Fourth Tier").

(3) The exercise of a portion of the Options of the employees of the Company (excluding senior management and directors of the Company) exercisable at each tier pursuant to the above Vesting Schedule (the "Adjustable Options") shall be subject to the results of the performance review of the grantee in respect of the year immediately preceding the commencement of the relevant tier as measured against the Company's performance review plan. Part or all of the Adjustable Options shall be subject to cancellation depending upon the results of the performance review. The Adjustable Options shall be determined by the Company with reference to the number of Options exercisable at each tier, the expected yield of each Option and the difference between the average price of the Shares in the year immediately preceding the commencement of the relevant tier and the exercise price of the Options.

(4) Except for the transmission of the Options on the death of a grantee of Options to his personal representatives or authorised persons, neither the Options nor any relevant rights may be transferred, assigned or otherwise disposed of by any grantee to any other person. If a grantee transfers, assigns or disposes of such Options or rights, the Company will be entitled to cancel the Options granted to the grantee.

(5) The increase in exercisable Options of the grantees at each tier (the Options exercisable at the First Tier shall be deemed as the increase in exercisable Options at the First Tier) shall be subject to cancellation upon the happening of any of the following events:

(i) the annual performance review of the Company for the year preceding the commencement of the relevant tier shows that the Company is unable to meet the performance review targets;

(ii) the issuance of a negative opinion by the Company's accountants or the Company's accountants being unable to issue an opinion on the financial reports in respect of the year preceding the commencement of the relevant tier;

(iii) where the Supervisory Panel or the audit authorities for State-owned enterprises of the State Council have raised material objections to the results or the annual report of the Company in respect of the year preceding the commencement of the relevant tier.

(6) In the event that the grantee is to be demoted, his unvested Options pursuant to the Vesting Schedule will be reduced to reflect his new position and the reduced Options will automatically lapse.

(7) In the event of a capitalisation issue, rights issue, sub-division or consolidation of shares or reduction of capital, the Board has the right to make corresponding alterations to the number of shares involved in the Options granted under the Share Option Scheme (outstanding Options) and the Exercise Price, provided that the proportion of the total number of ordinary shares involved in the Share Option Scheme to the total number of issued shares shall remain unchanged. Such adjustments shall give participants to the Share Option Scheme the same proportion of the issued share capital to which he would have been entitled prior to such alteration, and no adjustment shall be made the effect of which would be to enable shares to be issued at less than its nominal value.

(8) The proceeds from the exercise of Options shall be the multiple of the number of Share Options being exercised and the difference between the market price of the shares of the Company upon the exercise of the Options by the grantee and the Exercise Price, less the relevant tax expenses. After exercising the Options, the proceeds shall belong to the person who exercised the Options. If the grantee does not exercise the Options within the period during which he is entitled to exercise the Options, the proceeds shall be zero.

(9) Prior to exercising part or all of his Options, the grantee shall inform the Company in writing of his intention to exercise the Options together with the number of shares, the Exercise Price etc.

(10) The grantee is required to exercise his Options through the intermediaries selected by the Company.

Rights on cessation of employment

(1) If the grantee of an Option ceases to be an employee because of misconduct or criminal conviction, and as a result ceases to be an Eligible Participant under the Share Option Scheme, all the Effective Options not yet exercised shall lapse on the date of cessation of his employment and such Options shall in no circumstances be exercisable.

(2) If the grantee of an Option is transferred internally to China Network Communications Group Corporation and its controlled entities, the grantee shall be entitled to exercise the Options in accordance with the Vesting Schedule.

(3) If the grantee of an Option is transferred out of the Company with the Company's consent (for reason other than Clause 6(2)), the grantee may, at any time within 90 days of the date of the cessation of his employment, exercise the Effective Options which are exercisable as at the date of the cessation of his employment as well as the Options which are exercisable at the tier immediately following the date of cessation of his employment. Any such Options which are not exercised within the 90-day period shall lapse automatically. All the Options exercisable at later tiers shall lapse automatically.

(4) If the grantee of an Option retires, the grantee may, at any time within 90 days of the date of his retirement, exercise the Effective Options which are not yet exercised. Any such Options which are not exercised within the 90-day period shall lapse automatically.

(5) If the grantee of an Option ceases to be an employee for any reason other than death, loss of capacity or the reasons as referred to under Clauses 6(1), 6(2), 6(3) or 6(4) and for reason of his resignation, and thus as a result ceases to be an Eligible Participant under the Share Option Scheme, all of his Effective Options not yet exercised shall lapse on the date of cessation of his employment.

Where the employment of a grantee ceases or has ceased or the grantee

retires or has retired prior to the 2006 Amendments being approved by shareholders of the Company at general meeting, the date of cessation of employment or retirement will be deemed to be the day on which the 2006 Amendments are approved by shareholders of the Company at general meeting.

Rights on death

If the grantee of an Option dies and that none of the grounds for cessation of employment as referred to in Clause 6(1) has occurred, Effective Options granted (but not yet exercised) shall be vested in the grantee's estate, the grantee's personal representatives or authorised persons shall exercise such Effective Options within 90 days. Any such Options which are not exercised within the 90-day period shall lapse automatically.

Where the grantee dies or has died prior to the 2006 Amendments being approved by shareholders of the Company at general meeting, his death will be deemed to have occurred on the day on which the 2006 Amendments are approved by shareholders of the Company at general meeting.

Rights on loss of capacity

The guardian of the grantee of an Option or authorised persons may, at any time during the period within 90 days of the date of the loss of capacity of such grantee, exercise the Effective Options granted to such grantee but not yet exercised as at the date of the loss of capacity of such grantee. Any such Options which are not exercised within the 90-day period shall lapse automatically.

Where the loss of capacity takes place or has taken place prior to the 2006 Amendments being approved by shareholders of the Company at general meeting, the loss of capacity will be deemed to have taken place on the day on which the 2006 Amendments are approved by shareholders of the Company at general meeting.

Cancellation of the Options

The Board may resolve to cancel any Options granted but not yet exercised.

Lapsed Options shall be automatically cancelled on the date of lapse.

As at December 31, 2005, the directors, chief executive and employees of our company had the following personal interests in options to subscribe for shares of our company granted under the Share Option Scheme.

	No. of shares involved in the options outstanding at the beginning of the year	No. of shares involved in the options outstanding at the end of the year	Date of the of grant the options
		(in HK$)	
DIRECTORS			
Zhang Chunjiang.....	920,000	920,000	22 October 200
Tian Suning.....	920,000	920,000	22 October 200
Zuo Xunsheng (also the chief executive officer)	800,000	800,000	22 October 200
Zhang Xiaotie.....	800,000	800,000	22 October 200

Miao Jianhua.....	700,000	700,000	22 October 200
Jiang Weiping.....	700,000	700,000	22 October 200
Li Liming.....	700,000	700,000	22 October 200
Yan Yixun.....	590,000	590,000	22 October 200
Employees and other persons granted with options in 2004(1)	151,590,000	150,573,000	22 October 200
Employees and other persons granted with options after the completion of our 2005 Acquisition(2)(3).....	--	79,320,000	6 December 20
Total(4)(5).....		236,023,000	

Notes:

(1) The total number of shares involved in the options outstanding at the end of the year represents 3.6 per cent. of the issued share capital of our company as at the date of this annual report.

(2) Grantees of the share options granted on October 22, 2004 are entitled to exercise the options in the following periods:

- in respect of 40 per cent. of the options granted, from May 17, 2006 to November 16, 2010;
- in respect of a further 20 per cent. of the options granted, from May 17, 2007 to November 16, 2010;
- in respect of an additional 20 per cent of the options granted, from May 17, 2008 to November 16, 2010; and
- In respect of the remaining 20 per cent of the options granted, from May 17, 2009 to November 16, 2010.

(3) Options were granted by our company on December 6, 2005. The closing price per share on the trading day immediately before December 6, 2005 was HK$12.25.

(4) Grantees of the share options granted on December 6, 2005 are entitled to exercise the options in the following periods:

- in respect of 40 per cent. of the options granted, from December 6, 2007 to December 5, 2011;
- in respect of a further 20 per cent. of the options granted, from December 6, 2008 to December 5, 2011;
- in respect of an additional 20 per cent. of the options granted, from December 6, 2009 to December 5, 2011; and
- in respect of the remaining 20 per cent. Of the options granted, from December 6, 2010 to December 5, 2011.

(5) During the year ended December 31, 2005, no share option has been exercised and share options representing 1,017,000 shares lapsed as a result of the resignation of the employees to whom the share options were granted.

According to the requirements under HKFRS 2, the fair value of the options granted by our company to its employees (including directors) to subscribe for shares in our company shall be recognized as expenses in the Company's consolidated income statement. Our company has made retrospective adjustments to the recognized employee benefit costs or liabilities in relation

to the grant of options to subscribe for shares in our company to employees (including directors) in prior years.

Apart from the foregoing, at no time during the year ended December 31, 2005 was the Company, any of its holding companies or subsidiaries or fellow subsidiaries, a party for any arrangement to enable the directors or senior management of our company or any of their spouses or children under eighteen years of age to acquire benefits by means of the acquisition of shares in or debentures of our company or any other body corporate.

ITEM 7. MAJOR SHAREHOLDERS AND RELATED PARTY TRANSACTIONS

MAJOR SHAREHOLDERS

As of May 31, 2006, we had 6,602,431,000 shares outstanding. The table below sets forth information as of the date of this annual report regarding the beneficial ownership of our ordinary shares by each person known by us to beneficially own 5% or more of our outstanding ordinary shares. Except as otherwise indicated, we believe each shareholder named in this table has sole voting and investment power with respect to the shares shown as beneficially owned. None of our shareholders listed below has voting rights that are different from any of our other shareholders.

	Shares Beneficially Owned	
Name of Beneficial Owner	Number	Percentage
	(in millions)	
China Network Communications Group Corporation(1)	4,647,449,014	70.39%
Telefonica Internacional S.A.....	329,676,450	4.99%

(1) China Network Communications Group Corporation's beneficial interest is attributable to its ownership interest in CNC BVI, our direct parent company. The registered address of CNC BVI is P.O. Box 3140, Wickhams Cay 1, Road Town, Tortola, British Virgin Islands. The registered address of China Network Communications Group Corporation is Building C, No. 156 Fuxingmennei Avenue, Xicheng District, Beijing, PRC.

RELATED PARTY TRANSACTIONS

Connected Transactions

Our 2005 Acquisition

See "Item 4. Business Overview--History and Development--Our 2005 Acquisition".

Cooperation Agreement in relation to the 2008 Beijing Olympic Games

On 15 September 2005, the Company's wholly-owned subsidiary, China Netcom (Group) Company Limited ("CNC China") entered into a cooperation agreement (the "Cooperation Agreement") with China Netcom Group whereby CNC China agreed to provide telecommunications goods and services to the Beijing Organization Committee for the Games of the XXIX Olympiad ("BOCOG"). As consideration, CNC China is entitled to the right and opportunity to conduct products-related marketing activities by using the 2008 Olympics composite logo and sponsorship logo as provided for under the sponsorship agreement between China Netcom Group and BOCOG. The consideration of the Cooperation Agreement is RMB480 million.

Continuing Connected Transactions

As of the date of this annual report, China Netcom Group, as the ultimate controlling shareholder of the Company, beneficially owned 70.39% of the Company's issued share capital. China Netcom Group is therefore a connected person of the Company. In October 2004, China Netcom (Group) Company Limited ("CNC China"), a wholly owned subsidiary of the Company, entered into certain agreements with China Netcom Group, and certain ongoing transactions between CNC China on the one hand and China Netcom Group and its subsidiaries or associates (other than the Group) on the other hand ("Continuing connected transactions relating to CNC China") were conducted in accordance with the provisions under the aforesaid agreements up to October 31, 2005. In order to facilitate the management of our continuing connected transactions in China after the completion of our 2005 Acquisition, CNC China, CNC New Horizon and China Netcom Group entered into certain connected transaction agreements on September 12, 2005 to regulate the continuing connected transactions between China Netcom Group and its subsidiaries or associates (other than the Group) on one hand and the Group on the other hand in respect of the Group's operations in 12 provinces, autonomous region and municipalities in China, and these agreements would replace the existing connected transaction agreements between CNC China and China Netcom Group after the completion of our 2005 Acquisition. Certain ongoing transactions between CNC China and CNC New Horizon on the one hand and China Netcom Group and its subsidiaries or associates (other than the Group) on the other hand as from October 31, 2005, ("Continuing connected transactions relating to CNC China and CNC New Horizon") were conducted in accordance with the provisions under the new agreements.

On June 30, 2004, Asia Netcom Corporation Limited ("Asia Netcom"), a wholly owned subsidiary of the Company, entered into certain transactions and a series of connected transaction agreements with East Asia Netcom Ltd. ("EANL"), a connected person of the Company by virtue of being an indirect wholly owned subsidiary of China Netcom Group.

These transactions between CNC China, CNC New Horizon and China Netcom Group and between Asia Netcom and EANL (the "Continuing Connected Transactions") constitute continuing connected transactions of the Company under the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Ltd (the "Listing Rules"). Details of the Continuing Connected Transactions are set out below and in note 37 to the financial statements regarding relative transactions with ultimate holding company, fellow subsidiaries and other related companies. For the financial year ended December 31, 2005, the Continuing Connected Transactions have not exceeded their respective upper limits set by the Hong Kong Stock Exchange. In respect of all the connected transactions of the Company as stated in this annual report, the Company has complied with the disclosure requirements under the Listing Rules in force from time to time.

Continuing connected transactions relating to CNC China

The following continuing connected transaction agreements took effect until the completion of our 2005 Acquisition.

Interconnection Settlement Agreement

CNC China and China Netcom Group agreed to interconnect their respective networks and settle the charges received in respect of domestic and international long distance voice services within their respective service regions on a monthly basis.

For domestic long distance voice services between China Netcom Group and CNC China (except services between subsidiaries of China Netcom Group in four provinces and autonomous region and the branch companies of CNC China in

six provinces and municipalities), the telephone operator in the location of the calling party makes a settlement payment to the telephone operator in the location of the called party at the rate of RMB0.06 per minute or RMB0.09 per minute (depending on whether the call terminates within or outside the network of either party).

For outbound international calls, China Netcom Group reimburses CNC China for any amount it has paid to overseas telecommunications operators. The revenues received by China Netcom Group less the amount paid to overseas telecommunications operators are shared between China Netcom Group and CNC China in proportion to the estimated costs incurred by each party.

For inbound international calls, the revenues received by CNC China from overseas telecommunications operators less the amount paid to China Netcom Group at the rate of RMB0.06 per minute or RMB0.09 per minute (depending on whether the call terminates within the network of China Netcom Group or other operators) are shared between China Netcom Group and CNC China in proportion to the estimated costs incurred by each party.

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

Property Leasing Agreement

Pursuant to the Property Leasing Agreement:

(i) CNC China leases to China Netcom Group certain properties located throughout our northern service region and our southern service region, for use as offices and other ancillary purposes; and

(ii) China Netcom Group leases to CNC China certain properties located throughout our northern service region and our southern service region, for use as offices, telecommunications equipment sites and other ancillary purposes.

The charges payable by CNC China and by China Netcom Group under the Property Leasing Agreement are based on market rates or the depreciation and maintenance charges in respect of each property, provided such depreciation and maintenance charges shall not be higher than the market rates. The charges are payable quarterly in arrears and are subject to review every year to take into account the then prevailing market rates.

Property Sub-leasing Agreement

China Netcom Group agreed to sub-let to CNC China certain properties owned by and leased from independent third parties, for use as offices, telecommunications equipment sites and other ancillary purposes.

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

Master Services Sharing Agreement

Pursuant to the Master Services Sharing Agreement:

(i) CNC China agreed to provide customer relationship management services, network management services and supporting services such as billing and settlement to China Netcom Group, and to share with China Netcom Group the services provided by the administrative and managerial staff at the headquarters of CNC China in respect of the central management of both CNC China and China Netcom Group; and

(ii) China Netcom Group agreed to provide to CNC China supporting services, including telephone card production, development and related services and IC card inter-provincial and inter-network clearing services, and certain other shared services, and to provide certain office space in Beijing to CNC China for use as its principal executive office.

The above services are shared between CNC China and China Netcom Group on an on-going basis from time to time and the aggregate costs incurred by CNC China or China Netcom Group for the provision of such services are apportioned between CNC China and China Netcom Group according to the annual revenues generated by each party.

Engineering and Information Technology Services Agreement

The Engineering and Information Technology Services Agreement governs the arrangements with respect to the provision of certain engineering and information technology-related services to CNC China by China Netcom Group, including planning, surveying and design services, construction services and supervision services in relation to telecommunications engineering projects, and information technology services.

The charges payable for such services are determined with reference to market rates. In addition, where the value of any single item of services exceeds RMB 0.5 million (for design or supervision-related services), or where the value of any single item of services exceeds RMB 2 million (for construction-related services), the award of such services will be subject to tender. The charges are settled between CNC China and China Netcom Group as and when the relevant services are provided.

Materials Procurement Agreement

Under the Materials Procurement Agreement, CNC China may request China Netcom Group to act as its agent for the procurement of imported and domestic telecommunications equipment and other domestic non-telecommunications equipment, and may purchase from China Netcom Group certain products. China Netcom Group also agreed to provide to CNC China related storage and transportation.

Commission and/or charges are not to exceed the maximum rate of 3 per cent. of the contract value for the domestic materials procurement services and 1 per cent. of the contract value for imported materials procurement services. The price for the purchase of China Netcom Group's products is determined with reference to the following pricing principles and limits ("Pre-Acquisition Pricing Principles"):

(a) The government-fixed price;

(b) Where item (a) does not apply, the government guidance price;

(c) Where items (a) and (b) do not apply, the market price; or

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

Commission and/or charges for the storage and transportation services are determined with reference to market rates.

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

Ancillary Telecommunications Services Agreement

The Ancillary Telecommunications Services Agreement governs the arrangements with respect to the provision of certain ancillary telecommunications services to CNC China by China Netcom Group, including certain telecommunications pre-sale, on-sale and after-sale services.

The charges payable for the services described above are determined with reference to the Pricing Principles. The service charges are settled between CNC China and China Netcom Group as and when the relevant services are provided.

Support Services Agreement

Under the Support Services Agreement, China Netcom Group provide CNC China with various support services, including equipment leasing and maintenance services, motor vehicles services, security services, basic construction agency services, research and development services, employee training services and advertising services.

The charges payable for the services described above are determined with reference to the Pricing Principles. The service charges are settled between CNC China and China Netcom Group as and when relevant services are provided.

Telecommunications Facilities Leasing Agreement

Under the Telecommunications Facilities Leasing Agreement, China Netcom Group leases inter-provincial fibre-optic cables within our northern and southern service regions and certain international telecommunications resources (including international telecommunication channel gateways, international telecommunications service gateways, international submarine cable capacity, international land cables and international satellites facilities) to CNC China.

The rental charges for the leasing of inter-provincial fibre-optic cables and international telecommunications resources are based on the annual depreciation charges of such fibre-optic cables and resources, and are settled between CNC China and China Netcom Group on a quarterly basis.

Continuing connected transactions relating to CNC China and CNC New Horizon

The following continuing connected transaction agreements have come into effect only after the completion of our 2005 Acquisition.

Domestic Interconnection Settlement Agreement

Pursuant to the Domestic Interconnection Settlement Agreement:

CNC New Horizon, CNC China (CNC New Horizon and CNC China are collectively referred to as the "Combined Operating Group") and China Netcom Group agreed to interconnect the network of China Netcom Group on the one hand and that of the Combined Operating Group on the other and settle the charges received in respect of domestic long distance voice services within their respective service regions on a quarterly basis.

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

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

International Long Distance Voice Services Settlement Agreement

Pursuant to the International Long Distance Voice Services Settlement Agreement:

CNC China and China Netcom Group agreed to interconnect the networks of China Netcom Group and CNC China and settle the charge received in respect of international long distance voice services on a quarterly basis.

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

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

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

Property Leasing Agreement

Pursuant to the Property Leasing Agreement:

(i) The Combined Operating Group leases to China Netcom Group some certain properties located throughout the Combined Operating Group's service regions, for use as offices and other ancillary purposes; and

(ii) China Netcom Group leases to the Combined Operating Group some certain properties located throughout the Combined Operating Group's service regions, for use as offices, telecommunications equipment sites and other ancillary purposes.

The charges payable by the Combined Operating Group and by China Netcom Group are based on market rates or the depreciation and maintenance charges in respect of each property, provided such depreciation and maintenance charges shall not be higher than the market rates. The charges are payable quarterly in arrears and are subject to review every year to take into account the then prevailing market rates of the properties leased in that year.

Property Sub-leasing Agreement

Pursuant to the Property Sub-leasing Agreement:

China Netcom Group agreed to sub-let to the Combined Operating Group certain properties owned by and leased from independent third parties, for use

as offices, telecommunications equipment sites and other ancillary purposes.

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

Master Sharing Agreement

Pursuant to the Master Sharing Agreement:

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

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

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

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

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

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

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

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

The Combined Operating Group and China Netcom Group own certain equipment and facilities forming the Internet backbone network of China Netcom Group. This Internet backbone network interconnect with the networks of other operators. Such interconnection generates revenue which is settled with China Netcom Group and shared between China Netcom Group and the Combined Operating Group under the Master Sharing Agreement.

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

Engineering and Information Technology Services Agreement

The Engineering and Information Technology Services Agreement governs the arrangements with respect to the provision of certain engineering and information technology-related services to the Combined Operating Group by China Netcom Group, which include planning, surveying and design services in relation to telecommunications engineering projects, construction services in relation to telecommunications engineering projects, supervision services in relation to telecommunications engineering projects and information technology services.

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

Materials Procurement Agreement

Pursuant to the Materials Procurement Agreement, the Combined Operating Group may request China Netcom Group to act as its agent for the procurement of imported and domestic telecommunications equipment and other domestic non-telecommunications equipment, and may purchase from China Netcom Group certain products, including cables, modems and yellow pages telephone directories. China Netcom Group further agreed to provide to the Combined Operating Group storage and transportation services related to the procurement and purchase of materials or equipment.

Commission and/or charges for the domestic materials procurement services shall not exceed the maximum rate of 3% of the contract value. Commission and/or charges for the above imported materials procurement services shall not exceed the maximum rate of 1% of the contract value. The price for the purchase of China Netcom Group's products is determined with reference to the following principles and limits (the "Post-Acquisition Pricing Principles"):

(a) the government fixed price;

(b) where there is no government fixed price but a government guidance price exists, the government guidance price;

(c) where there is neither a government fixed price nor a government guidance price, the market price; or

(d) where none of the above is applicable, the price to be agreed between the relevant parties and determined on a cost-plus basis.

Commission charges for the storage and transportation services are determined with reference to market rates.

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

Ancillary Telecommunications Services Agreement

The Ancillary Telecommunications Services Agreement governs the arrangements with respect to the provision of ancillary telecommunications services to the Combined Operating Group by China Netcom Group, which include certain telecommunications pre-sale, on-sale and after-sale services, sales agency services, printing and invoice delivery services, maintenance of

telephone booths, customers acquisition and servicing and other customers' services.

The charges payable for the services described above are determined with reference to the Post-Acquisition Pricing Principles, and the service charges are settled between the Combined Operating Group and China Netcom Group as and when the relevant services are provided.

Support Services Agreement

Pursuant to the Support Services Agreement, China Netcom Group provides the Combined Operating Group with various support services, including equipment leasing (other than equipment covered under the Telecommunications Facilities Leasing Agreement) and maintenance services, motor vehicles services, security services, basic construction agency services, research and development services, employing training services and advertising services and other support services.

The charges payable for the services described above are determined with reference to the Post-Acquisition Pricing Principles, and are settled between the Combined Operating Group and China Netcom Group as and when relevant services are provided.

Telecommunications Facilities Leasing Agreement

Pursuant to the Telecommunications Facilities Leasing Agreement, China Netcom Group leases inter-provincial fiber-optic cables within the Combined Operating Group's service regions to the Combined Operating Group, and leases certain international telecommunications resources (including international telecommunications channel gateways, international telecommunications service gateways, international submarine cable capacity, international land cables and international satellite facilities) to the Combined Operating Group, and China Netcom Group leases certain other telecommunications facilities required by the Combined Operating Group for its operations.

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

Continuing connected transactions relating to Asia Netcom

Recent Development-Sale of Asia Netcom

On June 2, 2006, we agreed to sell our equity interest in Asia Netcom

to a group of investors for US$168.84 million. We expect this transaction to be completed by early August 2006. Upon completion of the transaction, we expect to continue our business relationship with Asia Netcom in connection with our remaining international operations, including the purchase of capacity from Asia Netcom.

Capacity Purchase Agreement

Asia Netcom and its subsidiaries receive from EANL and its subsidiaries a certain amount of long-term telecommunications capacity on the submarine network. The purchased capacity consists of (i) an initial fixed amount of capacity ; (ii) an additional amount of capacity up to a maximum figure to be activated upon written notice to EANL ; and (iii) further additional amount of capacity that may be ordered within three years following the date of the Capacity Purchase Agreement.

The charges payable by Asia Netcom to EANL for the initial capacity and charges payable for the additional capacity activated are based on market rates determined by reference to a similar transaction between Asia Netcom and a third party in January 2004 ("Benchmark Transaction") duly adjusted to take into account of advance receipt of payment prior to the delivery of the capacity. The pricing of the further additional capacity is to be determined between Asia Netcom and EANL prior to the placement of the actual order for such capacity.

In addition to the above charges, Asia Netcom pays EANL an annual operation and maintenance fee equal to 4% of the total charges payable by Asia Netcom to EANL for the capacity activated and ordered under the Capacity Purchase Agreement (in so far as such capacity has not been terminated) which is based on current market rate.

Capacity Lease Agreement

Pursuant to the Capacity Lease Agreement with EANL, Asia Netcom and its subsidiaries lease from EANL and its subsidiaries a fixed amount of capacity on EANL's telecommunications network, and may order additional lease capacity from EANL and its subsidiaries.

EANL and its subsidiaries agreed to permit Asia Netcom or any of its subsidiaries to interconnect its communications system with the leased capacity, and to connect such amount of capacity to the facilities of its backhaul suppliers and/or local exchange carrier. Furthermore, upon request by Asia Netcom, EANL and its subsidiaries are to use their best efforts to provide to Asia Netcom or its subsidiaries with local connectivity with end-users in jurisdictions where Asia Netcom or its subsidiaries are not otherwise authorized to provide services.

The charges payable by Asia Netcom to EANL for the initial lease capacity are determined based on market rates by reference to the Benchmark Transaction, as adjusted to take into account the particular circumstances under the Capacity Lease Agreement. The pricing for any additional lease capacity is to be agreed by Asia Netcom and EANL prior to the order for such capacity. These charges are payable quarterly in arrears.

The connections charges payable by Asia Netcom to EANL is the pro rata share of reasonable and actual expenses incurred by EANL in making such connections. The local connectivity charges payable by Asia Netcom to EANL is EANL's lowest wholesale price without discount, or, if the local connectivity is provided by an unrelated carrier, the amount charged to EANL by such unrelated carrier, without surcharge. Such charges for local connectivity are payable quarterly in arrears.

Management Services Agreement

Pursuant to the Management Services Agreement, Asia Netcom and its subsidiaries provide EANL and its subsidiaries with certain services, including government and corporate affairs services, treasury services, financial services, information technology services, legal and corporate secretarial services, tax services, payment services, and comprehensive engineering and operation services in relation to the submarine network.

The charges payable for the above services (except for the payment services) are determined on the basis of costs plus reasonable profits, but cannot exceed the market price for the provision of such services.

The charges payable for the payment services are the amounts required to reimburse all payments made by Asia Netcom and its subsidiaries on behalf of EANL and its subsidiaries in performing such services.

In the opinion of the independent non-executive directors, the Continuing Connected Transactions were entered into by the Company:

(i) in the ordinary and usual course of its business;

(ii) either on normal commercial terms or, where there are no sufficient comparables, on terms no less favorable than the terms the Company could have obtained from an independent third party; and

(iii) in accordance with the relevant agreements governing such transactions and on terms that are fair and reasonable and in the interests of the shareholders of the Company as a whole.

The board of directors has received a letter from the auditors of the Company stating that the Continuing Connected Transactions:

(A) have received the approval of the Company's board of directors;

(B) were carried out in accordance with the pricing policy as stated in note 40 to the financial statements for the year ended 31 December 2005;

(C) have been entered into in accordance with the relevant agreements governing the Continuing Connected Transactions; and

(D) have not exceeded their respective upper limits set by the Hong Kong Stock Exchange for the financial year ended 31 December 2005.

ITEM 8. FINANCIAL INFORMATION

Our audited consolidated financial statements are set forth beginning on page F-1. Other than as disclosed elsewhere in this annual report, no significant change has occurred since the date of the annual financial statements.

Legal Proceedings

We are involved in legal proceedings in the ordinary course of our business. We are not involved in any litigation, arbitration or administrative proceedings that could have a material adverse effect on our financial condition or results of operations, taken as a whole. So far as we are aware, no such material litigation, arbitration or administrative proceedings are threatened.

Dividend Policy

The payment and the amount of any dividends will depend on our results of operations, cash flows, financial condition, statutory and regulatory restrictions on the payment of dividends by us, future prospects and other factors, that our directors may consider relevant. In addition, our controlling shareholder, China Netcom Group, is able to influence our dividend policy.

Dividends may be paid only out of our distributable profits as permitted under Hong Kong law, which does not restrict the payment of dividends to non-resident holders of our securities. To the extent profits are distributed as dividends, such portion of profits will not be available to be reinvested in our operations.

Holders of our ADSs will be entitled to receive dividends, subject to the terms of the deposit agreement, to the same extent as holders of our shares, less the fees and expenses payable under the deposit agreement and any withholding taxes.

Our ability to pay dividends depends substantially on the payment of dividends to us by CNC China. CNC China must follow the laws and regulations of the PRC and its articles of association in declaring and paying dividends to us. As a wholly foreign-owned enterprise in China, CNC China is required to provide for a reserve fund and a staff and workers' bonus and welfare fund, each of which is appropriated from net profit after taxation but before dividend distribution according to the prevailing accounting rules and regulations in the PRC. CNC China is required to allocate at least 10% of its net profit to the reserve fund until the balance of this fund has reached 50% of its registered capital. Appropriations to the staff and workers' bonus and welfare fund, which are determined at the discretion of CNC China's directors, are charged to expense as incurred in the consolidated financial statements. None of CNC China's contributions to these statutory funds may be used for dividend purposes.

ITEM 9. THE OFFER AND LISTING

In connection with our initial public offering, our American depositary shares, or ADSs, each representing 20 ordinary shares, were listed and commenced trading on the New York Stock Exchange on November 16, 2004 under the symbol "CN". Our ordinary shares were listed and commenced trading on the Hong Kong Stock Exchange on November 17, 2004. Prior to these listings, there was no public market for our equity securities. The New York Stock Exchange and the Hong Kong Stock Exchange are the principal trading markets for our ADSs and ordinary shares, which are not listed on any other exchanges in or outside the United States.

As of December 31, 2005 and May 31, 2006, there were respectively 6,593,529,000 and 6,602,431,000 ordinary shares issued and outstanding. As of December 31, 2005 and May 31, 2006, there were, respectively 1 and 1 registered holders of American depositary receipts evidencing 8,991,910 and 6,064,368 ADSs. Since certain of the ADSs are held by nominees, the above number may not be representative of the actual number of U.S. beneficial holders of ADSs or the number of ADSs beneficially held by U.S. persons. The depositary for the ADSs is Citibank, N.A.

The high and low closing sale prices of the shares on the Hong Kong Stock Exchange and of the ADSs on the NYSE for the periods indicated are as follows.

	Price per Share (HK$)		Price

	High	Low	High
Annual			
2004 (from listing date).....	10.60	9.10	26.90
2005.....	13.95	9.95	35.99
Quarterly			
Fourth Quarter, 2004.....	10.60	9.10	26.90
First Quarter, 2005.....	12.55	9.75	31.58
Second Quarter, 2005.....	11.45	9.95	29.11
Third Quarter, 2005.....	13.70	11.30	35.99
Fourth Quarter, 2005.....	13.95	11.45	35.62
First Quarter, 2006.....	14.35	12.45	36.81
Monthly			
November 2005.....	13.10	12.40	34.20
December 2005.....	12.80	11.70	33.09
January 2006.....	13.45	12.60	35.03
February 2006.....	13.85	12.45	35.70
March 2006.....	14.35	13.10	36.81
April 2006.....	15.45	13.75	38.94
May 2006.....	15.45	12.10	40.28

ITEM 10. ADDITIONAL INFORMATION

SHARE CAPITAL

Not applicable.

MEMORANDUM AND ARTICLES OF ASSOCIATION

The section entitled "Description of Share Capital" contained in our registration statement on Form F-1 (File No. 333-119786) filed with the Security and Exchange Commission is hereby incorporated by reference.

MATERIAL CONTRACTS

See "Item 7. Major Shareholders and Related Party Transactions - Related Party Transactions" for certain arrangements we have entered into with China Netcom Group.

EXCHANGE CONTROLS

We receive substantially all of our revenues in Renminbi, which is not a freely convertible currency. Although central government's policies were introduced in 1996 to reduce restrictions on the convertibility of Renminbi into foreign currency for current account items, conversion of Renminbi into foreign exchange for capital items, such as foreign direct investment, loans or security, requires the approval of the State Administration of Foreign Exchange and other relevant authorities.

The People's Bank of China, or PBOC, sets and publishes daily a base exchange rate with reference primarily to the supply and demand of Renminbi against a basket of currencies in the market during the prior day. The PBOC also takes into account other factors, such as the general conditions existing in the international foreign exchange markets. Since 1994, the conversion of Renminbi into foreign currencies, including Hong Kong dollars and U.S. dollars, has been based on rates set by the PBOC, which are set daily based on the previous day's interbank foreign exchange market rates and current exchange rates in the world financial markets. From 1994 to July 20, 2005, the official exchange rate for the conversion of Renminbi to U.S. dollars was generally stable. Although Chinese governmental policies were introduced in 1996 to reduce restrictions on

the convertibility of Renminbi into foreign currency for current account items, conversion of Renminbi into foreign exchange for capital items, such as foreign direct investment, loans or securities, requires the approval of the State Administration for Foreign Exchange and other relevant authorities. On July 21, 2005, the PRC government introduced a managed floating exchange rate system to allow the value of the Renminbi to fluctuate within a regulated band based on market supply and demand and by reference to a basket of currencies. On the same day, the value of the Renminbi appreciated by 2% against the U.S. dollar. The PRC government has since made and in the future may make further adjustments to the exchange rate system. The PBOC announces the closing price of a foreign currency traded against the Renminbi in the inter-bank foreign exchange market after the closing of the market on each working day, and makes it the central parity for the trading against the Renminbi on the following working day.

TAXATION

The taxation of income and capital gains of holders of ordinary shares or ADSs is subject to the laws and practices of Hong Kong and of jurisdictions in which holders of ordinary shares or ADSs are resident or otherwise subject to tax. The following summary of certain relevant taxation provisions is based on current law and practice, is subject to change and does not constitute legal or tax advice. The discussion does not deal with all possible tax consequences relating to an investment in the ordinary shares or ADSs. In particular, the discussion does not address the tax consequences under state, local and other laws, such as non-Hong Kong and non-U.S. federal laws. The discussion is based upon laws and relevant interpretations in effect as of the date of this annual report. There is no reciprocal tax treaty in effect between Hong Kong and the United States.

Hong Kong

Tax on dividends

No tax is payable in Hong Kong in respect of dividends paid by us.

Profits

No tax is imposed in Hong Kong in respect of capital gains from the sale of property such as the shares. Trading gains from the sale of property by persons carrying on a trade, profession or business in Hong Kong where such gains are derived from or arise in Hong Kong from such trade, profession or business will be chargeable to Hong Kong profits tax, which is currently imposed at the rate of 17.5% on corporations and at a maximum rate of 16.0% on individuals. Gains from the sale of shares effected on the Hong Kong Stock Exchange will be considered to be derived from or arise in Hong Kong. Liability for Hong Kong profits tax would thus arise in respect of trading gains from the sale of shares realized by persons carrying on a business of trading or dealing in securities in Hong Kong.

Stamp duty

Hong Kong stamp duty will be payable by the purchaser on every purchase and by the seller on every sale of the shares. The duty is charged at the current rate of 0.2% of the consideration or, if higher, the fair value of the shares being sold or transferred (the buyer and seller each paying half of such stamp duty). In addition, a fixed duty of HK$5 is currently payable on any instrument of transfer of shares.

If one of the parties to the sale is a non-resident of Hong Kong and does not pay the required stamp duty, the duty not paid will be charged on the instrument of transfer (if any) (in addition to the stamp duty otherwise chargeable thereon), and the transferee will be liable for payment of such duty.

Estate duty

The shares are Hong Kong property for the purpose of the Estate Duty Ordinance (Chapter 111 of the Laws of Hong Kong). Accordingly, the shares may be subject to Hong Kong estate duty on the death of the beneficial owner of the shares, regardless of the place of the owner's residence, citizenship or domicile. Hong Kong estate duty is imposed on a progressive scale from 5% to 15%. No estate duty is payable when the aggregate value of the dutiable estate does not exceed HK$7.5 million, and the maximum rate of duty of 15% applies when the aggregate value of the dutiable estate exceeds HK$10.5 million.

On March 16, 2005, the Financial Secretary of the Hong Kong Special Administrative Region announced in his 2005/06 budget speech that the Hong Kong Government would propose for the abolition of estate duty and that the relevant bill would be introduced into the Hong Kong Legislative Council (the "Legislative Council") shortly. Such bill went through its first reading at the Legislative Council on May 11, 2005. However, as of the date of this annual report, such bill has yet to go through its second and third readings and other legal formalities to become law.

United States of America

The following is a summary of certain United States federal income tax consequences relating to the purchase, ownership and disposition of shares or ADSs by investors who are "U.S. Persons" (as defined below) that hold the shares or ADSs as a capital asset. This discussion is based on United States federal income tax law, as in effect on the date hereof and which is subject to differing interpretations on change, possibly with retroactive effect. This discussion is for general information only and does not address all of the tax considerations that may be relevant to specific holders in light of their particular circumstances or to holders subject to special treatment under United States federal income tax law (such as banks, insurance companies, partnerships and their partners, tax-exempt entities, financial institutions, broker-dealers, persons who have acquired our shares or ADSs as part of a straddle, hedge, conversion, or other integrated investment, persons who own, directly or by attribution, 10% or more of the combined voting power of all classes of stock of the Company, or persons that have a "functional currency" other than the United States dollar), and non-U.S. Holders. This summary does not address any United States state, local or foreign tax considerations or any United States federal estate, gift or alternative minimum tax considerations of a holder of shares or ADSs.

As used in this summary, the term "U.S. Person" means (i) an individual who is a citizen or resident of the United States, (ii) a corporation, or other entity treated as a corporation, created or organized under the laws of the United States or any political subdivision thereof, (iii) an estate the income of which is subject to United States federal income tax regardless of the source thereof, or (iv) a trust (A) if a court within the United States is able to exercise primary supervision over the administration of the trust and one or more United States persons have the authority to control all substantial decisions of the trust or (B) that otherwise elected to be treated as a United States person under the Code.

If a partnership (including any entity treated as a partnership for United States federal income tax purposes) holds shares or ADSs, the tax treatment of a partner in such partnership will depend upon the status of the partner and the activities of the partnership. Partners in such a partnership are urged to consult their tax advisers as to the particular United States federal income tax consequences applicable to them.

Prospective investors are urged to consult their tax advisers regarding

the United States federal, state, local and foreign income and other tax considerations of the purchase, ownership and disposition of shares or ADSs.

General

Holders of ADSs evidencing shares will be treated as the owners of the shares represented by those ADSs. Accordingly, no gain or loss will be recognized upon the exchange of ADSs for the holder's proportionate interest in the shares, a holder's tax basis in the withdrawn shares will be the same as its tax basis in the ADSs surrendered in exchange therefor, and the holding period in the withdrawn shares will include the period during which the holder held the surrendered ADSs.

Taxation of dividends

Subject to the discussion below under "--Passive Foreign Investment Company", the gross amount of cash distributions with respect to the shares or ADSs will, upon receipt, be includible in the gross income of a holder as dividend income to the extent of our current and accumulated earnings and profits, as determined under United States federal income tax principles. A non-corporate recipient of dividend income will generally be subject to tax on dividend income from a "qualified foreign corporation" at a maximum United States federal tax rate of 15% rather than the marginal tax rates generally applicable to ordinary income so long as certain holding period requirements are met. A non-United States corporation (other than a passive foreign investment company) generally will be considered to be a qualified foreign corporation (i) if it is eligible for the benefits of a comprehensive tax treaty with the United States which the Secretary of Treasury of the United States determines is satisfactory for purposes of this provision and which includes an exchange of information program or (ii) with respect to any dividend it pays on stock (or ADSs backed by such stock) which is readily tradable on an established securities market in the United States. There is currently no tax treaty in effect between the United States and Hong Kong. Because the ADSs are listed on the New York Stock Exchange (see ITEM 9) they are considered readily tradable on an established securities market in the United States. Distributions, if any, in excess of current and accumulated earnings and profits will constitute a return of capital and will be applied against and reduce the holder's tax basis in such ADSs or shares. To the extent that distributions are in excess of such basis, the distributions will constitute capital gain as discussed below. United States corporate holders will generally not be eligible for the dividends received deduction for distributions to domestic corporations in respect of distributions on our ADSs or shares.

The United States dollar value of any distribution made by us in Hong Kong dollars will be determined by reference to the exchange rate in effect on the date the distribution is actually or constructively received by the depositary or the holder of such shares, respectively, regardless of whether the payment is in fact converted into United States dollars on that date. Any subsequent gain or loss in respect of such Hong Kong dollars arising from exchange rate fluctuations will be ordinary income or loss. This gain or loss will generally be treated as United States source gain or loss for United States foreign tax credit limitation purposes. If the depositary converts the Hong Kong dollars to United States dollars on the date it receives such Hong Kong dollars, holders should not recognize any such gain or loss.

Dividends generally will be treated as income from foreign sources for United States foreign tax credit limitation purposes. Subject to the limitations and conditions set forth in the Code, holders may elect to claim a credit against their United States federal income tax liability in the event that any Hong Kong tax is withheld from dividends received in respect of the ADSs or shares. The rules relating to the determination of the foreign tax credit are complex and prospective purchasers are urged consult their personal tax advisors

to determine whether and to what extent they would be entitled to such credit. Holders that do not elect or are not permitted to claim foreign tax credits may instead claim a deduction for any Hong Kong tax withheld.

Sale or other disposition of shares or ADSs

Subject to the discussion below under "-- Passive Foreign Investment Company", a holder generally will recognize gain or loss for United States federal income tax purposes upon a sale or other disposition of our shares or ADSs in an amount equal to the difference between the amount realized from the sale or disposition and the holder's adjusted tax basis in the shares or ADSs. Such gain or loss generally will be long-term gain or loss if, on the date of sale or disposition, the shares or ADSs were held by the holder for more than one year and will generally be treated as United States source gain or loss for United States foreign tax credit limitation purposes. The deductibility of a capital loss may be subject to limitations.

Passive foreign investment company

A foreign corporation will be treated as a "passive foreign investment company" (a "PFIC"), for United States federal income tax purposes, if 75% or more of its gross income consists of certain types of passive income or 50% or more of its assets are passive. If a corporation owns at least 25% by value of the equity shares of another corporation, it is treated for purposes of these tests as owning a proportionate share of the assets of the other corporation and as receiving directly a proportionate share of the other corporation's income. We presently do not believe that we are a PFIC and do not anticipate becoming a PFIC. This is, however, a factual determination made on an annual basis and is subject to change. If we were to be classified as a PFIC in any taxable year, holders (i) would generally be required to treat any gain on sales of our shares held by them as ordinary income and pay an interest charge on the value of the deferral of their United States federal income tax attributable to such gain and (ii) could also be subject to an interest charge on distributions paid by us. In addition, we would not provide information to our holders that would enable them to make a "qualified electing fund" election under which, generally, in lieu of the foregoing treatment, our earnings would be currently included in their gross income.

The above results may be eliminated if a "mark-to-market" election is available and a holder validly makes such an election. If the election is made, such holder generally will be required to take into account the difference, if any, between the fair market value and its adjusted tax basis in shares or ADSs at the end of each taxable year as ordinary income or ordinary loss (to the extent of any net mark-to-market gain previously included in income). In addition, any gain from a sale or other disposition of shares or ADSs will be treated as ordinary income, and any loss will be treated as ordinary loss (to the extent of any net mark-to-market gain previously included in income).

DIVIDENDS AND PAYING AGENTS

Not applicable.

STATEMENT BY EXPERTS

Not applicable.

DOCUMENTS ON DISPLAY

You can read and copy documents referred to in this annual report that have been filed with the SEC at the SEC's public reference room located at 450 Fifth Street, NW, Washington, D.C. 20549. Please call the SEC at 1-800-SEC-0330 for further information on the public reference rooms and their copy charges.

The SEC also maintains a website at http://www.sec.gov that contains reports and other information that we have filed electronically with the SEC.

SUBSIDIARY INFORMATION

Not applicable.

ITEM 11. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

See "Item 5. Operating and Financial Review and Prospects--Market Risk and Risk Management".

ITEM 12. DESCRIPTION OF SECURITIES OTHER THAN EQUITY SECURITIES

Not applicable.

PART II

ITEM 13. DEFAULTS, DIVIDEND ARREARAGES AND DELINQUENCIES

None.

ITEM 14. MATERIAL MODIFICATIONS TO THE RIGHTS OF SECURITY HOLDERS AND USE OF PROCEEDS

MATERIAL MODIFICATIONS TO THE RIGHTS OF SECURITIES HOLDERS.

None.

USE OF PROCEEDS

The following use of proceeds information relates to our registration statement on Form F-1 (File No. 333-119786), filed by us in connection with our initial public offering of ordinary shares in the United States. In connection with the registration of the ordinary shares, a registration statement on Form F-6 (File No.333-119970) was also filed for ADSs representing such ordinary shares. Each of these two registration statements was declared effective by the SEC on November 10, 2004. Our ordinary shares commenced trading on the Hong Kong Stock Exchange on November 17, 2004 and the ADSs on the New York Stock Exchange on November 16, 2004.

The global offering, which consisted of our initial public offering in the United States, an international offering outside the United States and an initial public offering in the Hong Kong, was completed and all of the securities offered in connection therewith were sold. A portion of the securities registered under our registration statement on Form F-1 were sold in Hong Kong public offering and the international offering. China International Capital Corporation Limited, Citigroup Global Markets Inc., and Goldman Sachs (Asia) L.L.C. acted as U.S. representatives for the U.S. underwriters; and China International Capital Corporation Limited, Citigroup Global Markets Limited, and Goldman Sachs (Asia) L.L.C. acted as international representatives for the international underwriters.

The following table sets forth for CNC Hong Kong as the issuer and each selling shareholder information regarding our ordinary shares registered and sold in our November 2004 global offering, including the exercise of the over-allotment option:

Aggregate Price

	Amount Registered and Sold(1)	Amount Regis and Sold to (US$)(2)
CNC Hong Kong	1,093,529,000	1,193,040,1
China Netcom Group	102,768,985	112,120,9
Chinese Academy of Sciences	818,266	892,7
Information and Network Center of State Administration of Radio, Film and Television	818,266	892,7
China Railways Telecommunications Center	818,266	892,7
Shanghai Alliance Investment Limited	818,266	892,7
Shandong Provincial State-owned Assets Supervision and Administration Commission	3,309,951	3,611,1
Total	1,202,881,000	1,312,266,8

(1) The amount of shares registered includes any shares initially offered or sold outside the U.S. that were thereafter sold or resold in the U.S. Offers and sales of shares outside the U.S. were made pursuant to Regulation S under the Securities Act of 1933 and were not covered by the Registration Statement.

(2) The initial public offering price per ADS in the U.S. and international offerings was US$21.82. The initial public offering price per ordinary share in the Hong Kong public offering was HK$8.40, and when increased by a 1.0% brokerage fee, a 0.005% Hong Kong Securities and Futures Commission transaction levy, a 0.002% investor compensation levy and a 0.005% Hong Kong Stock Exchange trading fee payable by purchasers, was effectively equivalent to the initial public offering price per ADS in the U.S. and international offerings, based on an exchange rate of HK$7.8000 to US$1.00, the noon buying rate on June 30, 2004, and adjusted for the ratio of 20 ordinary shares per ADS.

The amount of expenses incurred by us in connection with the issuance and distribution of the registered securities totaled RMB 689 million, including RMB 353 million for underwriting discounts and commissions, and approximately RMB 336 million for other expenses. None of the payments were direct or indirect payments to our directors, officers, general partners of our associates, persons owning 10% or more of any class of our shares, or any of our affiliates.

The aggregate net proceeds from the initial public of our shares, after deduction of fees and expenses, amounted to RMB 8,944 million and were held in either H.K. dollars or U.S. dollars. The cash proceeds from our initial public offering were used as follows: (i) the expansion and upgrading of our telecommunications network infrastructure; (ii) the repayment of a term loan facility; (iii) the development of new applications and services; and (iv) general corporate purposes.

ITEM 15. CONTROLS AND PROCEDURES

Our principal executive officers and principal financial officer, after evaluating the effectiveness of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15(d)-15(e) of the Securities Exchange Act of 1934, as amended) as of the end of the period covered by this annual report, have concluded that, as of such date, our disclosure controls and procedures were effective to ensure that material information relating to us and our consolidated subsidiaries was made known to them by others within our company and our consolidated subsidiaries on a timely basis.

Our internal control and management systems were designed to meet the

standards generally adopted by companies in China. These standards are different from the standards and best practices adopted by companies listed in the United States. See "Item 3. Key Information -- Risk Factors -- Our internal controls and management systems are not currently consistent with international practices in certain respects and we are in the process of improving these controls and systems to enable us to certify the effectiveness of our internal controls under the Sarbanes-Oxley Act of 2002. Our failure to timely and successfully upgrade these controls and systems could subject us to regulatory actions and harm the price of our stock."In 2005, we began a series of initiatives to enhance our (i) corporate governance structure, (ii) internal controls, (iii) information system and (iv) administrative policies and compliance.

- Corporate governance structure. At the end of 2005, we retained a leading international consulting firm to assist us in launching a special corporate governance project under the direct leadership of our board's corporate governance committee. The project is designed to further define the rights and responsibilities of the board in relation to the management with a set of detailed policies and procedures. As of the date of this annual report, we have identified a number of areas which the project will focus on. We intend to implement the new policies and procedures produced under the project in the second half of 2006.

- Internal controls. We made significant progress on our internal controls project, which we launched at the end of 2004 in an effort to meet the requirements of the Sarbanes-Oxley Act of 2002. We first designed a standard set of internal control policies and procedures, which is based on the COSO internal control framework, and takes into account the current needs of our company. We then conducted a pilot test of our standard policies and procedures at our branches. Based on the results of the pilot test, we made adjustments to our standard policies and procedures and began implementation throughout our company at the end of 2005. We expect to complete the implementation of our internal control policies and procedures in the second half of 2006.

- Information system. In 2005, we began implementation of an Enterprise Resources Planning, or ERP, system. We also launched a program to integrate and streamline information systems, as well as to incorporate standardized internal control procedures into the system. The purpose is to ensure the efficiency of our internal controls and the accuracy and timeliness of our internal reporting system. As a result of these efforts, we expect to further strengthen security and monitoring of operations.

- Administrative procedures and compliance. In conjunction with efforts to enhance our internal controls, we developed "Stipulations on Information Quality Guarantee and Accountability Management" and "CNC Discipline" and other management rules to ensure the accuracy, completeness and integrity of statistical data. These guidelines clarify requirements for statistical data as well as setting out severe penalties for non-compliance. We also developed "Methods for Handling of Complaints and Reports Concerning Accounting Information, Internal Controls and Auditing Methods of the Audit Committee", which prohibits any intentional reporting of false or erroneous information from all levels of our company.

ITEM 16A AUDIT COMMITTEE FINANCIAL EXPERT

Our board of directors has determined that Mr. Timpson Chung Shui Ming

qualifies as an audit committee financial expert in accordance with the terms of Item 16.A of Form 20-F. For Mr. Chung's biographical information, see "Item 6. Directors, Senior Management and Employees--Directors and Senior Management".

ITEM 16B CODE OF ETHICS

We have adopted a code of ethics that applies to our Chief Executive Officer, Chief Financial Officer, and other designated members of senior management of the Company. We have filed this code of ethics as an exhibit to this annual report.

ITEM 16C PRINCIPAL ACCOUNTANT FEES AND SERVICES

The following table sets forth the aggregate audit fees, audit-related fees, tax fees of our principal accountants and all other fees billed for products and services provided by our principal accountants other than the audit fees, audit-related fees and tax fees for such of the two years ended December 31, 2005:

	Audit Fees	Audit-Related Fees	Tax Fees	Other Fees
		(in millions of RMB)		
2004.....	84.4(1)	0	0.5	6.9(2)
2005.....	33.8	38.0	4.9	0.8

(1) Includes the audit fees for our global offering in November 2004 and the annual financial statements in connection with statutory and regulatory filings or engagement for the fiscal year of 2004.
(2) Includes the audit fees paid by China Netcom Group in connection with PRC statutory and regulatory filings or engagements for the fiscal year of 2004.

Before our principal accountants were engaged by our company or our subsidiaries to rend audit or non-audit services, the engagement was approved by our audit committee as required by applicable rules and regulations of the U.S. Securities and Exchange Commission.

ITEM 16D EXEMPTIONS FROM THE LISTING STANDARDS FOR AUDIT COMMITTEES

Not applicable.

ITEM 16E PURCHASES OF EQUITY SECURITIES BY THE ISSUER AND AFFILIATED PURCHASERS.

None.

ITEM 17. FINANCIAL STATEMENTS

We have elected to provide the financial statements and related information specified in Item 18 in lieu of Item 17.

ITEM 18. FINANCIAL STATEMENTS

See Index to Financial Statements for a list of all financial statements filed as part of this annual report.

ITEM 19. EXHIBITS

Exhibit No.	Description of Exhibit
1.1	Memorandum and Articles of Association of the Registrant(1)
2.1	Form of share certificate(1)
2.2	Form of deposit agreement, including form of American Depositary Receipt(2)
3.1	Declaration of Trust, dated October 5, 2004, from CNC BVI to the Academy of Sciences(1
3.2	Declaration of Trust, dated October 5, 2004, from CNC BVI to INC-SARFT(1)
3.3	Declaration of Trust, dated October 5, 2004, from CNC BVI to CRTC(1)
3.4	Declaration of Trust, dated October 5, 2004, from CNC BVI to Shanghai Alliance(1)
3.5	Declaration of Trust, dated October 5, 2004, from CNC BVI to Shandong SASAC(1)
3.6	Trust Arrangement, dated October 5, 2004, entered into between CNC BVI, China Netcom G of Sciences (English Translation)(1)
3.7	Trust Arrangement, dated October 5, 2004, entered into between CNC BVI, China Netcom G (English Translation)(1)
3.8	Trust Arrangement, dated October 5, 2004, entered into between CNC BVI, China Netcom G (English Translation)(1)
3.9	Trust Arrangement, dated October 5, 2004, entered into between CNC BVI, China Netcom G Alliance (English Translation)(1)
3.10	Trust Arrangement, dated October 5, 2004, entered into between CNC BVI, China Netcom G SASAC (English Translation)(1)
4.1	Asset Injection Agreement, dated June 29, 2004, among China Netcom Group, CNC BVI, CNC (English Translation)(1)
4.2	Letter of Undertakings by China Netcom Group (English Translation)(1)
4.3	Trademark Licensing Agreement, dated October 8, 2004 among CNC China, China Netcom Gro Translation)(1)
4.4	Restructuring Agreement, dated September 6, 2004 among CNC China, China Netcom Group a Translation)(1)
4.5	Non-Competition Agreement, dated September 6, 2004 among CNC China, China Netcom Group Translation)(1)
4.6	Assets and Liabilities Transfer Agreement, dated June 23, 2004 entered into between CN Netcom Group (English translation)(1)
4.7	Interconnection Settlement Agreement, dated October 8, 2004 between CNC China and Chin (English Translation)(1)
4.8	Property Leasing Agreement, dated October 8, 2004 between CNC China and China Netcom G Translation)(1)
4.9	Property Sub-leasing Agreement, dated October 8, 2004 between CNC China and China Netc Translation)(1)
4.10	Master Services Sharing Agreement, dated October 8, 2004 between CNC China and China N Translation)(1)
4.11	Engineering and Information Technology Services Agreement, dated October 8, 2004 betwe China Netcom Group (English Translation)(1)
4.12	Materials Procurement Agreement, dated October 8, 2004 between CNC China and China Net Translation)(1)
4.13	Ancillary Telecommunications Services Agreement, dated October 8, 2004 between CNC Chi Group (English Translation)(1)
4.14	Support Services Agreement, dated October 8, 2004 between CNC China and China Netcom G Translation)(1)
4.15	Telecommunication Facilities Leasing Agreement, dated October 8, 2004 between CNC Chin Group (English Translation)(1)
4.16	Capacity Purchase Agreement, dated June 30, 2004 between Asia Netcom and East Asia Net
4.17	Capacity Lease Agreement, dated June 30, 2004 between Asia Netcom and East Asia Netcom Amendment No. 1 dated October 6, 2004(1)
4.18	Management Services Agreement, dated June 30, 2004 between Asia Netcom and East Asia N Amendment No. 1 dated October 6, 2004(1)
4.19	Share Option Plan (English Translation)(1)
4.20	Share Purchase and Exchange Agreement, dated June 11, 2004 and amendment dated July 20

	Netcom Holdings (BVI) Limited, CNC Fund L.P. and us(1)
4.21	Form of Senior Management Employment Agreement (English Translation)(1)
4.22	Form of Director's Employment Agreement (English Translation)(1)
4.23	Share Purchase and Sale Agreement dated June 30, 2004 entered into between Asia Netcom Corporation Limited(1)
4.24	Assignment and Novation Agreement dated June 30, 2004 entered into among Asia Netcom, Corporation Limited and us(1)
4.25	Share Purchase Agreement dated December 2, 2003 entered into among SBAIF Asia Netcom (China Netcom Corporation International Limited, Asia Netcom and us(1)
4.26	Shareholders Agreement dated March 12, 2003 entered into among China Netcom Corporatio Limited, SB Asia Infrastructure Fund L.P., Newbridge Asia Netcom (Cayman) Holdings, As
4.27	Share and Asset Purchase Agreement dated November 17, 2002 entered into between Asia N
4.28	Share Purchase Agreement, dated December 2, 2003 entered into among Newbridge Asia Net Holdings, China Netcom Corporation International Limited, Asia Netcom and us(1)
4.29	Share Transfer Agreement, dated June 10, 2004, entered into between China Netcom Group Holdings (English Translation)(1)
4.30	Share Transfer Agreement, dated April 20, 2004, entered into between China Netcom Grou Sciences, INC-SARFT, CRTC and Shanghai Alliance (English Translation)(1)
4.31	Asset Transfer Agreement, dated April 26, 2004, entered into between China Netcom Grou (English Translation)(1)
4.32	Telecommunications Assets Transfer Agreement, dated June 10, 2004, entered into betwee and Jitong Communications Company Limited (English Translation)(1)
4.33	Telecommunications Assets Transfer Agreement, dated June 10, 2004, entered into betwee and Guangdong Telecommunications Company Limited (English Translation)(1)
4.34	Debenture, dated July 29, 2004 entered into among Asia Netcom Asia Pacific Limited, As Pacific Commercial Limited, Asia Netcom Hong Kong Limited and Industrial and Commercia (Asia) Limited(1)
4.35	Deed of Mortgage of Shares, dated July 29, 2004 entered into between Asia Netcom and I Commercial Bank of China (Asia) Limited(1)
4.36	Debenture, dated July 29, 2004 entered into among Asia Netcom Services (S) Pte. Ltd., Corporation (Singapore) Pte. Limited, Asia Netcom Singapore Pte. Ltd., Southeast Asia Pte. Ltd. and Industrial and Commercial Bank of China (Asia) Limited(1)
4.37	Group Share Mortgage, dated July 29, 2004 entered into among Asia Netcom Corporation (Limited, Asia Netcom Services (S) Pte. Ltd., Southeast Asia Netcom (Singapore) Pte. Lt Singapore Pte. Ltd. and Industrial and Commercial Bank of China (Asia) Limited(1)
4.38	Assignment of Building Agreement, dated July 29, 2004 entered into between Asia Netcom and Industrial and Commercial Bank of China (Asia) Limited(1)
4.39	Share Pledge Agreement, dated July 28, 2004 entered into among Asia Netcom Corporation Ltd., the seven financial institutions listed in the Share Pledge Agreement and Indust Bank of China (Asia) Limited(1)
4.40	Amended and Restated Facility Agreement, dated July 27, 2004 entered into among Asia N banks named in the Amended and Restated Facility Agreement, Industrial and Commercial Limited(1)
4.41	Group Subordination Deed, dated July 27, 2004 entered into between Asia Netcom and Ind Commercial Bank of China (Asia) Limited(1)
4.42	Group Subordination Deed, dated July 27, 2004 entered into among our Company and China International Limited, Asia Netcom and Industrial and Commercial Bank of China (Asia)
4.43	Debenture, dated July 27, 2004 entered into between Asia Netcom and Industrial and Com China (Asia) Limited(1)
4.44	Group Assignment of Insurances, dated July 27, 2004 entered into among Asia Netcom, EA and Commercial Bank of China (Asia) Limited(1)
4.45	Security Assignment, dated July 27, 2004 entered into between Asia Netcom and Industri Bank of China (Asia) Limited(1)
4.46	Charge Over Deposit Account, dated July 27, 2004 entered into between Asia Netcom and Commercial Bank of China (Asia) Limited(1)
4.47	Charge Over Accounts, dated July 27, 2004 entered into between Asia Netcom and Industr Bank of China (Asia) Limited(1)
4.48	Deed of Mortgage of Shares in Asia Netcom, dated July 27, 2004 entered into between Ch Corporation International Limited and Industrial and Commercial Bank of China (Asia) L
4.49	Guarantee and Indemnity, dated July 27, 2004 entered into between our Company and Indu Commercial Bank of China (Asia) Limited
8.1	List of subsidiaries of the Registrant

11.1	Code of Ethics (3)
12.1	Chairman Certification
12.2	CEO Certification
12.5	CFO Certification
13.1	Certification by Chairman and CFO

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(1) Incorporated by reference to our Registration Statement on Form F-1 (File No. 333-119786) filed with the SEC in connection with our global offering in November 2004.

(2) Incorporated by reference to our Registration Statement on Form F-6 (File No. 333-119970) filed with the SEC with respect to American Depositary Shares representing our ordinary shares.

(3) Incorporated by reference to our Form 20-F filed with the SEC on June 23, 2005.

SIGNATURE

The registrant hereby certifies that it meets all of the requirements for filing on Form 20-F and that it has duly caused and authorized the undersigned to sign this annual report on its behalf.

China Netcom Group Corporation
(Hong Kong) Limited

/s/ Zhang Chunjiang

Name: Zhang Chunjiang
Title: Chairman of the Board of Directors

Date: June 9, 2006

Appendix A

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To The Board of Directors and Shareholders of China Netcom Group Corporation (Hong Kong) Limited:

In our opinion, the accompanying consolidated balance sheets and the related consolidated statements of income, shareholders' equity and cash flows present fairly, in all material respects, the financial position of China Netcom Group Corporation (Hong Kong) Limited and its subsidiary companies (collectively referred to as the "Group") at 31 December 2004 and 2005, and the results of their operations and their cash flows for the three years ended 31 December 2005, in conformity with accounting principles generally accepted in Hong Kong. These financial statements are the responsibility of the Group's management; our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with the standards of the Public Company Accounting Oversight Board (United States), which require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As discussed in Note 3 to the consolidated financial statements, the Group adopted certain new or revised Hong Kong Financial Reporting Standards ("HKFRS") in 2005 which resulted in changes in the accounting for share-based payments, goodwill and negative goodwill, lease prepayments and financial instruments.

Accounting principles generally accepted in Hong Kong vary in certain significant respects from accounting principles generally accepted in the United States of America ("US GAAP"). Information relating to the nature and effect of such differences is presented in Note 41 relating to the US GAAP reconciliation to the consolidated financial statements.

PricewaterhouseCoopers

Certified Public Accoutants

Hong Kong, 9 June 2006

CHINA NETCOM GROUP CORPORATION (HONGKONG) LIMITED
CONSOLIDATED INCOME STATEMENT

		Year ended Decemb		
	Note	2003	2004	

		RMB million Restated Notes 2&3	RMB million Restated Notes 2&3
Revenues	7	77,598	83,494
Operating expenses			
Depreciation and amortization		(26,800)	(25,180)
Networks, operations and support		(15,108)	(13,973)
Staff costs	14	(10,945)	(11,950)
Selling, general and administrative		(10,322)	(12,877)
Other operating expenses		(2,197)	(1,993)
Total of operating expenses	8	(65,372)	(65,973)
Operating profit before interest income, dividend income and deficit on revaluation of fixed assets		12,226	17,521
Interest income		95	87
Dividend income		45	17
Deficit on revaluation of fixed assets	20(c)	(25,778)	(11,318)
Profit from operations		(13,412)	6,307
Finance costs	9	(4,296)	(3,930)
Share of loss of			
-Associate companies		(1)	(1)
-Jointly controlled entity		(415)	-
(Loss)/profit before taxation		(18,124)	2,376
Taxation (charge)/credit	10	7,217	323
(Loss)/profit for the year		(10,907)	2,699
Attributable to :			
Equity holder of the Company		(10,906)	2,699
Minority interests		(1)	-
(Loss)/profit for the year		(10,907)	2,699
Dividends proposed after the balance sheet date	12	-	259
Basic (loss)/earnings per share	13	RMB(1.99)	RMB0.48
Diluted (loss)/earnings per share	13	RMB(1.99)	RMB0.48

The notes on pages F-9 to F-99 are an integral part of these consolidated financial statements

CHINA NETCOM GROUP CORPORATION (HONG KONG) LIMITED

CONSOLIDATED BALANCE SHEET

	Note	As a 2004 RMB million Restated Notes 2&3
Assets		
Current assets		
Cash and bank deposits	15	10,633
Short-term investments	16	2,876
Accounts receivable	17	7,174
Inventories and consumables	18	1,243
Prepayments, other receivables and other current assets	19	1,442
Due from ultimate holding company and fellow subsidiaries	28	1,087
Total current assets		24,455
Non-current assets		
Fixed assets	20	166,897
Construction in progress	21	10,597
Lease prepayments for land	22	1,746
Intangible assets	23	382
Deferred tax assets	31	3,804
Other non-current assets	24	8,536
Total non-current assets		191,962
Total assets		216,417

The notes on pages F-9 to F-99 are an integral part of these consolidated financial statements

CHINA NETCOM GROUP CORPORATION (HONG KONG) LIMITED

CONSOLIDATED BALANCE SHEET (CONTINUED)

	As a

	Note	2004
		RMB million Restated Notes 2&3
Liabilities and equity		
Current liabilities		
Accounts payable	25	21,125
Accruals and other payables	26	4,866
Short term bank loans	27(a)	44,882
Current portion of long term bank and other loans	27(b)	11,727
Due to ultimate holding company and fellow subsidiaries	28	10,080
Current portion of deferred revenues	29	8,876
Current portion of provisions	30	4,127
Taxation payable		361
Total current liabilities		106,044
Net current liabilities		(81,589)
Total assets less current liabilities		110,373
Non-current liabilities		
Long term bank and other loans	27(b)	26,052
Due to ultimate holding company and fellow subsidiaries	28	-
Deferred revenues	29	13,988
Provisions	30	3,574
Deferred tax liabilities	31	1,576
Other non-current liabilities		588
Total non-current liabilities		45,778
Total liabilities		151,822
Financed by:		
Share capital	32	2,181
Reserves		62,414
Shareholders' equity		64,595
Total liabilities & equity		216,417

The notes on pages F-9 to F-99 are an integral part of these consolidated financial statements

CHINA NETCOM GROUP CORPORATION (HONG KONG) LIMITED

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

	Attributable to equity holders o			
	Share capital RMB million (Note 32)	Share Premium RMB million	Revaluation reserve RMB million	Other reserve RMB million
Balance as at January 1, 2003, as previously reported	1,819	34,168	-	-
Adjusted for the Acquisition (Note 2)	-	-	-	7,554
Balance as at January 1, 2003, as restated	1,819	34,618		7,554
Revaluation surplus	-	-	2,982	-
Transfer from retained earnings to other reserve due to the Acquisition				2,729
Revaluation tax credit	-	-	(984)	-
Movement of deferred tax recognized in equity	-	-	-	-
Net income/(expense) recognized directly in equity	-	-	1,998	2,729
Loss for the year	-	-	-	-
Total expense recognised in 2003	-	-	1,998	2,279
Net contribution from owners	-	-	-	-
Distributions to owners	-	-	-	-
Balance at December 31, 2003	1,819	34,168	1,998	10,283

The notes on pages F-9 to F-99 are an integral part of these consolidated financial statements

	Attributable to equity holders of the compan					
	Share capital RMB million (Note 32)	Share premium RMB million	Capital reserve RMB million	Statutory reserve RMB million	Revaluation reserve RMB million	Other reserve RMB million
Balance as at January 1, 2004	1,819	34,168	-	-	1,998	10,283
Appropriation to statutory reserve (Note 11)	-	-	-	723	-	-
Revaluation surplus (Note 20(c))	-	-	-	-	3,863	-
Movement of deferred tax recognized in equity (Note 31)	-	-	-	-	846	2,355
Transfer to retained earnings	-	-	-	-	(697)	(241)

Transfer to capital reserve upon Listing Reorganization	-	-	265	-	-	-
Transfer from retained earnings to other reserve due to the Acquisition	-	-	-	-	-	(6,531)
Revaluation tax credit (Note31)	-	-	-	-	(1,275)	-
Net income/(expense) recognized directly in equity	-	-	265	723	2,737	(4,417)
Profit for the year	-	-	-	-	-	-
Total income recognized for 2004	-	-	265	723	2,737	(4,417)
Issue of shares through global offering ("Global Offering") net of issue expense	362	8,582	-	-	-	-
Contributions from owner	-	-	-	-	-	-
Distributions to owner	-	-	-	-	-	-
Tax loss as utilized by owner (Note 31)	-	-	-	-	-	-
Net assets distributed to owner in accordance with Listing Reorganization	-	-	-	-	-	-
Distribution to an owner upon assignment of loan	-	-	-	-	-	-
Share-based payments (Note 3(a))	-	-	18	-	-	-
Balance at December 31, 2004	2,181	42,750	283	723	4,735	5,866

The notes on pages F-9 to F-99 are an integral part of these consolidated financial statements

	Attributable to equity holders of the company					
	Share capital RMB million (Note 32)	Share premium RMB million	Capital reserve RMB million	Statutory reserve RMB million	Revaluation reserve RMB million	Other reserve RMB million
Balance as at December 31, 2004	2,181	42,750	283	723	4,735	5,866
Effect of adoption of HKFRSs:						
Derecognition of						

negative goodwill (Note 3(b))	-	-	-	-	-	-
Financial Instruments (Note 3(d))	-	-	-	-	-	-
Balance as at January 1, 2005, as restated	2,181	42,750	283	723	4,735	5,866
Transfer to statutory reserve (Note 11)	-	-	-	6,783	-	-
Appropriation to statutory reserve (Note 11)	-	-	-	1,044	-	-
Transfer to retained earnings	-	-	-	-	(1,731)	(96)
Currency translation differences	-	-	-	-	-	(56)
Movement of deferred tax recognized in equity (Note 31)	-	-	-	-	1,097	843
Transfer from retained earnings to other reserve due to the Acquisition	-	-	-	-	-	1,040
Net income/(expense) recognized directly in equity	-	-	-	7,827	(634)	1,731
Profit for the year	-	-	-	-	-	-
Total income recognized for 2005	-	-	-	7,827	(634)	1,731
Contributions from owner	-	-	-	-	-	-
Distributions to owner	-	-	-	-	-	-
Dividend distributed during the year (Note 12)	-	-	-	-	-	-
Net assets distributed to owner in accordance with reorganization for the Acquisition	-	-	-	-	-	-
Consideration for the Acquisition (Note 1)	-	-	-	-	-	(12,800)
Share-based payments (Note 3(a))	-	-	104	-	-	-
Balance as at December 31, 2005	2,181	42,750	387	8,550	4,101	(5,203)

The notes on pages F-9 to F-99 are an integral part of these consolidated financial statements

		Year ended Dec	
	Note	2003	2004

		RMB million Restated Notes 2	RMB million Restated Notes 2&3
Cash flows from operating activities			
Net cash inflows generated from operations	34(a)	35,527	37,434
Interest received		95	86
Dividends received		45	17
Interest paid		(3,819)	(3,877)
Profits tax paid		(931)	(7)
Net cash inflow from operating activities		30,917	33,653
Cash flows from investing activities			
Purchase of fixed assets and construction in progress		(36,416)	(28,054)
Prepayments for leased land		(34)	(202)
Sales of fixed assets		756	923
Sales of other investments		1,195	1,528
Net decrease in time deposits with maturity over three months		105	5
Investment in Asia Netcom	34(c)	(507)	-
Purchase of additional interest in Asia Netcom	34(c)	55	-
Purchase of other investments		(29)	(2,902)
Net cash outflow from investing activities		(34,875)	(28,702)
Cash flows from financing activities			
New bank loans and other loans		80,006	64,664
Repayment of bank loans		(81,992)	(70,051)
Capital element of finance lease payments		(140)	(964)
Payment of distribution to owner		(1,806)	(7,310)
Advance from owners		4,750	-
Payment to owner for the Acquisition (Note 1)		-	-
Dividends payment		-	-
Loans to fellow subsidiaries and related parties	38(e(i))	-	(1,021)
Global Offering net of issue expense	32(d)	-	8,944
Net loan from owner		2,777	3,995
Net cash inflow / (outflow) from financing activities		3,595	(1,743)
(Decrease)/increase in cash and cash equivalents		(363)	3,208
Cash and cash equivalents at beginning of year		7,736	7,373
Cash and cash equivalents at end of year	16	7,373	10,581

The notes on pages F-9 to F-99 are an integral part of these consolidated financial statements

CHINA NETCOM GROUP CORPORATION (HONG KONG) LIMITED

NOTES TO THE FINANCIAL STATEMENTS

1 The group and its principal activities

Background of the group

China Netcom Group Corporation (Hong Kong) Limited (the "Company") was incorporated in the Hong Kong Special Administrative Region ("Hong Kong") of the People's Republic of China ("PRC") on October 22, 1999 as a limited liability company under the Hong Kong Companies Ordinance. The shares of the Company were listed on The Stock Exchange of Hong Kong Limited on November 17, 2004 and the ADSs of the Company were listed on The New York Stock Exchange Inc. on November 16, 2004. Prior to a reorganization conducted for the listing of the shares of the Company (the "Listing Reorganization"), the Company's ultimate holding company was China Netcom Holdings Company Limited ("China Netcom Holdings").

The Company, China Netcom Holdings and China Network Communications Group Corporation (the "China Netcom Group") underwent the Listing Reorganization on June 30, 2004. China Netcom Group, established by the State Council of the PRC ("State Council") in May 2002, was formed under a restructuring plan approved by the State Council relating to the fixed line telecommunication section. Its fixed line telecommunications businesses were split from the Northern operations originally operated by China Telecommunication Corporation. Immediately after the Listing Reorganization, China Netcom Group became the ultimate holding company of the Group and the Company and its subsidiaries (the "Group") owned the assets and liabilities of fixed line telecommunications businesses originally owned by China Netcom Group in the six northern provinces and municipalities (namely Beijing Municipality, Tianjin Municipality, Hebei Province, Liaoning Province, Shandong Province and Henan Province) and two southern province and municipality (namely Shanghai Municipality and Guangdong Province) in the PRC and the assets and liabilities of fixed line telecommunications business in Asia Pacific Region originally owned by the Group. Also, the Group leased from China Netcom Group, the inter-provincial optic fibre of the twelve service regions in the PRC and the submarine cable assets in the Asia Pacific Region which had been retained by China Netcom Group.

Pursuant to a resolution passed in the extraordinary general meeting of the shareholders on October 25, 2005, the Company acquired the principal telecommunications operations and assets in the four northern provinces/autonomous region, namely Shanxi Province, Neimenggu Autonomous Region, Jilin Province and Heilongjiang Province from China Netcom Group (the "Acquisition"). In anticipation for the Acquisition, China Netcom Group established China Netcom Group New Horizon Communications Corporation (BVI) Limited ("New Horizon (BVI)") and China Netcom Group New Horizon Communications Corporation Limited ("New Horizon"). China Netcom Group's fixed line telecommunications businesses in the four northern provinces/autonomous region were transferred to New Horizon (BVI) through a group restructuring. Upon the completion of the acquisition of the entire interest of New Horizon (BVI) and New Horizon from China Netcom Group, the Company controlled

the fixed line telecommunications businesses in the four northern provinces/autonomous region.

After taking into consideration the financial position and prospects of the acquired businesses and the conditions of the capital market, the consideration for Acquisition was determined at RMB12,800 million. The consideration consists of an initial cash payment of RMB3,000 million and deferred payments of RMB9,800 million. The deferred payments will be settled in half-yearly instalments over five years. The interest charged on the deferred payments is to be calculated at 5.265% per annum.

CHINA NETCOM GROUP CORPORATION (HONG KONG) LIMITED

NOTES TO THE FINANCIAL STATEMENTS

1 The group and its principal activities (continued)

Background of the group (continued)

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

Under the Telecommunications Regulations, all telecommunications operators in the PRC must obtain a telecommunications service operating license from the MII or from the provincial telecommunications administrations. Providers of value-added services within a single province are required to obtain licenses from provincial telecommunications administrations. Providers of basic telecommunications services and providers of value-added services in two or more provinces, autonomous regions and municipalities are required to obtain licenses from the MII. China Netcom (Group) Company Limited ("CNC China") and New Horizon, the Group's principal operating subsidiaries in China, as indirect subsidiaries of China Netcom Group, have the right to operate the Group's telecommunications business in twelve service regions under the authorization of China Netcom Group, which holds the license required for operating the Group's telecommunications businesses in the PRC.

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

Following the Acquisition, the Group is the dominant provider of fixed line telephone services, broadband, other internet-related services, and business and data communications services in ten northern provinces, municipalities and autonomous region, namely Beijing Municipality, Tianjin Municipality, Hebei Province, Liaoning Province, Shandong Province, Henan Province, Shanxi Province, Neimenggu Autonomous Region, Jilin Province, and Heilongjiang Province. The Group

also provides telecommunications services to selected business and residential customers in two southern municipality and province, namely Shanghai Municipality and Guangdong Province in the PRC. In addition, the Group operates a network and offers international data services throughout the Asia Pacific countries and regions.

CHINA NETCOM GROUP CORPORATION (HONG KONG) LIMITED

NOTES TO THE FINANCIAL STATEMENTS

1 The group and its principal activities (continued)

Background of the group (continued)

Following the Listing Reorganization and the Acquisition, the Group's principal services consist of:

- Fixed line telephone services (including the personal handy phone system (PHS) services), comprising:
  - (a) Local, domestic long distance and international long distance services;
  - (b) Value-added services, including caller identity, telephone information services; and
  - (c) Interconnection services provided to other domestic telecommunications service providers including the fellow subsidiary owned by China Netcom Group operating outside the twelve service regions;
- Broadband services and other Internet-related services;
- Business and data communications services, including integrated regional data and voice communications services; and
- International services consisting of international voice services including international inbound calls destined for the PRC or transit through the PRC or other Asia-Pacific countries and regions, and leased line, Internet access, managed data and other telecommunications services provided to business and carrier customers located outside the PRC.

2 Basis of presentation

The financial statements have been prepared in accordance with Hong Kong Financial Reporting Standards ("HKFRS"), Hong Kong Accounting Standards ("HKAS") and interpretations issued by the Hong Kong Institute of Certified Public Accountants ("HKICPA"). They have also been prepared in accordance with the disclosure requirements of the Hong Kong Companies Ordinance and Rules Governing the Listing Securities on The Stock Exchange of Hong Kong Limited. They have been prepared under the historical cost convention modified by the revaluation of certain fixed assets and the marking to fair values of certain investments as explained in the accounting policies in Note 4 below, and on a going concern basis.

Prior to the Acquisition, China Netcom Group held the entire telecommunications operations and assets of four northern provinces/autonomous region. Since China Netcom Group is the Group's ultimate holding company, the Acquisition constitutes a business combination under common control. Accordingly, the Company has used merger accounting to record the Acquisition in accordance with the Accounting Guideline 5 "Merger Accounting For Common Control Acquisition" ("AG5") issued by HKICPA, and the acquired assets are stated at carrying amounts as if the fixed line telecommunications operations and assets of the four provinces/autonomous region have been held by the Company from the beginning of the earliest period presented. The 2003 and 2004 comparatives of the financial statements have been restated accordingly.

CHINA NETCOM GROUP CORPORATION (HONG KONG) LIMITED

NOTES TO THE FINANCIAL STATEMENTS

2 Basis of presentation (continued)

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

The financial statements include the financial information of the Company and its subsidiaries (collectively referred to as the "Group").

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

3 Changes in accounting policies

In 2005, the Group adopted certain new or revised HKFRSs which are relevant to its operations as listed below. The comparative figures in respect of the year ended December 31, 2003 and 2004 have been restated where necessary, in accordance with the relevant requirements.

- HKAS 1 Presentation of Financial Statements
- HKAS 2 Inventories
- HKAS 7 Cash Flow Statements
- HKAS 8 Accounting Policies, Changes in Accounting Estimates and Errors
- HKAS 10 Events after the Balance Sheet Date
- HKAS 12 Income Taxes
- HKAS 14 Segment Reporting

- o HKAS 16 Property, Plant and Equipment
- o HKAS 17 Leases
- o HKAS 18 Revenue
- o HKAS 19 Employee Benefits
- o HKAS 21 The Effects of Changes in Foreign Exchange Rates
- o HKAS 23 Borrowing Costs
- o HKAS 24 Related Party Disclosures
- o HKAS 27 Consolidated and Separate Financial Statements
- o HKAS 28 Investments in Associates
- o HKAS 32 Financial Instruments: Disclosure and Presentation
- o HKAS 33 Earnings per Share
- o HKAS 36 Impairment of Assets
- o HKAS 37 Provisions, Contingent Liabilities and Contingent Assets
- o HKAS 38 Intangible Assets
- o HKAS 39 Financial Instruments: Recognition and Measurement
- o HKFRS 2 Share-based Payment
- o HKFRS 3 Business Combinations

3 Changes in accounting policies (continued)

The adoption of these new or revised HKFRSs did not have any significant impact on the results of operations and financial position of the Group, except for the adoption of HKFRS 2, HKFRS 3, HKAS 36, HKAS 17, HKAS 32 and HKAS 39 as detailed below.

The impact of the adoption of HKFRS 2, HKFRS 3, HKAS 36, HKAS 17, HKAS 32 and HKAS 39 to the financial position and results of the Group was as follows:

(a) HKFRS 2

In prior years, no employee benefits cost or obligation was recognized when employees (including directors) were granted share options by the Group over shares in the Company. When the share options were exercised, equity was increased by the amount of the proceeds received.

With effect from January 1, 2005, in order to comply with HKFRS 2, the Group recognized the fair value of such share options as an expense in the consolidated income statement, or as an asset if the cost qualifies for recognition as an asset under the group's accounting policies. A corresponding increase is recognized in a capital reserve within equity.

This change in accounting policy has been accounted for retrospectively as follows:

	After adjustment for the Acquisition	Effect of adoption of new HKFRS

	RMB million	RMB million
As at December 31, 2004		
Reserves:		
Retained earnings	8,075	(18)
Capital reserve	265	18

The adoption of HKFRS 2 resulted in:

	Year ended De
	2004
	RMB million Restated
Increase in staff costs	18

Details of the share option scheme are presented in Note 33 of the financial statements.

3 Changes in accounting policies (continued)

(b) HKFRS 3 and HKAS 36

In prior years:

- Positive goodwill arising from acquisition on or after January 1, 2001 was amortized to the consolidated income statement on a straight-line basis over 20 years. Positive goodwill was stated in the consolidated balance sheet at cost less accumulated amortization and any impairment losses; and

- Negative goodwill which arose from acquisition on or after January 1, 2001 was amortized over the weighted average useful life of the depreciable/amortizable non-monetary assets acquired, except to the extent in relation to identified expected future losses as at the date of acquisition. In such cases it was recognized in the consolidated income statement as those expected losses were incurred.

With effect from January 1, 2005, the Group adopted a new accounting policy in order to comply with HKFRS 3 and HKAS 36. The Group no longer amortized positive goodwill. Such goodwill is tested annually for impairment, including in the year of its initial recognition, as well as when there are indications of impairment. Impairment losses are recognized when the carrying amount of the cash generating unit to which the goodwill has been allocated exceeds its recoverable amount.

With effect from January 1, 2005 and in accordance with HKFRS 3, if the fair value of the net assets acquired in a business combination exceeds the consideration paid (i.e. an amount arises which would have been known as negative goodwill under the previous accounting policy), the excess is recognized immediately in the consolidated income statement as it arises.

The change in the net book value of negative goodwill, as disclosed in Note 23, arising from the above change in accounting policy has been prospectively accounted for from January 1, 2005 as follows:

	Before adoption of new HKFRS	Effect of adoption of new HKFRS
	RMB million	RMB million
As at January 1, 2005		
Negative goodwill (included in intangible assets)	(166)	166
Retained earnings	8,057	166

3 Changes in accounting policies (continued)

(b) HKFRS 3 and HKAS 36 (continued)

The adoption of HKFRS 3 and HKAS 36 resulted in:

	Year ended December 31, 2005
	RMB million
Increase in amortization expense	15

(c) HKAS 17

In prior years, land use rights and buildings held for own use were stated at cost less accumulated depreciation and impairment losses. Depreciation was calculated to write-off the cost of such assets on a straight-line basis over their estimated useful lives, to residual value.

With effect from January 1, 2005, in order to comply with HKAS 17, land use rights held for own use are accounted for as operating leases where

the fair value of the interest in any buildings situated on the leasehold land can be separately identified from the fair value of the land use rights at either the time the lease was first entered into by the Group or taken over from the previous lessee, or at the date of construction of those buildings, if later.

Any pre-paid land premiums for acquiring the land use rights, or other lease payments, are stated at cost and are written off on a straight-line basis over the respective periods of the rights.

Any buildings held for own use which are situated on such land leases continue to be presented as part of property, plant and equipment.

The new accounting policy has been adopted retrospectively and land use rights have been reclassified from "Property, plant and equipment" or "Construction in progress" to "Lease prepayments for land" on the face of the consolidated balance sheet. The reclassification has no impact on the Group's net assets as at year end nor on the Group's profit attributable to equity shareholders for the years presented.

3 Changes in accounting policies (continued)

(c) HKAS 17 (continued)

	After adjustment for the Acquisition	Effect of adoption of HKFRS
	RMB million	RMB million
As at December 31, 2004		
Land and buildings	21,860	(1,275)
Construction in progress	11,068	(471)
Lease prepayments for land (Note 22)	-	1,746

(d) HKAS 32 and HKAS 39

HKAS 32 and HKAS 39 establish principles for disclosure, presentation, recognition and measurement of financial instruments, including non-derivative financial assets, non-derivative financial liabilities and derivative instruments for hedging activities.

Under HKAS 39, financial instruments will be carried at either amortized cost or fair value, depending on their classification. Movements in fair value will be either charged to income statement or taken to equity in accordance with the standards. In addition, all derivatives, including those embedded in non-derivative host contracts

are recognized in the balance sheet at fair value.

This change in accounting policy has been prospectively accounted for from January 1, 2005 as follows:

	Before adoption of new HKFRS	Effect of adoption of new HKFRS
	RMB million	RMB million
As at January 1, 2005		
Contracts receivable (Included in other non-current assets)	408	(408)
Contracts payable (Included in other non-current liabilities)	(533)	533
Discount on foreign currency exchange forward contracts (Included in other non-current assets)	59	(59)
Derivative assets (Included in other non-current assets)	-	9
Derivative liabilities (Included in other non-current liabilities)	-	(74)
Retained earnings	8,057	1

There is no significant impact on the basic and diluted (losses)/earnings per share upon the adoption of new accounting policies.

3 Changes in accounting policies (continued)

(d) HKAS 32 and HKAS 39 (continued)

The adoption of HKAS 39 resulted in:

	Year ended December 31, 2005
	RMB million
Decrease in profit before taxation	15

(e) Summary of impact of changes in accounting policies

The impact of the changes to accounting policies as set out in Notes (a) to (d) above on the Group's profit and equity was as follows:

	2005
	RMB million
For the year ended December 31	
(a) HKFRS 2	104
(b) HKFRS 3 and HKAS 36	15
(d) HKAS 32 and HKAS 39	15
Decrease in profit before taxation	134
As at January 1,	
(b) HKFRS 3 and HKAS 36	166
(d) HKAS 32 and HKAS 39	1
Increase in total equity	167

4 Principal accounting policies

(a) Basis of consolidation

Acquisitions of businesses under common control are accounted for using merger accounting in accordance with AG5 issued by HKICPA. The results of operations and financial position of such businesses are included in the consolidated financial statements as if the businesses had been acquired from the beginning of the earliest period presented or the date that such businesses were acquired by the party common control.

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

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

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

(b) Subsidiaries

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

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

4 Principal accounting policies (continued)

(c) Revenue recognition

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

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

- Monthly telephone service fees are recognized in the period during which the telephone services are provided to customers.

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

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

- Revenues from PHS bundled service contracts are recognized as local, DLD, or ILD service fees according to the type of usage and on a systematic basis to match the pattern of usage of the PHS services by customers. PHS bundled service contracts comprise the provision of PHS services and handsets to customers, under which customers either prepay a certain amount of service fee or commit to spend a minimum monthly service fee for a designated period in order to receive a free handset (see Note 4(s)(ii) for the policy on cost of the handset).

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

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

- Interconnection fees from domestic and foreign

telecommunications operators are recognized when the services are rendered as measured by the minutes of traffic processed.

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

(ii) Interest income

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

4 Principal accounting policies (continued)

(c) Revenue recognition (continued)

(iii) Dividend income

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

(d) Interest expenses

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

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

(e) Interconnection charges

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

(f) Translation of foreign currencies

(i) Functional and presentation currency

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

(ii) Transactions and balances

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

4 Principal accounting policies (continued)

(f) Translation of foreign currencies (continued)

(iii) The Group

The results and financial position of all the group entities that have a functional currency different from the presentation currency are translated into the presentation currency as follows:

- Assets and liabilities for each balance sheet presented are translated at the closing rate at the date of that balance sheet;
- Income and expenses for each income statement are translated at average exchange rates (unless this average is not a reasonable approximation of the cumulative effect of the rates prevailing on the transaction dates, in which case income and expenses are translated at the dates of the transactions); and
- All resulting exchange differences are recognized as a separate component of equity.

On consolidation, exchange differences arising from the translation of the net investment in foreign entities, and of borrowings and other currency instruments designated as hedges of such investments, are taken to shareholders' equity. When a foreign operation is sold, such exchange differences are recognized in the income statement as part of the gain or loss on sale.

(g) Cash and cash equivalents

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

(h) Accounts receivable and other receivables

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

(i) Inventories and consumables

Inventories comprise mainly telephone handsets and are stated at the lower of cost and net realizable value on a first-in, first-out basis, after provisions for obsolescence. Net realizable value is the estimated selling price in the ordinary course of business, less applicable variable selling expenses.

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

4 Principal accounting policies (continued)

(j) Lease prepayments for land

Lease prepayments for land represent payments for land use rights. Lease prepayments for land are stated at cost initially and expensed on a straight line basis over the respective periods of the rights.

(k) Fixed assets

(i) Construction-in-progress

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

(ii) Other fixed assets

Fixed assets are initially stated at cost less accumulated depreciation and accumulated impairment losses. Historical

cost includes expenditure that is directly attributable to the acquisition of the items. The subsequent costs of an item of property, plant and equipment that qualifies for recognition as an asset shall be measured at its revenues and costs. Any other costs incurred in restoring fixed assets are charged to the income statement as incurred.

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

(iii) Revaluations

Fixed assets other than buildings are carried at their revalued amounts. Revalued assets are stated at fair value as of the revaluation date less depreciation. When an item of fixed asset is revalued, any accumulated depreciation at the date of the revaluation is restated proportionately together with the change in the gross carrying amount of the asset so that the carrying amount of the asset after revaluation equals its revalued amount.

Increases in valuation are credited to the revaluation reserve. Decreases in valuation are first set off against revaluation surplus on earlier valuations in respect of the same item and thereafter are debited to operating profit. Any subsequent increases are credited to operating profit up to the amount previously debited. Each year the difference between depreciation based on the revalued carrying amount of the asset expensed in the income statement and depreciation based on the asset's original cost is transferred from revaluation reserve to retained earnings.

4 Principal accounting policies (continued)

(k) Fixed assets (continued)

Revaluations on fixed assets will be performed with sufficient regularity by independent valuers, in each of the intervening years valuations will be undertaken by executives of the Group.

(iv) Depreciation

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

Buildings	8-30 years
Telecommunications	

networks and equipment	5-10 years
Furniture, fixture, motor vehicles and other equipment	5-10 years

The useful lives and estimated residual values are reviewed and modified periodically at every balance sheet date.

(v) Gain or loss on sale of fixed assets

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

(l) Impairment of assets

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

(m) Assets under leases

(i) Finance leases

Leases of assets where the Group has substantially all the risks and rewards of ownership are classified as finance leases. Finance leases are capitalized upon commencement of the lease at the lower of the fair value of the leased assets and the present value of the minimum lease payments. Each lease payment is allocated between the liability and finance charges so as to achieve a constant rate on the finance balance outstanding.

4 Principal accounting policies (continued)

(m) Assets under leases (continued)

The corresponding rental obligations, net of finance charges, are included in current and non-current borrowings. The interest element of the finance cost is recognized in the

income statement over the lease period so as to produce a constant periodic rate of interest on the remaining balance of the liability for each period.

(ii) Operating leases

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

(n) Intangible assets

(i) Purchased software

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

(ii) Sponsorship fee

The sponsorship fee for 2008 Beijing Olympic Games has been capitalized and being amortized on a straight-line basis over 4 years, being the beneficial period under the sponsorship program. The cost of the intangible asset is calculated based on the expected cash payment and the fair value of the services to be provided.

(o) Short-term investments

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

4 Principal accounting policies (continued)

(p) Provisions

Provisions are recognized when the Group has a present legal or constructive obligation as a result of past events, it is probable that an outflow of resources will be required to settle the obligation, and a reliable estimate of the amount can be made. Provisions are not recognized for operating loss arising from future periods.

Where there are a number of similar obligations, the likelihood that an outflow will be required in settlement is determined by considering the

class of obligations as a whole. A provision is recognized even if the likelihood of an outflow with respect to any one item included in the same class of obligations may be small.

(q) Employee benefits

(i) Pension obligations

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

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

(ii) Early retirement benefits

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

(iii) Employee housing benefits

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

PRC full-time employees of the Group participate in various government-sponsored housing funds. The Group contributes on a monthly basis to these funds based on certain percentages of the salaries of the employees.

4 Principal accounting policies (continued)

(q) Employee benefits (continued)

The Group's liability in respect of these funds is limited to the contributions payable in each period. Contributions to these housing funds are expensed as incurred.

(iv) Share option scheme

The Group operates an equity-settled, share-based compensation plan. The fair value of the employee services received in exchange for the grant of the options is recognized as an expense. The total amount to be expensed over the vesting period is determined by reference to the fair value of the options granted, excluding the impact of any non-market vesting conditions (for example, profitability and sales growth targets). Non-market vesting conditions are included in assumptions about the number of options that are expected to become exercisable. At each balance sheet date, the entity revises its estimates of the number of options that are expected to become exercisable. It recognizes the impact of the revision of original estimates, if any, in the income statement, and a corresponding adjustment to equity over the remaining vesting period.

(r) Deferred taxation

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

(s) Other non-current assets

(i) Deferred installation costs

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

(ii) Customer acquisition costs

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

(iii) Prepaid network capacities

Prepayments for the network capacities purchased on an

indefeasible rights to use ("IRU") basis are capitalized and expensed over the corresponding lease period.

4 Principal accounting policies (continued)

(t) Derivative financial instruments

Derivative financial instruments are stated at fair value on the balance sheet. Realised and unrealised gains and loses arising from change in the fair value are included in the income statement in the period in which they arise.

(u) Contingent liabilities

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

A contingent liability is not recognized but is disclosed in the notes to the financial statements when an outflow of economic benefits is less than probable but not remote. When a change in the probability of an outflow occurs so that the outflow is probable, the contingent liability will then be recognized as a provision.

A contingent asset is a possible asset that arises from past events and whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain events not wholly within the control of the Group. A contingent asset is disclosed when an inflow of economic benefits is probable but only recognized in income statement when realized.

(v) Segmental reporting

Business segments provide services that are subject to risks and returns that are different from other business segments. Geographical segments provide services within a particular economic environment that is subject to risks and returns that differ from those of components operating in other economic environments. Currently the Group has one business segment, the provision of fixed line telecommunications services. Less than 10% of the Group's assets and operations are located outside the PRC. Accordingly, no business and geographical segment information is presented.

(w) Earnings per share ("EPS") and per American Depository Shares ("ADS")

Basic EPS is computed by dividing net profit attributable to ordinary shareholders by the weighted average number of ordinary shares outstanding during the year.

Diluted EPS is computed by dividing net profit attributable to shareholders by the weighted average number of ordinary and dilutive ordinary equivalent shares outstanding during the year. Ordinary equivalent shares consist of ordinary shares issuable upon the exercise of outstanding stock options using the treasury stock method.

Earnings per ADS is computed by multiplying the EPS by 20, which is the number of shares represented by each ADS.

CHINA NETCOM GROUP CORPORATION (HONG KONG) LIMITED

NOTES TO THE FINANCIAL STATEMENTS

4 Principal accounting policies (continued)

(x) New accounting standard pronouncements

The HKICPA has issued a number of new and revised HKFRSs and HKFRS Interpretations ("HKFRS - Ints"), and HKAS and HKAS Interpretations ("HKAS - Ints") as set out below which are effective for accounting periods beginning on or after January 1, 2006. The Group has not early adopted these new and revised standards and interpretations in the financial statements for the year ended December 31, 2005. The Group has commenced an assessment of the impact of these new and revised standards and interpretations, but is not yet in a position to state whether these new and revised standards and interpretations would have a significant impact on its results of operations and financial position.

- HKFRS 7 -- Financial Instruments: Disclosures
- HKAS 1 (amended) -- Capital Disclosure
- HKAS 21 (amended) -- The Effects of Changes in Foreign Exchange Rates - Net Investment in a Foreign Operation
- HKAS 39 (amended) -- Cash Flow Hedge Accounting of Forecast Intragroup Transactions
- HKAS 39 (amended) -- The Fair Value Option
- HKAS 39 (amended) and HKFRS 4 (amended) -- Financial Guarantee Contracts

CHINA NETCOM GROUP CORPORATION (HONG KONG) LIMITED

NOTES TO THE FINANCIAL STATEMENTS

5 Critical accounting estimates and judgments

Estimates and judgements are continually evaluated and are based on

historical experience and other factors, including expectations of future events that are believed to be reasonable under circumstances.

(a) Critical accounting estimates and assumptions

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

(i) Depreciation of property, plant and equipment

The property, plant and equipment of the Group are depreciated at rates sufficient to write off their costs or revalued amounts less accumulated impairment losses and estimated residual values over their estimated useful lives on a straight-line basis. The Group reviewed the useful lives periodically to ensure that the method and rates of depreciation are consistent with the expected pattern of economic benefits from property, plant and equipment. The Group estimates the useful lives of the property, plant and equipment as set out in Note 4(k)(iv) based on the historical experience with similar assets, taking into account anticipated technological changes. The depreciation expenses in the future periods will change if there are significant changes from previous estimates.

(ii) Revaluation of property, plant and equipment

For the Listing Reorganization, property, plant and equipment of the Group were revalued as of December 31, 2003 on a depreciated replacement cost basis. The property, plant and equipment acquired as part of the Acquisition were revalued as of December 31, 2004 on a depreciated replacement cost basis in preparation for the Acquisition. Apart from lease prepayments for land and buildings, which are carried at cost, other property, plant and equipment are carried at revalued amounts, being the fair value at the date of revaluation, less subsequent accumulated depreciation and impairment losses. Revaluations on property, plant and equipment will be performed with sufficient regular intervals by independent valuers, in each of the intervening years valuations will be undertaken by executives of the Group. If the subsequent revalued amounts differ significantly from the carrying amounts of the property, plant and equipment in the future, the carrying amounts will be adjusted to the revalued amounts. The key assumptions made to determine the revalued amounts include the newly estimated replacement costs and the estimated useful lives of the property, plant and equipment. This will have an impact on the Group's future results, since any subsequent decreases in valuation are set off first against increases on earlier valuations in respect of the same item and thereafter are charged as an expense to the income statement and any subsequent increases are credited as income to the income statement up to the amount previously charged. In addition, the depreciation expense in future periods will change as the carrying amounts of such property, plant and equipment change as a result of the revaluation.

NOTES TO THE FINANCIAL STATEMENTS

5 Critical accounting estimates and judgments (continued)

(iii) Impairment of non-current assets

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

(iv) Revenue recognized for upfront connection and installation fees

The Group defers the recognition of upfront customer connection and installation and amortizes them over the expected customer relationship period of 10 years. The related direct incremental installation costs are deferred and amortized over the same expected customer relationship periods of 10 years, except that when the direct incremental costs exceed the corresponding installation fees, if any, the excess amounts are immediately written off as expense to the income statement. The Group estimates the expected customer relationship period based on the historical customer retention experience and after factoring in the expected level of future competition, the risk of technological or functional obsolescence to the Group's services, technological innovation, and the expected changes in the regulatory and social environment. If the Group's estimate of the expected customer relationship period changes as a result of increased competition, changes in telecommunications technology or other factors, the amount and timing of recognition of the deferred revenues may change for future periods.

(v) Provision for doubtful debts

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

(vi) Fair value

The Group estimates the fair value of its financial assets and

financial liabilities including the accounts receivable, prepayments, other receivables and other current assets, accounts payable, and bank and other loans for disclosure purposes by discounting its future contractual cash flows at the estimated current market interest rate that is available to the Group for similar financial instruments. The future disclosed values will change if there are changes in the estimated market interest rate.

5 Critical accounting estimates and judgments (continued)

(b) Critical judgments in applying the entity's accounting policy

(i) Accounting for business combinations under common control

The Group completed the Acquisition on October 31, 2005. The Acquisition is a business combination under common control. The Group adopted merger accounting to account for the business combinations under common control as the Group believes that the financial statements prepared under merger accounting is more relevant to those transactions.

(ii) Recognition of revenues and costs under PHS bundled service contracts

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

6 Financial risk management

(a) Financial risk factors

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

(i) Foreign exchange risk

As at December 31, 2005 and 2004, the Group had foreign currency denominated bank balances amounting to RMB1,098 million and RMB8,186 million respectively. As at December 31,

2005 and 2004, the Group had foreign currency denominated bank loans amounting to RMB1,998 million and RMB5,365 million respectively.

(ii) Credit risk

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

6 Financial risk management (Continued)

(a) Financial risk factors (Continued)

(iii) Liquidity risk

A significant percentage of the Group's funding requirements is achieved through short term borrowings, and the balance sheet indicates a significant working capital deficit. Please refer to Note 2 for the details.

(iv) Cash flow and fair value interest rate risk

The Group is exposed to changes in interest due to its long-term debt obligations. The Group enters into debt obligations to support general corporate purpose including capital expenditures, acquisitions, and working capital needs. Borrowings at variable rates expose the Group to cash flow interest rate risk. Borrowings issued at fixed rates expose the Group to fair value interest rate risk. The bank loans issued at variable rates and fixed rates are disclosed in Note 27 of these financial statements.

(b) Fair value estimation

The fair value of financial instruments traded in active markets is based on quoted market prices at the balance sheet date. The quoted market price used for financial assets held by the Group is the current bid price; the appropriate quoted market price for financial liabilities is the current ask price.

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

CHINA NETCOM GROUP CORPORATION (HONG KONG) LIMITED

NOTES TO THE FINANCIAL STATEMENTS

7 Revenues

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

	Year ended December 31,		
	2003	2004	
	RMB million Restated Note 2	RMB million Restated Note 2	
Revenues			
Local usage fees	24,685	24,858	
Monthly telephone services	16,476	17,964	
Upfront installation fees	1,267	1,568	
DLD usage fees	11,425	11,266	
ILD usage fees	1,543	1,415	
Value-added services	2,095	2,993	
Interconnection fees	4,980	6,453	
Upfront connection fees	5,122	4,346	
Broadband services	2,928	5,307	
Other Internet-related services	1,418	1,259	
Managed data services	1,617	1,829	
Leased line income	2,883	2,591	
Other services	1,159	1,645	
Total	77,598	83,494	

CHINA NETCOM GROUP CORPORATION (HONG KONG) LIMITED

NOTES TO THE FINANCIAL STATEMENTS

7 Revenues (continued)

The Group's revenues by geographical location of the customers can be summarized as follows:

Year ended December 31,

	2003	2004
	RMB million Restated Note 2	RMB million Restated Note 2
DOMESTIC TELECOMMUNICATIONS SERVICES (Being revenues generated from customers located in the PRC)		
Local usage fees	24,685	24,858
Monthly telephone services	16,476	17,964
Upfront installation fees	1,267	1,568
DLD usage fees	11,425	11,266
ILD usage fees	1,543	1,234
Value-added services	2,095	2,993
Interconnection fees	3,763	5,441
Upfront connection fees	5,122	4,346
Broadband services	2,914	5,202
Other Internet-related services	1,418	1,004
Managed data services	1,553	1,520
Leased line income	2,820	2,095
Other services	1,138	1,360
Subtotal	76,219	80,851
INTERNATIONAL TELECOMMUNICATIONS SERVICES (Being revenues generated from customers located outside the PRC, including Hong Kong and Macau Special Administrative Regions and Taiwan)		
ILD usage fees	-	181
Interconnection fees	1,217	1,012
Broadband services	14	105
Other Internet-related services	-	255
Managed data services	64	309
Leased line income	63	496
Other services	21	285
Subtotal	1,379	2,643
Total	77,598	83,494

NOTES TO THE FINANCIAL STATEMENTS

8 Operating expenses

Operating expenses include:

	Year ended Dece	
	2003	2
	RMB million Restated Note 2	mill Resta Not
Depreciation (included in depreciation and amortization):		
- Owned property, plant and equipment (Note 20)	26,479	24,
- Leased property, plant and equipment (Note 20)	183	
Loss on disposal of property, plant and equipment (included in networks, operations and support expenses)	2,224	
Amortization of intangible assets (included in depreciation and amortization) (Note 23)	119	
Contributions to pension plans (included in staff costs) (Note 14)	1,051	1,
Early retirement benefits (included in staff costs) (Note 14)	336	
Operating leases:		
- Land and buildings (included in networks, operations and support)	12	
- Land and buildings (included in selling, general and administrative)	123	
- Network and machinery (included in networks, operations and support)	698	1,
- Network and machinery (included in selling, general and administrative)	21	
Interconnection charges (included in networks, operations and support)	2,013	2,
Bad and doubtful debt expenses (included in selling, general and administrative)	1,026	1,
Auditor's remuneration (included in selling, general and administrative)	-	
PHS subscriber acquisition costs (included in selling, general and administrative)	741	3,
Cost of PHS handsets (included in other operating expenses)	381	

9 Finance costs

	Year ended December 31,	
	2003	2004
	RMB million Restated Note 2	RMB million Restated Note 2
Interest expenses on:		
- Bank and other loans wholly repayable within five years	4,613	4,185
- Bank and other loans wholly repayable after more than five years	174	114
	4,787	4,299
Less: Interest expenses capitalized in construction in progress	(779)	(548)
Amortization of discount on foreign currency exchange forward contracts	20	18
Exchange loss/ (gain), net	238	105
Bank charges	30	56
	4,296	3,930
Interest expenses were capitalized in construction in progress using the following annual interest rates	3.68%-6.77%	3.69%-5.45%

10 Taxation

	Year ended December 31,	
	2003	2004
	RMB million Restated Note 2	RMB million Restated Note 2
PRC enterprise income tax ("EIT")	946	2,932
Overseas profit tax	-	-
Deferred taxation (Note 31)	(8,179)	(3,255)
Share of taxation attributable to jointly controlled entity	16	-
Taxation (credit) /charges	(7,217)	(323)

The provision for PRC EIT is calculated based on the statutory income tax rate of 33% on the assessable profit of each of the entities now

comprising the Group in the PRC as determined in accordance with the relevant income tax rules and regulations in the PRC.

10 Taxation (continued)

Taxation on profits derived from certain subsidiaries outside the PRC, including Hong Kong, has been calculated on the estimated assessable profit at the rates of taxation ranging from 17.50% to 30.00%, prevailing in the countries in which those entities operate.

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

	Year ended December 31,	
	2003	2004
	RMB million Restated Note 2	RMB million Restated Note 2
(Loss)/profit before taxation	(18,124)	2,376
Weighted average statutory tax rate	33%	33%
Tax calculated at the weighted average statutory tax rate	(5,981)	784
Non-taxable income (Note (a) below)	(1,690)	(1,583)
Utilization of tax losses not recognized in previous years (Note (b) below)	-	-
Expenses not deductible for tax purposes	266	275
Tax losses not recognized	246	354
Others	(58)	(153)
Tax (credit)/charge	(7,217)	(323)

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

Note (b) In previous years, deferred tax arising from certain tax losses was not recognized as it was uncertain at that time following the change of a subsidiary's tax registration district that the taxable loss could be utilized at the previous period end date.

11 Profit attributable to shareholders

(a) Two of the Company's subsidiaries, CNC China and New Horizon were registered as foreign investment enterprises in the PRC. In accordance with the Articles and Association of both CNC China and New Horizon, they are required to provide for certain statutory reserves, namely, general reserve and staff bonus and welfare fund, which are appropriated from profits after tax but before dividend distributions. CNC China and New Horizon are required to allocate at least 10% of their profits after tax determined under PRC GAAP to the general reserve fund until the cumulative amounts reach 50% of the registered capital. The statutory reserve can only be used, upon obtaining approval from the relevant authority, to offset accumulated losses or increase capital.

11 Profit attributable to shareholders (continued)

(a) (Continued)
Accordingly, CNC China and New Horizon appropriated approximately RMB894 million and RMB150 million respectively to the general reserve fund for the year ended December 31, 2005 (2004: RMB723 million and Nil respectively).

(b) According to a notification on income tax issued by Ministry of Finance and State Administration of Taxation to the Group's primary operating subsidiaries, the Group's upfront connection fees are not subject to EIT and an amount equal to the upfront connection fees recognized in the income statement should be transferred from retained earnings to a statutory reserve. For the year ended December 31, 2005, the aggregated upfront connection fees recognized in the income statement amounted to RMB6,783 million (2004: Nil), which was transferred to the statutory reserve in accordance with the aforementioned approval document.

12 Profit distributions

	Year ended December 31,			
	2003		2004	
	HK$ million	RMB million	HK$ million	RMB million
Final dividend proposed after balance sheet date of HK$0.466 per share (2004 : HK$0.037 per share)	-	-	245	259
Dividend distributed	-	-		

during the year			-	-

Notes:

In a meeting of board of directors held on March 21, 2006, the directors proposed a final dividend of HK$0.466 per ordinary share for the year ended December 31, 2005. Dividend proposed after the balance sheet date have not been reflected as dividend payable and will be reflected as an appropriation in the 2006 financial statements.

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13 Earnings per share

Basic earnings per share is computed using the weighted average number of ordinary shares outstanding during the year. Diluted earnings per share is computed using the weighted average number of ordinary shares and potential ordinary shares outstanding during the year.

The following table sets forth the computation of basic and diluted earnings per share:

	Year ended December 3	
	2003	2004
	(in RMB millions, except share and	
	Restated Notes 2	Restated Notes 2&3
Numerator:		
(Loss)/profit for the year	(10,906)	2,699
Denominator		
Weighted average number of ordinary shares outstanding and shares used in computing basic earnings per share:	5,492,258,218	5,622,685,175
Weighted average number of potential ordinary shares:		
Diluted equivalent shares arising from convertible preference shares prior to their conversion into ordinary shares during 2004	-	5,140,036
Diluted equivalent shares arising from share options	-	2,209,241
Shares used in computing diluted (loss)/earnings per share	5,492,258,218	5,630,034,452

Basic (loss)/earnings per share (RMB)	(1.99)	0.48
Diluted (loss)/earnings per share (RMB)	(1.99)	0.48

The diluted loss per share for the year ended December 31, 2003 is the same as the basic loss per share as all potential ordinary shares are anti-dilutive.

All the numbers of shares stated above have taken into consideration the effect of the share consolidation conducted on September 7, 2004 as set out in note 32(a).

14 Staff cost including directors' remunerations

	Year ended December 3	
	2003	2004
	RMB million Restated Note 2	RMB million Restated Note 2&3
Wages, salaries and welfare	9,558	10,076
Contributions to pensions	1,051	1,181
Early retirement benefits	336	693
Total	10,945	11,950

15. Cash and bank deposits

	Group
	As at Decembe
	2004

	RMB million Restated Note 2
Cash and cash equivalents	10,581
Time deposits with original maturities over three months	52
Total cash and bank deposits	10,633
Effective interest rate of time deposits with original maturities over three months (%)	0.72

Included in cash and bank deposits as at December 31, 2005 and 2004 are Renminbi denominated balance amounts held in the PRC amounting to RMB3,797 million and RMB2,448 million respectively. The conversion of Renminbi denominated balances into foreign currencies and the remittance of bank balances and cash out of the PRC are subject to the rules and regulation of foreign exchange control promulgated by the PRC government.

16. Short-term investments

The Group and the Company's short-term investments comprise primarily investments in listed debt securities and investment funds. Most of the short-term investments were disposed of during the year.

17. Accounts receivable

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

17 Accounts receivable (continued)

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

	As at Decem
	2004
	RMB million

	Restated Note 2
0-30 days	5,503
31-90 days	1,122
Over 90 days	1,961
Total	8,586
Less: Allowance for doubtful debts	(1,412)
Net carrying amounts	7,174

The movement of allowance for doubtful debts is as follows:

	As at Decemb
	2004
	RMB million Restated Note 2
Balance at beginning of year	1,175
Additional provisions	1,244
Less: Amounts utilized	(958)
Distributed to owner in accordance with Listing Reorganization	(49)
Balance at end of year	1,412

The carrying value of accounts receivable approximates their fair values based on cash flows discounted using a rate based on the average short-term borrowing rate of 5.58% (2004: 5.22%).

Included in the accounts receivable are amounts due from other state-owned telecommunication operators amounting to RMB 1,003 million (2004: RMB 1,278 million).

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18 Inventories and consumables

	As at Decembe

	2004
	RMB million Restated Note 2
Telephone handsets and other customer end-products held for resale, at cost	427
Consumables, at cost	816
Total	1,243

19 Prepayments, other receivables and other current assets

	Group
	As at Decembe
	2004 RMB million Restated Note 2
Prepaid expenses, deposits and other current assets	637
Other receivables	805
Total	1,442

Included in the other current assets is deferred customer acquisition cost of RMB 324 million (2004: Nil).

The carrying value of prepayments and other receivables approximates their fair values based on cash flows discounted using a rate based on the average short-term borrowing rate of 5.58% (2004: 5.22%).

20 Fixed assets

	Buildings	Telecommu-nications networks and equipment	Furnitu fixtu mo vehicles ot equipm

	RMB million	RMB million	mill
Cost / valuation:			
Balance at January 1, 2004, as restated due to the Acquisition (Note 2)	38,369	247,128	11,
Effects of adoption of HKAS 17:			
Reclassification of land use rights to lease prepayments for land (Note 3(c))	(2,107)	-	
Balance at January 1, 2004, as restated	36,262	247,128	11,
Additions	114	713	
Transferred from construction in progress	1,686	30,817	1,
Disposals/write off	(67)	(949)	(
Increase as a result of revaluation	-	17,140	1,
Decrease as a result of revaluation	-	(21,201)	(1,
Distributed to owner on Listing Reorganization	(12,028)	(9,265)	(
Balance at December 31, 2004, as restated	25,967	264,383	13,
Accumulated depreciation:			
Balance at January 1, 2004, as restated due to the Acquisition (Note 2)	(7,361)	(102,487)	(4,
Effects of adoption of HKAS 17:			
Reclassification of land use rights to lease prepayments for land (Note 3(c))	375	-	
Balance at January 1, 2004, as restated	(6,986)	(102,487)	(4,
Depreciation charge for the year	(1,042)	(22,377)	(1,
Disposals/write off	7	683	
Increase as a result of revaluation	-	(13,458)	(1,
Decrease as a result of revaluation	-	10,461	
Distributed to owner on Listing Reorganization	2,639	2,505	
Balance at December 31, 2004, as restated	(5,382)	(124,673)	(7,
Net book value at December 31, 2004, as restated	20,585	139,710	6,
Net book value at January 1, 2004, as restated	29,276	144,641	6,

NOTES TO THE FINANCIAL STATEMENTS

20 Fixed assets (continued)

	Buildings	Telecommu-nications networks and equipment	Furnitu fixtu mo vehicles ot equipm
	RMB million	RMB million	mill
Cost / valuation:			
Balance at January 1, 2005, as restated due to the Acquisition (Note 2)	27,649	264,383	13,78
Effects of adoption of HKAS 17:			
Reclassification of land use rights to lease prepayments for land (Note 3 (c))	(1,682)	-	
Balance at January 1, 2005, as restated	25,967	264,383	13,78
Reclassifications	818	(4,981)	4,16
Additions	413	975	49
Transferred from construction in progress	1,659	23,106	2,05
Disposals/write off	(48)	(1,940)	(54
Distributed to owner upon reorganization for the Acquisition	(1,759)	(1,242)	(18
Balance at December 31, 2005	27,050	280,301	19,77
Accumulated depreciation:			
Balance at January 1, 2005, as restated due to the Acquisition (Note 2)	(5,789)	(124,673)	(7,18
Effects of adoption of HKAS 17:			
Reclassification of land use rights to lease prepayments for land (Note 3(c))	407	-	
Balance at January 1, 2005, as restated	(5,382)	(124,673)	(7,18
Reclassifications	(354)	1,170	(81
Charge for the year	(956)	(21,541)	(2,15
Disposals/write off	4	1,662	45

Distributed to owner upon reorganization for the Acquisition	487	743	9
Balance at December 31, 2005	(6,201)	(142,639)	(9,61
Net book value at December 31, 2005	20,849	137,662	10,15
Net book value at January 1, 2005, as restated	20,585	139,710	6,60

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20 Fixed assets (continued)

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

	Buildings	Telecommu-nications networks and equipment	Furniture, fixture, motor vehicles and other equipment
	RMB million	RMB million	RMB million
As at December 31, 2004	8	3,574	97
As at December 31, 2005	1	2,551	109

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

	Buildings	Telecommu-nications networks and equipment	Furniture, fixture, motor vehicles and other equipment
	RMB million	RMB million	RMB million

December 31, 2004			
Cost	25,967	-	-
Valuation	-	264,383	13,788
	25,967	264,383	13,788
December 31, 2005			
Cost	27,050	-	-
Valuation	ii-	280,301	19,770
	27,050	280,301	19,770

The Group's buildings are primarily located in the PRC on land held on leases of primarily between 10 to 50 years.

20 Fixed assets (continued)

(c) As required by the PRC rules and regulations relevant to the Listing Reorganization, each class of fixed assets as at December 31, 2003 was valued by Beijing China Enterprise Appraisal Co. Ltd. (the "PRC valuer "), independent valuers registered in the PRC, on a depreciated replacement cost basis. The value of such assets in the PRC injected into the Group was determined at RMB122,456 million. Such revalued amount serves as the tax base of the assets with immediate effect. Certain fixed assets, other than lease prepayments for land and buildings, of which the surplus on revaluation of RMB2,982 million was credited to the revaluation reserve while the deficit arising from the revaluation of such fixed assets of RMB25,778 million was recognized as an expense for the year ended December 31, 2003.

For the Listing Reorganization, valuations of the lease prepayments for land and buildings were also performed. The surplus value of such assets was determined at RMB6,967 million. Such amount serves as the tax base for such assets with immediate effect. Details have been set out in Note 31(ii).

As required by the PRC rules and regulations relevant to the Acquisition, each class of fixed assets in the PRC, acquired as at December 31, 2004, was valued by Beijing China Enterprise Appraisal Co. Ltd. (the "PRC valuer"), independent valuers registered in the PRC, on a depreciated replacement cost basis. The value of such assets in the PRC acquired was determined at RMB42,879 million. Such amount serves as the tax base for such assets with immediate effect. Certain fixed assets, other than lease prepayments for land and buildings, of which the surplus on revaluation of RMB3,863 million was credited to the revaluation reserve while the deficit arising from the revaluation of such fixed assets of RMB11,318 million was recognized as an expense for the year ended December 31, 2004.

For the Acquisition, valuations of the lease prepayments for land and buildings were also performed. The surplus value of such assets was determined at RMB2,553 million. Such amount serves as the tax base for such assets with immediate effect. Details have been set out in Note 31(ii).

The respective carrying amount of the telecommunications networks and equipment and furniture, fixture, motor vehicles and other equipment would have been RMB158,193 million and RMB11,233 million as at December 31, 2005 and RMB141,314 million and RMB6,645 million as at December 31, 2004 had they been stated at cost less accumulated depreciation.

20 Fixed assets (continued)

(c) (continued)

Regarding the valuation of fixed assets carried out at December 31, 2004 in relation to the Acquisition, the carrying amounts of these fixed assets and, where applicable, the corresponding revalued amounts of these assets are as follows:

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

The directors have carried out a review of the Group's fixed assets and concluded that there was no impairment of fixed assets as at December 31, 2005, nor was there any significant change in value of fixed assets at that date.

At December 31, 2005, no fixed assets were pledged as security for the Group's long term bank and other loans (2004: RMB 22 million)

21 Construction in progress

	As at December 31,
	2004
	RMB million Restated Notes 2&3
Balance at beginning of year	18,049
Effects of adoption of HKAS 17:	
Reclassification from land use rights to lease prepayments for land (Note 3 (c))	(643)
Balance as at January 1, as restated	17,406
Additions	28,983
Transferred to fixed assets	(34,391)
Distributed to owner in accordance with the Reorganizations	(1,401)
Balance at end of year	10,597

22 Lease prepayment for land

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

	As at December 31
	2004
	RMB million Restated Notes 2&3
Held for	
Lease of between 10 to 50 years	1,733
Lease of less than 10 years	13
	1,746

The movement of the lease prepayments for land is as follows:

	As at December 31,
	2004
	RMB million Restated Notes 2&3
Balance at beginning of year from reclassification from land use right	2,375
Additions	202
Charge for the year	(51)
Distributed to owner in accordance with the reorganizations	(780)
Balance at end of year	1,746

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23 Intangible assets

	Negative goodwill	Purchased software	
	RMB million	RMB million	
Cost:			
Balance at January 1, 2004	(178)	984	
Additions	-	266	
Balance at December 31, 2004	(178)	1,250	
Accumulated amortization:			
Balance at January 1, 2004	(2)	(529)	
Amortization for the year	14	(173)	
Balance at December 31, 2004	12	(702)	
Net book value at January 1, 2004	(180)	455	
Net book value at December 31, 2004	(166)	548	

Cost:			
Balance at January 1, 2005	(178)	1,250	
Impacts of adoption of HKFRS 3:			
Transferred from negative goodwill to retained earnings (Note 3(b))	181	-	
Balance at January 1, 2005, as restated	3	1,250	
Additions	-	663	
Balance at December 31, 2005	3	1,913	
Accumulated amortization			
Balance at January 1, 2005	12	(702)	
Impacts of adoption of HKFRS 3:			
Transferred from negative goodwill to retained earnings (Note 3(b))	(15)	-	
Balance at January 1, 2005, as restated	(3)	(702)	
Amortization for the year	-	(223)	
Balance at December 31, 2005	(3)	(925)	
Net book value at December 31, 2005	-	988	

The intangible assets will be fully amortized in the five succeeding fiscal years.

24 Other non-current assets

	As at December
	2004
	RMB million Restated Notes 2&3
Installation cost	4,866
Customer acquisition costs	1,304
Prepaid network capacities	1,322
Discount on foreign exchange forward contracts (note 3(d))	59
Others	985
	8,536

During 2005, due to a change in the nature of promotions offered by the Group, the amortisation period of customer acquisition costs fell below one year. In response to this, the Group has recorded customer acquisition costs arising from 2005 as prepayments and other receivables. The total amount of customer acquisition costs in prepaid expenses as at December 31, 2005 was RMB 324 million (2004: Nil).

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25 Accounts payable

	As at December 31,	
	2004	2005
	RMB million Restated Note 2	RMB million
0-30 days	8,371	6,281
31-60 days	2,351	1,796
61-90 days	1,223	1,297
91-180 days	2,922	1,940
Over 180 days	6,258	5,405
Total	21,125	16,719

Included in accounts payable are amounts due to other state-owned telecommunications operators amounting to RMB 48 million (2004: RMB 69 million).

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26 Accruals and other payables

	Group	
	As at December 31,	
	2004	2005

	RMB million	RMB million
	Restated Note 2	
Accrued expenses	1,580	872
Other payables	3,286	3,033
Total	4,866	3,905

27 Bank and other loans

(a) The short term bank loans were unsecured and comprise:

Currency	Interest rate and final maturity	As at Decem 2004
		RMB million Restated Note 2
Renminbi denominated	Interest rates ranging from 4.70% to 5.02% per annum with maturity through December 18, 2006	44,692
US Dollar denominated	Interest rates ranging from 2.59% to 3.98% per annum	190
		44,882

The carrying values of short term bank loans approximate their fair values which are based on cash flows discounted using a rate based on the borrowing rate of 4.70%-5.02% (2004: 2.59%-5.94%).

Included in short-term bank loans were loans from state-owned banks amounting to RMB 46,541 million as at December 31, 2005 (2004: RMB 43,472 million).

27 Bank and other loans (continued)

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

	Note	As at December 31, 2004
		RMB million Restated Note 2
Bank loans	(i)	34,678
Finance lease obligations	(ii)	3,101
		37,779
Less: Current portion		(11,727)
		26,052

The carrying values of the current portion of long term bank loans approximate their fair values which are based on cash flows discounted using a rate based on the borrowing rate of 5.58% (2004: 5.22%).

Included in the long term bank loans were loans from state-owned banks amounting to RMB 22,685 million as at December 31, 2005 (2004: RMB 33,218 million).

(i) Long term bank loans

	As at December 31, 2004
	RMB million Restated Note 2
Loans	
Unsecured	32,075
Secured	2,603
Total	34,678
Less: Current portion	(10,796)
Long term loans	23,882

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27 Bank and other loans (continued)

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

(i) Long term bank loans (continued)

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

	As at December 31,
	2004
	RMB million Restated Note 2
Within one year	10,796
In the second year	8,276
In the third to fifth year, inclusive	12,140
After the fifth year	3,466
	34,678

		As at December 31
Currency	Interest rate and final maturity	2004
		RMB million Restated Note 2
Bank loan		
Renminbi denominated	Interest rates ranging from 2.40% to 10.08% per annum with maturity through December 20, 2019	29,503
US Dollar denominated	Interest rates ranging from 1.25% to 8.00% per annum with maturity through October 31, 2039	3,223
Japanese Yen denominated	Interest rate is 2.12% per annum with maturity through January 7, 2014	1,342
Euro denominated	Interest rates ranging from 0.50% to 7.35% per	

annum with maturity through March 15, 2034	610
	34,678

As at December 31, 2005, secured bank loans of RMB 320 million (2004: RMB 2,603 million) which were secured by the following:

- Corporate guarantees granted by China Netcom Group to the extent of RMB 75 million (2004: RMB 2,148 million); and
- Corporate guarantee granted by third parties to the extent of RMB 245 million (2004: RMB 452 million).

27 Bank and other loans (continued)

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

(ii) Finance lease obligations

	As at December 31,	
	2004	2005
	RMB million Restated Note 2	RMB million
Obligation under finance leases	3,101	2,255
Less: current portion	(931)	(1,267)
	2,170	988

In 2005, the Group has entered into a finance lease arrangement with a related party, getting funding of RMB 322 million. The net book value of the assets under finance lease was RMB 317 million as at December 31, 2005 (2004: RMB 2,592 million). The accumulated finance lease obligation as at December 31, 2005 amounted to RMB 2,255 million. (2004: RMB 2,408 million).

The interest rates charged on finance lease are ranging from 2.50% to 5.70% with maturity through December 8, 2008 (2004: 2.50% to 5.18% with maturity through December 31, 2007).

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

	As at Decemb
	2004
	RMB million Restated Note 2
Within one year	1,005
In the second year	1,396
In the third to fifth year, inclusive	831
	3,232
Less: future finance charges on finance leases	(131)
Present value of finance lease liabilities	3,101

The present value of finance lease liabilities is as follows:

Within one year	931
In the second year	1,350
In the third to fifth year, inclusive	820
	3,101

27 Bank and other loans (continued)

(c) The fair value of the Group's non-current portion of long term bank and other loans at December 31, 2005 and 2004 were as follows:

	As at Decem
	2004
	RMB million Restated Notes 2&3
Long term bank loans	21,899
Finance lease obligations	1,908
	23,807

The fair value are based on cash flows discounted using rates based on the borrowing rates of ranging from 2.54% to 6.12% (2004: 0.19% to 9.20%).

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

	Note	As at 3 2004
		RMB million Restated Note 2
Current:		
Due from ultimate holding company	(a)	785
Due from other holding companies	(a)	1
Due from fellow subsidiaries	(a)	301
Total		1,087
Due to ultimate holding company		
-Deferred consideration	(b)	-
-Others	(a)	3,704
Due to fellow subsidiaries	(a)	6,376
Total		10,080
Non-current:		
Due to ultimate holding company		
-Deferred consideration	(b)	-
Total		-

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

Note:

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

(b) Balance represents the deferred payments arising from the Acquisition outstanding at year end. The balance is charged at interest rate of 5.265% per annum with final maturity through June 30, 2010. The deferred payment is analyzed as follows:

	As at 31 Decembe
	2004
	RMB million
Within one year	-
In the second year	-
In the third to fifth year, inclusive	-
Total	-

29 Deferred revenues

	As at December 31
	2004
	RMB million Restated Note 2
Balance at beginning of year:	
-upfront connection fees	13,256
-upfront installation fees	8,001
-advances from network capacity sales	2,050
-prepaid telephony services	3,677
	26,984
Additions for the year:	
-upfront connection fees	-
-upfront installation fees	1,205
-advances from network capacity sales	242
-prepaid telephony services	18,636
	20,083
Reductions for the year:	
-upfront connection fees	(4,346)
-upfront installation fees	(1,568)
-advances from network capacity sales	(114)
-prepaid telephony services	(18,126)
	(24,154)

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29 Deferred revenues (continued)

	As at Dece
	2004
	RMB million Restated Note 2
Distributed to owner in accordance with Listing Reorganization	
- advances from network capacity sales	(5)
- prepaid telephony services	(44)
	(49)
Balance at end of year:	
- upfront connection fees	8,910
- upfront installation fees	7,638
- advances from network capacity sales	2,173
- prepaid telephony services	4,143
	22,864
Representing:	
- Current portion	8,876
- Non-current portion	13,988
	22,864

30 Provisions

	Early retirement benefits	One-off housing subsi
	RMB million Note(b), 4p(ii)	mil Note(a)
At January 1, 2004, as restated (Note 2)	4,139	3
Additional provisions	693	
Payments during the year	(640)	(

At December 31, 2004	4,192	3
Analysis of total provisions:		
-Current portion	618	3
-Non-current portion	3,574	
	4,192	3
At January 1, 2005	4,192	3
Additional provisions	2	
Payments during the year	(431)	
At December 31, 2005	3,763	3

30 Provisions (continued)

	Early retirement benefits	One-off cash housing subsidies
	RMB Million Note(b), 4p(ii)	RMB million Note(a), (b)(C
Analysis of total provisions:		
-Current portion	589	3,440
-Non-current portion	3,174	-
	3,763	3,440

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

Based on the relevant detailed local government regulations promulgated, certain entities within the Group have adopted cash housing subsidy plans. In accordance with these plans, for those eligible employees who had not been allocated with quarters or who had not been allocated with quarters up to the prescribed standards before the discounted sales of quarters were terminated, the Group is required to pay them one-off cash housing subsidies based on their years of service, positions and other criteria. Based on the available information, the Group estimated the required provision for these cash housing subsidies amounting to RMB4,142 million, which was charged to the consolidated income statement in the year ended December 31, 2000 when the State Council circular in respect of cash subsidies was issued.

(b) Pursuant to the Listing Reorganization and the Acquisition, if the actual payments required for these subsidies and early retirement benefits differ from the amount provided as at June 30, 2004 and June 30, 2005, China Netcom Group will bear any additional payments required or will be paid the difference if the actual payments are lower than the amount provided. There was no material settlement during the year ended December 31, 2005. (2004: Nil)

31 Deferred taxation

Movements of the deferred tax assets and liabilities are as follows:

	Balance at December 31, 2004	Recognized in income statement	Recognized in equity
	RMB million	RMB million	RMB million
	Restated Note 2&3		Note (i)
Deferred tax assets:			
Deferred revenue, primarily advances from customers	208	(29)	(9)
Temporary differences from allowance for doubtful debts	398	245	(293)
Unrecognized revaluation surplus and deficit (Note (ii))	2,114	(96)	-
Provision for early retirement benefits	597	(99)	(498)
Depreciation of fixed assets	325	95	(420)
Others	162	(10)	(53)
Balance at end of year	3,804	106	(1,273)

Deferred tax liabilities			
Interest capitalized	(1,489)	32	196
Others	(87)	24	-
Balance at end of year	(1,576)	56	196
The amounts in the consolidated balance sheet are as follows:			
Deferred tax assets to be recovered after more than 12 months	2,997		
Deferred tax liabilities to be settled after more than 12 months	(1,318)		

CHINA NETCOM GROUP CORPORATION (HONG KONG) LIMITED

NOTES TO THE FINANCIAL STATEMENTS

31 Deferred taxation (continued)

	Balance at December 31, 2003	Recognized in income statement	Recognized in equity	Recognized in equity	Recogn in eq
	RMB million	RMB million	RMB million	RMB million	RMB mil
	Restated Note 2&3		Note (iii)	Note (i)	Note
Deferred tax assets:					
Deferred revenue, primarily advances from customers	944	(223)	-	-	(
Temporary differences from allowance for doubtful debts	458	166	-	-	(
Unrecognized revaluation surplus and deficit (Note (ii))	-	(241)	-		
Provision for early retirement benefits	1,431	111	-	-	(
Disposal of fixed assets	1,577	(944)	-	-	(
Losses of taxation purpose	-	704	(704)	-	
Depreciation of fixed assets	-	325	-	-	
Others	450	(25)	-	-	(
Balance at end of year	4,860	(127)	(704)	-	(2,
Deferred tax liabilities:					
Revenue recognition	(712)	133	-	-	

Depreciation of fixed assets	(4,843)	3,321	–	(1,275)	2
Deferred costs	(245)	114	–	–	
Interest capitalized	(1,059)	(160)	–	–	(
Others	(113)	(26)	–	–	
Balance at end of year	(6,972)	3,382	–	(1,275)	3

The amounts in the consolidated balance sheet as follows:	
Deferred tax assets to be recovered after more than 12 months	2,408
Deferred tax liabilities to be settled after more than 12 months	(5,997)

	Recognized in equity	Recognized in equity
	RMB million	RMB million
	Note (i)	Note (ii)
Deferred tax assets:		
Deferred revenue, primarily advances from customers	(513)	–
Temporary differences from allowance for doubtful debts	(226)	–
Unrecognized revaluation surplus and deficit (Note (ii))	–	2,355
Provision for early retirement benefits	(945)	–
Disposal of fixed assets	(633)	–
Losses of taxation purpose	–	–
Depreciation of fixed assets	–	–
Others	(263)	–
Balance at end of year	(2,580)	2,355
Deferred tax liabilities:		
Revenue recognition	579	–
Depreciation of fixed assets	2,797	–
Deferred costs	131	–
Interest capitalized	(270)	–
Others	52	–
	ii	
Balance at end of year	3,289	–
The amounts in the consolidated balance sheet as follows:		
Deferred tax assets to be recovered after more than 12 months		–
Deferred tax liabilities to be settled after more		

than 12 months

CHINA NETCOM GROUP CORPORATION (HONG KONG) LIMITED

NOTES TO THE FINANCIAL STATEMENTS

31 Deferred taxation (continued)

Notes:

(i) As described in Note 20, in connection with the Listing Reorganization and the Acquisition, certain of the Group's telecommunications networks and equipment and furniture, fixture, motor vehicles and other equipment were revalued as at December 31, 2003 and 2004. Such revalued amounts determine the tax bases for these assets for future years. In addition, except for the item described in Note (ii) below, the tax bases of certain assets and liabilities have been adjusted to the revalued amounts incorporated as the carrying values in the balance sheet.

In connection with the Listing Reorganization, the Group's net deferred tax liabilities were reduced by RMB 709 million (comprising the recognition of deferred tax assets of RMB 2,580 million and deferred tax liabilities of RMB 3,289 million), and this decrease was recorded as a credit to owner's equity upon the date of the Reorganization on June 30, 2004. The RMB 709 million net reduction of deferred tax liabilities, comprised RMB 846 million, being the deferred tax liabilities from the revaluation surplus of fixed assets credited to revaluation reserves and RMB 137 million of deferred tax assets debited to retained earnings.

In connection with the Acquisition, the Group's net deferred tax assets were subsequently reduced by RMB 1,076 million (comprising deferred tax assets of RMB 1,272 million and deferred tax liabilities of RMB 196 million), and this decrease was recorded as a debit to owner's equity upon the date of the Reorganization on June 30, 2005. The RMB 1,076 million net decrease of comprised RMB 1,097 million, being deferred tax liabilities originating from the revaluation surplus of fixed assets recorded, was credited to revaluation reserves and RMB 2,174 million deferred tax assets were debited to retained earnings.

(ii) In addition, in order to determine the future tax bases used for future years after the Listing Reorganization and the Acquisition, the Group's up-front prepayments made for the leasehold land and buildings were revalued for PRC tax purposes as at December 31, 2003 and 2004. However, the resulting revaluations of the up-front prepayments made for the leasehold land and buildings were not incorporated into the consolidated financial statements. As a result, deferred tax assets were subsequently recorded with corresponding increases in owner's equity upon the Listing Reorganization on June 30, 2004 and the Acquisition on June 30, 2005. In the opinion of the directors, it is more likely than not that the Group will realize the benefits of the deferred tax asset after making reference to the

historical taxable income of the Group. The amount is transferred to retained earnings upon the corresponding realization of the underlying deferred tax assets.

During the Listing Reorganization, the leasehold land and buildings had a net surplus on revaluation of RMB 6,967 million as at December 31, 2003. As explained in the preceding paragraph, a deferred tax asset of RMB 2,355 million was subsequently recorded with a corresponding increase in owner's equity upon the Listing Reorganization on June 30, 2004. The amount of transfer to retained earnings for the year ended December 31, 2005 was RMB 57 million (2004: 241 million).

31 Deferred taxation (continued)

Notes:

(ii) (continued)

During the Acquisition, the leasehold land and buildings has a net surplus on revaluation of RMB 2,553 million as at December 31, 2004. As explained above, a deferred tax asset of RMB 843 million was subsequently recorded with a corresponding increase in owner's equity upon the Acquisition on June 30, 2005. The amount of transfer to retained earnings for the year ended December 31, 2005 was RMB 39 million.

(iii) This represents the net tax loss carried forward of the four newly acquired provinces/autonomous from year 2004. As the tax loss was utilised by China Netcom Group in the same year, the utilization of the deferred tax assets was reflected as a distribution to the owner in the combined statement of changes in owner's equity.

32 Share capital

	Authorized

	Ordinary shares of US$0.04 each			Convertible preference shares US$0.04 each (Note (c))		
	No of shares	US$	RMB Million	No of shares	US$	RMB Mil
At January 1, 2004, December 31, 2004 and 2005	25,000,000,000	1,000,000,000	8,277	7,741,782	309,671	3

	Issued					
	Ordinary shares of US$0.04 each			Convertible preference shares US$0.04 each (Note (c))		
	No of shares	US$	RMB million	No of shares	US$	RMB Mil
At January 1, 2004 (Note (b))	5,492,258,218	219,690,329	1,816	7,741,782	309,671	3
Conversion of convertible preference shares (Note (c))	7,741,782	309,671	3	(7,741,782)	(309,671)	(3)
Issue of shares through Global Offering (Note (d))	1,093,529,000	43,741,160	362	-	-	-
At December 31, 2004 and 2005	6,593,529,000	263,741,160	2,181	-	-	-

CHINA NETCOM GROUP CORPORATION (HONG KONG) LIMITED

NOTES TO THE FINANCIAL STATEMENTS

32 Share capital (continued)

Notes:

(a) Pursuant to an ordinary resolution dated September 1, 2004, the authorized share capital of the Company was increased to US$1,000,000,000 by creating additional 99,600,000,000 shares of US$0.01 each. Pursuant to an ordinary resolution passed on September 7, 2004, every four issued and unissued shares of US$0.01 each were consolidated into one new share of US$0.04 each. Following the creation of 99,600,000,000 additional shares and the share consolidation, the authorized share capital of the Company is RMB 8,277 million

divided into 25,000,000,000 shares of US$0.04 each, of which 5,492,258,218 shares were in issue and fully paid. The shares after the share consolidation rank pair in all respects with each other. All references to the share capital of the Company in this annual report have been adjusted retrospectively to take into account the increase in authorized share capital and share consolidation. The increase in authorized capital is applied respectively in presentation of share capital of the consolidated balance sheets as detailed in notes below.

(b) The share capital presented in the consolidated balance sheet at January 1, 2004 represents (i) the share capital of the Company, including the shares as at January 1, 2004 totaling 50,000,000 ordinary shares, (ii) shares issued for the asset injection arising from the Listing Reorganization totaling 5,442,258,218 ordinary shares.

The shares described in (ii) are deemed to have been issued since January 1, 2004 as the shares were issued for business combination under common control. The difference between the nominal value of the shares described in (ii) and the value of the net assets injected into the Company under the asset injection, totaling approximately RMB 3,100 million, is reflected as share premium.

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

(d) On December 8, 2004, the Company completed its Global Offering. The listing proceeds of the aforementioned Global Offering of shares, net of share issue expenses of HK$650 million (equivalent to RMB689 million) amounted to approximately HK$8,438 million (equivalent to RMB8,944 million). The resulting share premium amounted to approximately HK$8,096 million (equivalent to RMB 8,582 million).

33 Share option scheme

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

On October 22, 2004, 158,640,000 share options with an exercise price of HK$ 8.40 each were granted to the directors of the Company and certain employees of the Group (the "First Grant").

The total number of ordinary shares that are available for issuance upon the exercise of options granted pursuant to this scheme may not exceed 10% of the total number of issued ordinary shares. The Company may, however, seek separate approvals from its shareholders for granting options beyond the 10% limit.

Pursuant to the Company's share option plan, the Company granted 158,640,000 options to certain of its directors and employees, immediately prior to the closing of its global offering, to subscribe for its ordinary shares at the initial public offering price under the Hong Kong public offering, excluding brokerage and trading fees, and transaction and investor compensation levies. The First Grant has an exercise period of six years from the date of grant.

On December 6, 2005, the board of directors approved the granting of 79,320,000 shares of share options to certain management personnel of the newly acquired four northern provinces/autonomous region and other professional personnel designated by the Compensation and Nomination Committee.

A director resigned in 2004 and the options granted to him amounting to 920,000 were cancelled on the date of his resignation in accordance with the terms of the share option scheme.

Three staff resigned in 2005 and the options granted to them amounting to 1,017,000 cancelled on the date of his resignation in accordance with the terms of the share option scheme.

The movement of the share options granted in the First Share scheme during the year is summarized as follows:

	No. of share options					
	Outstanding as at January 1, 2005	Granted during the year	Exercised r during the year	Lapsed during the year	Cancelled during the year	Ou Dec
No. of share options	157,720,000	79,320,000	-	-	(1,017,000)	2
No. of directors and employees	455	260	-	-	(3)	

The grant date fair value of the share options granted in the First Grant is determined by the Black-scholes model based on the following assumptions: expected dividend pay-off ratio of 35%, expected vesting period of 5 years, expected fluctuation rate of 23.6% and risk-free interest rate of 4.3%. The weighted average fair value of the share option on grant date was determined as HK$ 1.22 per share (RMB1.28 per share). Since there is subjectivity exercised in the valuation model

adopted and the assumption based on which the fair value of the share options are determined, and any change in these subjective assumption may have significant impact to the fair value of the share options, the Black-Scholes Model adopted may not be able to reliably determine the fair value of the share options.

34 Consolidated cash flow statements

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

	Year ended Dece	
	2003	
	RMB million Restated Note 2	mill Resta Note
Profit before taxation	(18,124)	2,
Depreciation of fixed assets and amortization of intangible assets	26,781	25,
Lease prepayments for land	19	
Amortization of deferred revenues	(20,365)	(24,
Deferred costs charged to the income statements	2,050	3,
Deficit on revaluation of fixed assets	25,778	11,
Bad and doubtful debts	1,026	1,
Loss on disposal of fixed assets	2,224	
Share based compensation	-	
Dividend income	(45)	
Share of loss of associated companies	416	
Interest income	(95)	
Interest expense	4,008	3,
Discount on foreign currency exchange forward contracts	20	
Realized (gain) on disposal of short-term investments	(1)	
Unrealized loss on short-term investments	(7)	
Foreign exchange (gain)/loss	142	
Impairment of property, plant and equipment and lease prepayments for land	149	
Operating cashflow before working capital changes	23,976	23,
Increase in accounts receivable	(2,164)	(1,
(Increase)/decrease in inventories and consumables	(148)	
Decrease/(increase) in prepayments, other receivables		

and other current assets	436	(
Increase in other non-current assets	(3,665)	(3,
Increase/(decrease) in accounts payable	1,511	1,
Decrease in accruals and other payables	(592)	(3,
Increase in deferred revenues	16,173	20,
Net cash inflow generated from operations	35,527	37,

(b) Major non-cash transactions

During 2005, the Group paid RMB 3,000 million out of the total consideration for the Acquisition (Note 1). The remaining balance of RMB 9,800 is recognized as deferred payments and included in amount due to the ultimate holding company.

During 2005, the Group entered into finance lease arrangements in respect of newly acquired fixed assets with a total capital value at the inception of the lease of RMB 338 million (2004: RMB1,950 million; 2003: RMB 1,175 million).

34 Consolidated cash flow statements (continued)

(b) Major non-cash transactions (continued)

During 2004, the immediate holding company assigned a loan to the Company which resulted in a direct debit to the Company's equity.

(c) Acquisition of Asia Global Crossing through Asia Netcom

The Group acquired 100% of certain entities previously controlled by Asia Global Crossing through Asia Netcom by way of two acquisitions. On March 10, 2003, the Group injected RMB 507 million into Asia Netcom, a 51% owned jointly controlled entity which acquired the entire interest in certain entities, which own and operate an Asia-Pacific region cable network providing city-to-city connectivity, data communications and IP-based services, previously controlled by Asia Global Crossing. On December 31, 2003, the Group acquired the remaining 49% of the equity of Asia Netcom for a total cost of RMB 525 million.

From March 10, 2003 to December 31, 2003, Asia Netcom was accounted for as a jointly controlled entity. On December 31, 2003, Asia Netcom became a wholly owned subsidiary of the Company and was consolidated into the Group's financial statements.

The net assets acquired and the net cash inflow in respect of the purchase of the remaining 49% interest in Asia Netcom, which has a

group of subsidiaries, is analyzed as follows:

	As at December 31, 2003 RMB million
Net assets acquired at their respective estimated fair values	
Fixed assets	3,037
Deferred costs	870
Other non-current assets	157
Cash and bank deposits	580
Accounts receivables and other current assets	442
Accounts payable and other current liabilities	(1,207)
Advances from network capacity sales	(2,032)
Bank and other loans	(1,011)
Net assets	836
49% of net assets	410
Goodwill (note 3b)	115
Satisfied by Cash	525
	(525)
Cash and bank deposits acquired	580
Net cash inflow in respect of the purchase of subsidiaries	55

35 Banking facilities

As at December 31, 2005 and 2004, the Group's banking facilities are as follows:

	Group	
	As at December 31	
	2004	2005
	RMB million Restated Note 2	RMB million
Amount utilized	79,560	70,075
Amount unutilized	24,349	104,731

Aggregate banking facilities	103,909	174,806

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NOTES TO THE FINANCIAL STATEMENTS

36 Commitments

(a) Capital commitments

	Group
	As at December 31,
	2004
	RMB million Restated Note 2
Contracted but not provided for	
-Leasehold land and buildings	137
-Telecommunications networks and equipment	1,072
-Others	6
	1,215
Authorized but not contracted for	
-Leasehold land and buildings	2
-Telecommunications networks and equipment	1,778
-Others	-
	1,780

(b) Operating lease commitments

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

Group

	As at December 31, 2004 RMB million Restated Note 2
Not later than one year	804
Later than one year and not later than five years	1,148
Later than five years	1,518
	3,470

37 Related party transactions

All state-controlled enterprises, their subsidiaries, their key management and their close family, and their employees represent related parties of the Group as defined by HKAS 24. China Netcom Group, the Group's parent company, is a state-controlled enterprise directly controlled by the PRC government, which controls different state-owned enterprises and drives the economy of the PRC. The Group is the dominant fixed line telecommunications service provider in northen China by virtue of its historical monopoly over these services. As a result, the Group has extensive transactions including sales to, purchases of services, goods and fixed assets from, leasing of assets from and banking transactions with other state-owned parties in its ordinary course of business. These transactions are carried out at terms similar to those obtained by other state-owned parties and have been reflected in the financial statements.

The Group's operations are subject to the supervision of and regulation by the PRC Government. The Ministry of Information Industry (MII), pursuant to the authority delegated by the PRC's State Council, is responsible for formulating the policies and regulations for the telecommunications industry in China, including granting license, allocating frequency spectrum, formulating interconnection and settlement arrangement between telecommunications operator, enforcing industry regulation and reviewing tariffs for domestic services. Other PRC governmental authorities also regulate tariff polices, capital investment and foreign investment in the telecommunications industry.

As a state-owned telecommunication operator, the Group has extensive transactions with other state-owned telecommunication operators in its ordinary course of business. These transactions are carried out in

accordance with the rules and regulations stipulated by the MII of the PRC Government and disclosed below.

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

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

37 Related party transactions (continued)

	Notes	For the year ende 2003 RMB million Restated Note 2	2004 RMB million Restated Note 2&3
Emolument of key management	(i)		
- salaries and welfare		-	14
- contributions to retirement scheme		-	1
Subtotal		-	15
Interconnection fees			
- from fellow subsidiaries	(iv)(b)	-	148
- from other state-owned telecommunications operators	(iv)(b)	3,763	5,481
Subtotal		3,763	5,629
Interconnection charges			
- to fellow subsidiaries	(iv)(b)	-	198
- to other state-owned telecommunications operators	(iv)(b)	756	1,200
Subtotal		756	1,398

Rental income from properties leased to fellow subsidiaries	(iv)(a),(iv)(c)	4	3
Purchase of materials			
- from fellow subsidiaries	(iv)(a),(iv)(c)	3,091	2,122
- from other related companies	(iv)(a),(iv)(c)	1,801	822
Subtotal		4,892	2,944
Receipt of engineering, project planning, design, construction and information technology services			
- from fellow subsidiaries	(iv)(a),(iv)(b)	2,624	3,185
- from other related companies	(iv)(a),(iv)(b)	1,573	392
Subtotal		4,197	3,577
Ancillary telecommunications support services			
- from fellow subsidiaries	(v)	1,113	554
- from other related companies	(v)	767	235

Subtotal		1,880	789

37 Related party transactions (continued)

	Notes	For the year ende 2003 RMB million Restated Note 2	2004 RMB million Restated Note 2&3
Payment of operating lease rentals of premises			
- to fellow subsidiaries	(iv)(a),(iv)(c)	17	311
- to other related companies	(iv)(a),(iv)(c)	35	5
Subtotal		52	316
Property sub-lease rentals to fellow subsidiaries	(iv)(a),(iv)(c)	-	33
Common corporate services income from ultimate holding company	(vi)	-	19
Common corporate services expenditure paid to ultimate holding company	(vi)	-	213
Support services received			
- from ultimate holding company	(vii)	-	-
- from fellow subsidiaries	(vii)	1,494	937
- from other related companies	(vii)	1,479	1,487
Subtotal		2,973	2,424
Telecommunications rental income from other state-owned telecommunications operators	(iv)(b)	1,656	1,182
Payment for lease of Telecommunications facility			
- to ultimate holding company	(viii)	-	-
- to fellow subsidiaries	(viii)	-	138
Subtotal		-	138
Payment for purchase of long-term telecommunications capacity to fellow subsidiaries	(ix)	-	173

Payment for lease of long-term telecommunications capacity to fellow subsidiaries	(x)	-	28
Management fee received from fellow subsidiaries	(xi)	-	28

37 Related party transactions (continued)

Notes:

(i) Represents the emoluments paid to all of the directors and the top management of the Group, who are considered as the related parties of the Group.

(ii) The Group entered into finance lease arrangements with a related party, details have been set out in Note 27 (b(ii)).

(iii) Related party represents the non-listed investees of the fellow subsidiaries.

(iv) priced based on one of the following three criteria:

(a) market price;
(b) prices based on government guidance; or
(c) cost plus basis.

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

(vi) The Group entered into a Master Service Sharing agreement with China Netcom Group pursuant to which expenses associated with common corporate services is allocated between the Group and China Netcom Group based on total asset as appropriate.

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

(viii) The Group entered into a Telecommunications Facilities Leasing Agreement with China Netcom Group pursuant to which the Group leases the international telecommunications facilities and inter-provincial transmission optic fibers from China Netcom Group. The lease payment is based on the depreciation charge of the assets.

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

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

37 Related party transactions (continued)

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

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

(xiii) China Netcom Group has also agreed to indemnify the Group in connection with any tax and deferred tax liabilities not recognized in the financial statements of the Group arising from transactions prior to the date of Listing Reorganization and the Acquisition in relation to the business of the Group prior to the Acquisition and the business of the newly required four provinces/autonomous region respectively.

(xiv) As at December 31, 2005, China Netcom Group granted corporate guarantee to the Group as set out in Note 27 (b(i)).

(xv) China Netcom Group, the Group's ultimate holding company,

entered into an agreement (the "Sponsorship Agreement") with Beijing Organization Committee ("BOCOG") which designated China Netcom Group as the exclusive fixed-line telecommunications services partner in the People's Republic of China ("PRC") to sponsor the 2008 Beijing Olympic Games. China Netcom Group allocated the sponsorship fee to its members based on the estimated future benefits derived from the Sponsorship Agreement to respective members and the Group has contributed a portion of the required support under the Sponsorship Agreement through providing cash to BOCOG amounting to RMB 540 million. Accordingly, an intangible asset and a payable to the ultimate holding company of the said amount have been recognized on the Group' balance sheet.

(xvi) At December 31, 2005, the Group has balances with other state-owned telecommunication service providers and loans granted from state-owned banks as set out in Notes 17, 25 and 27 respectively.

(xvii) The Acquisition was completed at October 31, 2005. Details have been set out in Note 1.

CHINA NETCOM GROUP CORPORATION (HONG KONG) LIMITED

NOTES TO THE FINANCIAL STATEMENTS

38 Condensed financial statements of the Company

INCOME STATEMENT-THE COMPANY

	Year ended December 3	
	2003	2004
	RMB Million	RMB Million Restated Notes 3
Net revenue	38	-
Cost of revenues	-	-
Gross profit	38	-
Operating expenses:		
Staff cost	-	(18)
Selling, general and administrative	(19)	(59)
Total operating expenses	(19)	(77)

Operating loss before interest income, dividend income and deficit on revaluation of fixed assets	19	(77)
Interest income	–	11
Profit from operations		
Finance costs	–	–
Investment income	–	7
Profit/(loss) before tax	19	(59)
Income tax benefit/(expense)	–	–
Net profit/(loss)	19	(59)

CHINA NETCOM GROUP CORPORATION (HONG KONG) LIMITED

NOTES TO THE FINANCIAL STATEMENTS

BALANCE SHEET–THE COMPANY	Note	As at December 3 2004 RMB million Restated Note 3
Assets		
Current assets		
Cash and bank deposits	(b)	7,789
Short-term investments		1,651
Due from subsidiaries	(d)	–
Prepayments, other receivables and other current assets	(c)	16
Total current assets		9,456
Non-current assets		
Investments in subsidiaries	(d)	37,509
Total assets		46,965

Liabilities and equity		
Current liabilities		
Accrued expense		140
Due to subsidiaries	(d)	-
Due to ultimate holding company	(g)	142
Net current (liabilities)/assets		9,174
Total assets less current liabilities		46,683
Financed by:		
Share capital		2,181
Reserves	(e)	44,502
Shareholders' equity		46,683
Total liabilities & equity		46,965

CONDENSED STATEMENT OF CASH FLOWS-THE COMPANY

	For the year e	
	2003	20
	RMB Million	R Milli
Net cash used in operating activities	(17)	9
Net cash used in investing activities	(62)	(1,33
Net cash provided by financing activities	-	8,94
Net (decrease) / increase in cash	(79)	7,70
Cash and bank deposits, at beginning of the year	167	8

Cash and bank deposits, at end of the year	88	7,78

CHINA NETCOM GROUP CORPORATION (HONG KONG) LIMITED

NOTES TO THE FINANCIAL STATEMENTS

38 Condensed financial statements of the Company (Continued)

(a) The condensed financial statements of the Company have been prepared in accordance with HKFRS issued by HKICPA.

The subsidiaries declared RMB 260 million dividend to the Company in 2005 (2004: Nil).

Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States have been condensed or omitted. The footnote disclosures contain supplemental information relating to the operations of the Company and, as such, these statements should be read in conjunction with the notes to the consolidated financial statements of the Company.

The Company did not have any significant commitment as at December 31, 2004 and 2005.

(b) Cash and bank deposits

	The Compa
	As at Decemb
	2004
	RMB million
Cash and cash equivalents	7,789

(c) Prepayments, other receivables and other current assets

	The Compa
	As at Decembe
	2004 RMB

	million
Prepaid expenses, deposits and other current assets	8
Other receivables	8
Total	16

38 Condensed financial statements of the Company (Continued)

(d) Investments in subsidiaries

	Th As at 20 R milli
Investments cost in subsidiaries	37,5
Due from subsidiaries (Note (b))	
Due to subsidiaries (Note (c))	
	37,5

38 Condensed financial statements of the Company (Continued)

(d) Investments in subsidiaries (continued)

Notes:

(a) As at the December 31, 2005, the Group has direct and indirect interests in the following principal subsidiaries, all of which are private companies:

Company name	Place and date of incorporation/ establishment	Issued and fully paid up/ registered capital	Percentage of equity interest attributable to the Group
Directly held:			
China Netcom (Group) Company Limited (Note (i))	PRC, August 6, 1999	Registered capital of RMB 51,481,675,600	100%
Indirectly held:			
China Netcom Group New Horizon Telecommunications Co. Limited (Note (ii))	PRC, August 9, 2005	Registered share capital of RMB 9,466,366,618	100%
Asia Netcom Corporation Limited (Note (iii))	Bermuda October 15, 2002	120,000,000 ordinary shares of US$ 0.01 each	100%

(i) The company is a wholly owned foreign enterprise established in the PRC. The accounts of the company for the years ended December 31, 2004 and 2005 were audited by PricewaterhouseCoopers Zhong Tian CPAs Limited Company.

(ii) The company is a wholly owned foreign enterprise established in the PRC. The accounts of this company for the year ended December 31, 2005 were audited by PricewaterhouseCoopers Zhong Tian CPAs Limited Company.

(iii) The financial statements for the years ended December 31, 2004 and 2005 had been audited by PricewaterhouseCoopers.

(b) The balances are unsecured, non-interest bearing and have no fixed repayment terms.

(c) Deferred payments arising from the Acquisition (see note 1) has been transferred to CNC China at the carrying amount. The balance is non-secured, non interest bearing and has no fixed repayment terms

CHINA NETCOM GROUP CORPORATION (HONG KONG) LIMITED

NOTES TO THE FINANCIAL STATEMENTS

38 Condensed financial statements of the Company (Continued)

(e) Reserves

	Share premium	Capital reserve	Re ea
	RMB million	RMB million	m
At January 1, 2004	2,771	-	
Issue of shares under listing Reorganisation	31,397	2,982	
Distribution to owner in accordance with Listing Reorganization	-	-	
Loss for the year	-	-	
Distribution to an owner upon assignment of loan prior to the Global Offering	-	-	
Issue of shares through Global Offering (net of issue expenses)	8,582	-	
Share based payments (Note 3(a))	-	18	
At December 31,2004 as restated	42,750	3,000	
Profit for the year	-	-	
Dividends distributed during the year (Note 12)	-	-	
Share based payments	-	104	
At December 31,2005	42,750	3,104	

(i) Pursuant to the promissory note (the "Note") signed by Group Wealth Finance Limited ("Group Wealth"), a fellow subsidiary owned by CNC BVI, the Company's immediate holding company, dated July 27, 2004, Group Wealth has borrowed an amount of US$123,301,980 (RMB 1,020,644,470) from Asia Netcom, and used these funds to acquire the right to receive the outstanding debt payments owed by East Asia Netcom Limited, a fellow subsidiary, from the vendors to the aggregate amount of approximately US$123 million on July 29, 2004.

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

(f) For the year ended December 31, 2005, profit attributable to shareholders included current year profit of RMB 126 million (2004: a loss of 59 million), which has been dealt with in the financial

statements of the Company.

(g) The balances are unsecured, non-interest bearing and have no fixed repayment terms paid on behalf of the Group.

39 Significant subsequent events

(a) After the balance sheet date the directors proposed a final dividend. Further details are disclosed in Note 12.

(b) On 2 June 2006, the Group entered into an agreement to dispose of the entire interests in Asia Netcom Corporation Limited and its subsidiaries (collectively referred to as "ANC Group") to two independent third parties at an aggregate cash consideration of US$168.84 million (equivalent to RMB 1, 362.57 million). The disposal is subject to a number of conditions including the receipt of all regulatory approvals. The Group will receive the aggregate consideration upon the completion of the disposal which is expected to be in the second half year of 2006. After the disposal, the Group will maintain its business relationship with ANC Group in connection with its own international operations and such business relationship will include the purchase of certain network capacity from ANC Group. The directors are currently evaluating the transaction, which will be recorded when the disposal completes, expected to be in the second half of 2006.

(c) On 16 May 2006, the Board of Directors of CNC China passed a resolution to obtain short-term financing through Commercial Paper offering to a number of PRC banks. The amount of the offering shall not exceed RMB 20 billion. The offering requires an approval from the People's Bank of China and the Company is currently in the process of applying for such an approval.

40 Ultimate holding party

The ultimate holding company is China Netcom Group which is owned and controlled by PRC Government.

CHINA NETCOM GROUP CORPORATION (HONG KONG) LIMITED

NOTES TO THE FINANCIAL STATEMENTS

41 Reconciliation of HKFRS and Accounting Principles Generally Accepted in the United States ("U.S. GAAP")

(A) Reconciliation of HKFRS and U.S. GAAP at the Group level

The consolidated financial statements of the Group have been prepared in accordance with HKFRS, which differs in certain material respects from U.S.GAAP. Differences between HKFRS and U.S.GAAP, which may have significant impacts on the consolidated net income/(loss) and the consolidated shareholders' equity are described below.

The effect on net profit/(loss) of significant differences between HKFRS and U.S.GAAP for the years ended December 31, 2003, 2004 and 2005 is as follows:

	Note	2003 Restated Note 2&3	2004 Restated Note 2&3
		RMB million except per shar	
Consolidated net income/(loss) for the year under HKFRS		(10,906)	2,699
U.S.GAAP adjustments(pound)(0)			
Revaluation of fixed assets	(a)	25,778	11,318
Depreciation of revalued fixed assets	(a)	-	(3,529)
Share-based compensation	(b)	(2)	-
Others		3	14
Tax effect on the above adjustments	(e)	(8,508)	(2,570)
Consolidated profit for the year under U.S.GAAP		6,365	7,932
Shares used in computing basic earnings per share		5,492	5,623
Shares used in computing diluted earnings per share		5,500	5,630
Basic earnings per share under U.S.GAAP		RMB1.16	RMB1.41
Diluted earnings per share under U.S.GAAP		RMB1.16	RMB1.41

CHINA NETCOM GROUP CORPORATION (HONG KONG) LIMITED

NOTES TO THE FINANCIAL STATEMENTS

41 Reconciliation of HKFRS and Accounting Principles Generally Accepted in the United States ("U.S. GAAP") (continued)

(A) Reconciliation of HKFRS and U.S. GAAP at the Group level (continued)

The effect on shareholders' equity of significant differences between HKFRS and U.S.GAAP as at December 31, 2003, 2004 and 2005 is as follows:

	Note	Year ended December 2003 Restated Note 2&3	2004 Restated Note 2&3	
			RMB million	
Consolidated shareholders' equity under HKFRS		53,659	64,595	
U.S.GAAP adjustments(pound)(0)				
Revaluation of fixed assets	(a)	22,796	30,251	
Depreciation of revalued fixed assets	(a)	-	(3,529)	
Convertible preference shares and corresponding share premium	(d)	(2,637)	-	
Difference in distribution to owner upon Listing Reorganization	(f)	-	166	
Others		(13)	-	
Tax effect on the above adjustments	(e)	(7,522)	(8,819)	
Consolidated shareholders' equity under U.S.GAAP		66,283	82,664	

CHINA NETCOM GROUP CORPORATION (HONG KONG) LIMITED

NOTES TO THE FINANCIAL STATEMENTS

41 Reconciliation of HKFRS and Accounting Principles Generally Accepted in the United States ("U.S. GAAP") (continued)

(A) Reconciliation of HKFRS and U.S. GAAP at the Group level (continued)

In 2005, the Group acquired the fixed line telecommunication service of the northern four provinces/autonomous region (Shanxi Province, Inner Mongolia Autonomous Region, Jilin Province and Heilongjiang Province) from the ultimate holding company, China Netcom Group. Since the Group has adopted merger accounting to account for the Acquisition, 2003 and 2004 comparative figures have been restated as if the Acquisition has been completed before January 1, 2003 (note 2). Also, in 2005, the Group has adopted certain new or revised HKFRSs as set out in Note 3 of the financial statement. Certain 2004 comparative has been restated as required by the relevant new or revised HKFRSs.

(a) Revaluation of fixed assets

In the Listing Reorganization, certain classes of fixed assets of the Group were revalued as at December 31, 2003. The revaluation was performed based on the depreciated replacement costs of the fixed assets and was not based upon the expected future cash flows of the

fixed assets. The revaluation resulted in a charge of RMB 25,778 million to the Group's consolidated income statement for the year ended December 31, 2003 with respect to the reduction in carrying amounts of certain fixed assets below their historical cost bases. In addition, a surplus arising from the revaluation of certain other fixed assets totaling RMB 2,982 million has been credited to the revaluation reserve.

In 2005, the Group acquired telecommunications business and assets of the four northern provinces/autonomous region from China Netcom Group as set out in Note 1 to the Group's financial statements. The acquired fixed assets were revalued as at December 31, 2004. The revaluation was performed based on the depreciated replacement costs of the fixed assets and was not based upon the expected future cash flows of the fixed assets. The revaluation resulted in a charge of RMB 11,318 million to the Group's consolidated income statement for the year ended December 31, 2004 with respect to the reduction in carrying amounts of certain fixed assets below their historical cost bases. In addition, a surplus arising from the revaluation of certain other fixed assets totaling RMB 3,863 million has been credited to the revaluation reserve. The effect of the reduction in depreciation of the revalued assets amounted to RMB 5,110 million in the year ended December 31, 2005 (2004: RMB 3,529 million).

Under U.S.GAAP, the carrying values of fixed assets are stated at their historical costs less accumulated depreciation and provision for impairment without making reference to their respective depreciated replacement costs. An impairment loss on fixed assets is recorded under U.S.GAAP if the carrying value of such assets exceeds its future undiscounted cash flow resulting from the use of the assets and their eventual disposition. The future undiscounted cash flows of the Group's fixed assets, whose carrying amounts were reduced in connection with the Reorganization, exceed the historical costs of such fixed assets and, therefore, no impairment of such assets is recognized under U.S.GAAP. Accordingly, the deficit on revaluation of fixed assets charged to the Group' consolidated income statements and the surplus credited to revaluation reserve recorded under HKFRS during 2003 and 2004 and the corresponding effect on the depreciation of the revalued assets during the year 2004 and 2005 are reversed for U.S.GAAP purposes.

41 Reconciliation of HKFRS and Accounting Principles Generally Accepted in the United States ("U.S. GAAP") (continued)

(A) Reconciliation of HKFRS and U.S. GAAP at the Group level (continued)

(b) Share-based compensation in the years ended December 31, 2003

The Group had share-based compensation arrangements in the years ended December 31, 2003. Under HKFRS, the Group accounts for shares issued to employees as ordinary share issuance and the difference between the amounts paid by the employees and the par values of the share were

recognized as share premium.

Under U.S.GAAP, the Group accounts for share-based compensation arrangements in accordance with the provisions of Accounting Principles Board Opinion No.25 ("APB No.25"), "Accounting for Share Issued to Employees" and related interpretations thereof. Accordingly, the difference between the estimated fair values of the ordinary shares issued and the issuance prices at the issuance dates in recorded as deferred stock compensation, which is an item in the equity of the Group, and amortized over two years on a straight-line basis over the service period of each individual employee.

The estimated fair value of the ordinary shares issued to the employees was US$ 2.45 per share, which was based on a valuation report from an independent appraiser dated July 31, 2001 and derived on a non-marketable aggregate minority basis as of February 7, 2001. The directors of the Company believe that the assumption that was used in the valuation report as of February 7, 2001 did not change significantly in the subsequent periods. As at December 31, 2004 the difference between the estimated fair value of the ordinary shares issued and the issuance price at the date has been fully amortized.

(c) Grants of share options in the year ended December 31, 2004 and 2005

The Group granted share options to directors and employees in the years ended December 31, 2004 and 2005 pursuant to the Company's Stock Option Scheme as set out in Note 31.

Prior to January 1, 2005, under HKFRS, no charge is recorded to the income statement and the proceeds received are recognized as an increase to capital upon the exercise of share options.

Prior to January 1, 2005, under U.S.GAAP, in accordance with the provisions of SFAS No.148, "Accounting for Stock-Based Compensation-Transition and Disclosure", the Group has selected to apply the disclosure only provisions related employee stock and share purchases and follows the provision of Accounting Principles Board Opinion No.25(APB 25) in accounting for stock options issued to employees. Under APB 25, compensation expense, if any, is recognized as the difference between the exercise price and the estimated fair value of the ordinary shares on the measurement date, which is typically the date of grant, and is expensed ratably over the service period, which is typically the vesting period. Since the options exercise price was set to be the share issuance price at the time of initial public offering, there is no expense charged to the income statement.

In 2005, the Group adopted HKFRS 2 - Share-based payment issued by HKICPA. The Group recognizes the fair value of the share options as an expense over the vesting period in the consolidated income statement, or as an asset if the cost qualifies for recognition as an asset under the Group's accounting policy. A corresponding increase is recognized in a capital reserve within equity. This change in accounting policy has been accounted for retrospectively.

In 2005, the Group applied the retroactive restatement method under FAS148 and retrospectively restated the prior year financial statements to recognize the share-based compensation to give effect to the fair-value-based method of accounting for all awards granted on a basis consistent with the pro forma disclosures required for those periods by FAS123. Upon the change of accounting policy, the treatment under U.S.GAAP is consistent with that under HKFRS upon the changes in accounting policies.

CHINA NETCOM GROUP CORPORATION (HONG KONG) LIMITED

NOTES TO THE FINANCIAL STATEMENTS

41 Reconciliation of HKFRS and Accounting Principles Generally Accepted in the United States ("U.S. GAAP") (continued)

(A) Reconciliation of HKFRS and U.S. GAAP at the Group level (continued)

(d) Convertible preference shares

Under HKFRS, the convertible preference shares and the corresponding share premium are classified as equity while under U.S.GAAP they are presented as balances between liabilities and owners' equity because of the mandatorily redeemable feature of the convertible preference shares. This difference resulted in a reduction of the owners' equity by RMB 2,637 million as at December 31, 2003 under U.S.GAAP. The convertible preference shares were converted to ordinary shares in 2004 and therefore the GAAP difference ceased to exist from that date.

(e) Deferred income tax

The amounts included in the reconciliation show the income tax effects of the differences between HKFRS and U.S.GAAP as described above.

However, HK GAAP requires recognition of deferred tax asset only to the extent that recovery of the deferred tax assets is probable, whereas U.S. GAAP requires full recognition of deferred tax assets and appropriate valuation allowance is required if the recovery is less than 50% likely. Recognition of deferred tax previously not recognized under HK GAAP is presented as a reversal of valuation allowance under U.S. GAAP.

(f) Goodwill and negative goodwill

Before January 1, 2005, goodwill on acquisition was included in intangible assets and amortized using the straight-line method over its estimated useful life of no more than twelve years. Negative goodwill is presented in the same balance sheet classification as goodwill and recognized in the income statement over the remaining weighted average useful life of the related fixed assets.

On January 1, 2005, the Group adopted HKFRS 3 - Business Combination issued by the HKICPA. Goodwill could no longer be amortized and is tested annually for impairment, as well as when there are indications of impairment. If the fair value of the net assets acquired in a business combination exceeds the consideration paid (i.e. an amount arises which would have been known as negative goodwill under the previous accounting policy), the excess is recognized immediately in the consolidated income statement as it arises. According to the transitional provision of HKFRS3, the Group should not retrospectively adjust the financial statements issued in previous years.

Under U.S.GAAP, goodwill is not amortized but tested for impairment

annually and whenever events or circumstances occur indicating that goodwill might be impaired. When negative goodwill results from an acquisition, the acquirer must reassess whether all acquired assets and assumed liabilities have been identified and properly valued and then allocate negative goodwill to certain acquired non-monetary assets on a pro rata basis as applicable. Any remaining unallocated negative goodwill must be recognized immediately as an extraordinary gain.

Goodwill was recognized from the acquisition of the 49% equity interest in Asia Netcom on December 31, 2003. Accordingly, the amortization of goodwill of RMB 10 million during the year ended December 31, 2004 under HKFRS is reversed for U.S.GAAP purpose and credited to the owners' equity.

After the Listing Reorganization, the value of the fixed assets transferred to China Netcom Group under HKFRS was higher than that under U.S.GAAP by RMB 166 million for reason of the different treatment as of the negative goodwill from the acquisition of Asia Global Crossing. The negative goodwill of RMB 166 million was included in the balance sheet under HKFRS while offset against certain fixed assets under U.S.GAAP and the fixed assets had been distributed to owner in accordance with the Reorganization plan. Accordingly, the amount distributed to owner under U.S.GAAP was lower than that under HKFRS by RMB 166 million.

On January 1, 2005, the balance of negative goodwill under HKFRS was credited directly to the shareholders' equity upon the adoption of HKFRS 3 and the GAAP difference ceased to exist from then.

CHINA NETCOM GROUP CORPORATION (HONG KONG) LIMITED

NOTES TO THE FINANCIAL STATEMENTS

41 Reconciliation of HKFRS and Accounting Principles Generally Accepted in the United States ("U.S. GAAP") (continued)

(A) Reconciliation of HKFRS and U.S. GAAP at the Group level (continued)

(g) Presentation of revenue

Under HKFRS, revenues are presented net of the PRC business taxes and government levies which amounted to RMB 2,392 million, RMB 2,493 million and RMB 2,421 million for the years ended December 31, 2003, 2004 and 2005 respectively.

Under U.S.GAAP, revenues should be presented gross with these type of taxes classified as a cost of revenue.

(h) Presentation of depreciation expenses

Under HKFRS, depreciation expense can be excluded from "Network, operations and support" and separately disclosed on the face of income statement.

Under U.S.GAAP, "Network, operations and support" expenses should

include charges for depreciation of property, plant and equipment and amortization of intangible assets. Industry practice adopted by the Chinese telecommunications sector is to present these costs of operations net of depreciations charges. In such circumstance, U.S.GAAP requires such fact to be highlighted on the face of the income statement.

(i) Presentation of amortization of subscriber acquisition costs

Under HKFRS, amortization of capitalized subscriber acquisition costs, being RMB 741 million, RMB 2,602 million and RMB 1,887 million for the years ended December 31, 2003, 2004 and 2005 respectively is classified as selling expenses due to the marketing and promotional nature of the expenditure.

Under U.S.GAAP, amortization of subscriber acquisition costs needs to be included in the item "Network, operations and support" expense for the Company.

(j) Other U.S.GAAP disclosures

(i) Acquisition of business under common control

During the year, the Company acquired the businesses of the northern four provinces, details of which were set out in note 1. Under HKFRS, the Company applied merger accounting to record the Acquisition and the acquired assets and liabilities were stated at carrying amounts as if the fixed line telecommunications operations and assets of the four provinces/autonomous region had been held by the Company from the beginning of the earliest period presented. The 2003 and 2004 comparatives of the financial statements were restated accordingly.

Under U.S. GAAP, the Acquisition was treated as a "business combination of entities under common control" and accounted for in a manner similar to pooling-of-interests. It also required to reconcile the financial data from the previously reported figures to the restated amounts. Accordingly, the Company set out the reconciliation of financial data from the previously reported figures to the restated amounts for the income statements for the years ended December 31, 2003 and 2004 and the balance sheets as of December 31, 2003 and December 31, 2004 as follows:

Reconciliation of HKFRS and Accounting Principles Generally Accepted in the United States ("U.S. GAAP") (continued)

(A) Reconciliation of HKFRS and U.S. GAAP at the Group level (continued)

(j) Other U.S.GAAP disclosures (Continued)

(i) Acquisition of business under common control (Continued)

	The year ended at December 31, 2004
	Effect of adoption of merger

	As previously stated	Effect of adoption of new HKFRSs (Note 3)	Adjusted	accounting on acquisition of Acquired Businesses (Note 2)	Restated
	RMB'000	RMB'000	RMB'000	RMB'000	RMB'000
Revenue	64,922	–	64,922	18,616	83,538
Operating expenses					
Depreciation and amortization	(18,754)	–	(18,754)	(6,426)	(25,180)
Networks, operations and support	(11,591)	–	(11,591)	(2,426)	(14,017)
Staff costs	(8,041)	(18)	(8,059)	(3,891)	(11,950)
Selling, general and administrative	(9,566)	–	(9,566)	(3,311)	(12,877)
Other operating expenses	(1,534)	–	(1,534)	(459)	(1,993)
Total of operating expenses	(49,486)	(18)	(49,504)	(16,513)	(66,017)
Operating profit before interest income, dividend income and deficit on revaluation of fixed assets	15,436	(18)	15,418	2,103	17,521
Interest income	76	–	76	11	87
Dividend income	17	–	17	–	17
Deficit on revaluation of fixed assets	–	–	–	(11,318)	(11,318)
Profit/(loss) from operations	15,529	(18)	15,511	(9,204)	6,307
Finance costs	(2,932)	–	(2,932)	(998)	(3,930)
Share of loss of associated companies	(1)	–	(1)	–	(1)
Profit/(loss) before taxation	12,596	(18)	12,578	(10,202)	2,376
Taxation credit	(3,348)	–	(3,348)	3,671	323
Profit/(loss) for the year	9,248	(18)	9,230	(6,531)	2,699

Reconciliation of HKFRS and Accounting Principles Generally Accepted in the United States ("U.S. GAAP") (continued)

(A) Reconciliation of HKFRS and U.S. GAAP at the Group level (continued)

(j) Other U.S.GAAP disclosures (Continued)

(i) Acquisition of business under common control (Continued)

	The year ended at December 31, 2004				
	As previously stated	Effect of adoption of new HKFRSs (Note 3)	Adjusted	Effect of adoption of merger accounting on acquisition of Acquired Businesses (Note 2)	Restated
	RMB'000	RMB'000	RMB'000	RMB'000	RMB'000
Revenue	59,898	-	59,898	17,700	77,598
Operating expenses					
Depreciation and amortization	(20,483)	-	(20,483)	(6,317)	(26,800)
Networks, operations and support	(11,990)	-	(11,990)	(3,118)	(15,108)
Staff costs	(7,547)	-	(7,547)	(3,398)	(10,945)
Selling, general and administrative	(7,053)	-	(7,053)	(3,269)	(10,322)
Other operating expenses	(1,660)	-	(1,660)	(537)	(2,197)
Total of operating expenses	(48,733)	-	(48,733)	(16,639)	(65,372)
Operating profit before interest income, dividend income and deficit on revaluation of fixed assets	11,165	-	11,165	1,061	12,226
Interest income	79	-	79	16	95
Dividend income	45		-	45	45
Deficit on revaluation of fixed assets	(25,778)	-	-	(25,778)	(25,778)
Profit/(loss) from operations	(14,489)	-	(14,489)	1,077	(13,412)
Finance costs	(3,026)	-	(3,026)	(1,270)	(4,296)
Share of loss of :					
-Associated companies	(1)	-	(1)	-	(1)
-Jointly controlled entity	(415)	-	(415)	-	(415)
Profit/(loss) before taxation	(17,931)	-	(17,931)	(193)	(18,124)
Taxation credit	6,819	-	6,819	398	7,217
Minority interests	1	-	1	-	1

Profit/(loss) for the year	(11,111)	-	(11,111)	205	(10,906)

Reconciliation of HKFRS and Accounting Principles Generally Accepted in the United States ("U.S. GAAP") (continued)

(A) Reconciliation of HKFRS and U.S. GAAP at the Group level (continued)

(j) Other U.S.GAAP disclosures (Continued)

(i) Acquisition of business under common control (Continued)

	The year ended at December 31, 2004			
	As previously stated RMB'000	Effect of adoption of new HKFRSs (Note 3) RMB'000	Adjusted RMB'000	Ef ad me ac on ac of Ac Bu RM (N
Assets				
Current assets				
Cash and bank deposits	10,053	-	10,053	
Short-term investments	2,876	-	2,876	
Accounts receivable	5,688	-	5,688	
Inventories and consumables	941	-	941	
Prepayments and other receivables	1,006	-	1,006	
Due from holding companies and fellwo subsidiaries	373	-	373	
Total current assets	20,937	-	20,937	
Non-current assets				
Lease prepayments for land	-	1,266	1,266	
Fixed assets	125,582	(795)	124,787	
Construction in progress	8,073	(471)	7,602	
Intangible assets	316		316	
Deferred tax assets	2,394	-	2,394	
Other non-current assets	7,873		7,873	
Total non-current assets	144,238	-	144,238	
Total assets	165,175	-	165,175	

Liabilities			
Current liabilities			
Accounts payable	14,653	-	14,653
Accruals and other payables	3,353	-	3,353
Short-term bank loans	29,339	-	29,339
Current portion of long-term bank and other loans	7,270	-	7,270
Due to ulitmate holding company	8,244	-	8,244
Current portion of deferred revenues	6,653	-	6,653
Current portion of provisions	2,596	-	2,596
Taxation payable	196	-	196
Total current liabilities	72,304	-	72,304
Net current liabilities	(51,367)	-	(51,367)
Total assets less current liabilities	92,871	-	92,871
Non-current liabilities			
Long-term bank and other loans	21,861	-	21,861
Deferred revenues	11,817	-	11,817

Provisions	2,143	-	2,143
Deferred tax liabilities	1,321	-	1,321
Other non-current liabilities	564		564
Total non-current liabilities	37,706	-	37,706
Total liabilities	110,010	-	110,010
Financed by :			
Share capital	2,181	-	2,181
Reserves	52,984		52,984
Shareholders' equity	55,165	-	55,165
Total liabilities and equity	165,175	-	165,175

	As at December 31, 2003			
	As previously stated RMB'000	Effect of adoption of new HKFRSs (Note 3) RMB'000	Adjusted RMB'000	Effect adopti merger accoun on acquis of Acq Busine (Note RMB'00
Cash and bank deposits	6,316	-	6,316	
Short-term investments	1,506	-	1,506	

Accounts receivable	6,343	-	6,343	
Inventories and consumables	1,238	-	1,238	
Prepayments and other receivables	1,640	-	1,640	
Due from holding companies and fellwo subsidiaries	449	-	449	
Total current assets	17,492	-	17,492	
Non-current assets				
Lease prepayments for land	-		-	
Fixed assets	133,919		133,919	
Construction in progress	15,695		15,695	
Intangible assets	184		184	
Deferred tax assets	2,784	-	2,784	
Lont-term investment	880	-	880	
Interest in associated companies	90	-	90	
Other non-current assets	8,490		8,490	
Total non-current assets	162,042	-	162,042	
Total assets	179,534	-	179,534	
Liabilities				
Current liabilities				
Accounts payable	14,786	-	14,786	
Accruals and other payables	4,410	-	4,410	
Short-term bank loans	32,217	-	32,217	
Current portion of long-term bank and other loans	15,716	-	15,716	

Due to ulitmate holding company	9,002	-	9,002	
Current portion of deferred revenues	7,229	-	7,229	
Current portion of provisions	3,083	-	3,083	
Taxation payable	428	-	428	
Total current liabilities	86,871	-	86,871	
Net current liabilities	(69,379)	-	(69,379)	(2
Total assets less current liabilities	92,663	-	92,663	
Non-current liabilities				
Long-term bank and other loans	22,309	-	22,309	
Due to holding companies	4,750	-	4,750	
Deferred revenues	14,604	-	14,604	

Provisions	2,341	-	2,341
Deferred tax liabilities	4,213	-	4,213
Other non-current liabilities	1,067		1,067
Total non-current liabilities	49,284	-	49,284
Total liabilities	136,155	-	136,155
Minority interest	3	-	3
Financed by :			
Share capital	1,819	-	1,819
Reserves	41,557		41,557
Shareholders' equity	43,376	-	43,376
Total liabilities and equity	179,534	-	179,534

(ii) Comprehensive income

U.S.GAAP requires that all items that are required to be recognized as components of comprehensive income (including cumulative translation adjustment) be reported in a separate financial statement. There are no material differences between total recognized gains and losses for the periods shown in the Consolidated Statements of Changes in Equity presented under HKFRS and U.S.GAAP comprehensive income, except for the differences between HKFRS and U.S.GAAP profit attributable to shareholders shown above.

41 Reconciliation of HKFRS and Accounting Principles Generally Accepted in the United States ("U.S. GAAP") (continued)

(B) Reconciliation of HKFRS and U.S. GAAP at the Company level

The condensed financial statements of the Company as set out in Note 38 have been prepared in accordance withy HKFRS, which differs in certain material respects from U.S. GAAP. Differences between HKFRS and U.S. GAAP, which may have significant impacts on the Company's net profit/ (loss) and the Company's shareholders' equity are described below.

The effect on the net profit/(loss) of significant differences between HKFRS and U.S. GAAP at the Company's level for the years ended December 31, 2003, 2004 and 2005 is as follows:

	Note	Years ended Dec 2003 RMB million Restated Notes 2	2004 RMB million Restated Notes 2&3	
Net profit/(loss) for the year under HKFRS		19	(59)	
U.S. GAAP adjustments:				
Equity accounting for share of results of its subsidiaries, net of tax effect	(a)	6,346	7,991	
Net profit for the year under U.S. GAAP		6,365	7,932	

The effect on the shareholders' equity of significant differences between HKFRS and U.S. GAAP at the Company's level as at December 31, 2003, 2004 and 2005 is as follows:

	Note	2003 RMB million Restated Notes 2	2004 RMB million Restated Notes 2&3	2 mill
Shareholders' equity under HKFRS		2,981	46,683	46
U.S. GAAP adjustments:				
Equity accounting for the subsidiaries of China Netcom Group, net of tax effect (Restated (note B(a)))	(a)	65,939	21,671	26
Revaluation of fixed assets and difference in the value of investments in subsidiaries injected from China Netcom Group up on Reorganization	(b)	--	14,144	4
Convertible preference share and corresponding share premium	(c)	(2,637)	--	
Difference in distribution to owners upon Reorganization	(d)	--	166	
Shareholders' equity under U.S. GAAP		66,283	82,664	77

(a) Equity accounting for share of results and net assets of its subsidiaries

Under HKFRS, the Company records its investment in its subsidiaries under cost method of accounting. In the Company's balance sheet, the investment in subsidiaries are stated at cost less provision for impairment losses. The results of the subsidiaries are accounted for by the Company on the basis of dividend received and receivable.

CHINA NETCOM GROUP CORPORATION (HONG KONG) LIMITED

NOTES TO THE FINANCIAL STATEMENTS

41 Reconciliation of HKFRS and Accounting Principles Generally Accepted in the United States ("U.S. GAAP") (continued)

(B) Reconciliation of HKFRS and U.S. GAAP at the Company level

Under U.S. GAAP, the Company restates its financial statements as if the Reorganization happened at the earliest period presented. It records its investment in its subsidiaries under the equity method of accounting as prescribed in APB Opinion No. 18, "The Equity Method of Accounting for Investments in Common Stock". Since the company holds 100% equity interest in the subsidiaries, the net asset value of the subsidiaries has been fully reflected as Investment in subsidiaries on the balance sheet and the results of the subsidiaries have been accounted for under share of results of subsidiaries, net of tax on the income statement.

(b) Revaluation of fixed assets and difference in the value of investments in subsidiaries injected from China Netcom Group up on Reorganization and on Acquisition.

As a result of the Group's Reorganization consummated on June 30, 2004, the Company issued 5,442,258,218 ordinary shares in exchange of the telecommunications operations and the related assets and liabilities in the Eight Service Regions previously owned by China Netcom Group and injected these operations into its major operating subsidiary, CNC China. The fixed assets injected by China Netcom Group have been revalued on December 31, 2003, based on depreciated replacement cost method pursuant to the PRC rules and regulations relevant to the Reorganization, resulting in a net reduction of their total carrying value by RMB 22,796 million (see Note 20). These fixed assets were then contributed by the Company into CNC China as an increase in its investment in CNC China.

During the Acquisition, the fixed assets injected by China Netcom Group have been revalued on December 31, 2004, based on depreciated replacement cost method pursuant to the PRC rules and regulations relevant to the Acquisition, resulting in a net reduction of their total carrying value by RMB 11,318 million (see Note 20).

Under U.S. GAAP, the carrying values of fixed assets are stated at their historical costs less accumulated depreciation and provision for impairment without making reference to their respective depreciated replacement costs. Since the future undiscounted cash flows of the Group's fixed assets exceed the historical costs of such fixed assets, no impairment of such assets is recognized under U.S. GAAP. Accordingly, the carrying value of the fixed assets injected by China Netcom Group reported under U.S.GAAP was higher than the carrying value of those assets reported under HKFRS and the carrying value of the investment in subsidiaries under US GAAP was also higher than the carrying value of the investment under HKFRS.

(c) Please refer to Note (d) of Section A above.

(d) Please refer to Note (f) of Section A above.

CHINA NETCOM GROUP CORPORATION (HONG KONG) LIMITED

NOTES TO THE FINANCIAL STATEMENTS

41 Reconciliation of HKFRS and Accounting Principles Generally Accepted in the United States ("U.S. GAAP") (continued)

(C) Recent HK Accounting Pronouncements

The HKICPA has issued a number of new and revised HKFRSs and HKFRS Interpretations ("HKFRS - Ints"), and HKAS and HKAS Interpretations ("HKAS - Ints") as set out in Note 4(x) to the Group's financial statements which are effective for accounting periods beginning on or after January 1, 2006. The Group has not early adopted these new and revised standards and interpretations in the financial statements for the year ended December 31, 2005. The Group has commenced an assessment of the impact of these new and revised standards and interpretations, but is not yet in a position to state whether these new and revised standards and interpretations would have a significant impact on its results of operations and financial position.

(D) Recent U.S. Accounting Pronouncements

SFAS No. 123R

Revised SFAS No. 123 ("SFAS No. 123R") is a revision of FASB Statement No. 123, Accounting for Stock-Based Compensation ("SFAS No. 123") and superseded APB 25, Accounting for Stock Issued to Employees, and its related implementation guidance. SFAS No. 123 establishes standards for the accounting for transactions in which an entity exchanges its equity instruments for goods or services that are based on the fair value of the entity's equity instruments or that may be settled by the issuance of those equity instruments. SFAS No. 123R requires all share-based payments to employees, including grants of employee stock options, to be recognized in the financial statements based on their grant date fair values. SFAS No. 123R is effective as at the beginning of the first interim or annual reporting period that begins after June 15, 2005 for public entities that do not file as small business issuers. The Company is required to adopt SFAS No. 123R in the fiscal year beginning January 1, 2006.

In March 2005, the SEC issued Staff Accounting Bulletin No. 107 ("SAB No. 107") regarding the SEC's interpretation of SFAS No. 123R and the valuation of share-based payments for public companies. SAB No. 107 provides the staff's view regarding the valuation of share-based payment arrangements for public companies. In particular, SAB No. 107 provides guidance related to share-based payment transactions with non-employees, the transition from non public to public entity status, valuation methods (including assumptions such as expected volatility and expected term), the accounting for certain redeemable financial instruments issued under share-based payment arrangements, the classification of compensation expense, non-GAAP financial measures, first time adoption of SFAS No. 123R, the modification of employee share options prior to the adoption of SFAS No. 123R and disclosure in Management's Discussion and Analysis subsequent to

adoption of SFAS No. 123R.

Upon the adoption of retrospective restatement transitional method under SFAS No. 148 in the fiscal year 2005, the Company has retrospectively restated the prior year financial statements to recognize the share-based compensation to give effect to the fair-value-based method of accounting for all awards granted on a basis consistent with the pro forma disclosures required for those periods by SFAS No. 123.

41 Reconciliation of HKFRS and Accounting Principles Generally Accepted in the United States ("U.S. GAAP") (Continued)

(D) Recent U.S. Accounting Pronouncements (continued)

SFAS No. 151

SFAS No. 151 amends and clarifies the accounting for abnormal amounts of idle facility expense, freight, handling costs and wasted material (spoilage). It requires that allocation of fixed production overheads to the costs of conversion be based on the normal capacity of the production facilities. SFAS No. 151 is effective for inventory costs incurred during the fiscal years beginning after June 15, 2005. The Company is required to adopt SFAS No. 151 in the fiscal year beginning January 1, 2006. The Company considered the effects of adoption SFAS No. 151 does not have material impact on its financial statements.

SFAS No. 153

SFAS No. 153 amends APB Opinion No. 29 on Accounting for Non-monetary Transactions, to eliminate the exception for nonmonetary exchanges of similar productive assets and replaces it with a general exception of exchanges of nonmonetary assets that do not have commercial substance. It defines `a nonmonetary exchange has commercial substance if the future cash flows of the entity are expected to change significantly as a result of the exchange. SFAS No. 153 is effective for nonmonetary asset exchanges occurring in fiscal periods beginning after June 15, 2005. The Company is required to adopt SFAS No. 153 in the fiscal year beginning January 1, 2006. The Company considered the effects of adoption SFAS No. 153 does not have material impact on its financial statements.

41 Reconciliation of HKFRS and Accounting Principles Generally Accepted in the United States ("U.S. GAAP") (continued)

(D) Recent U.S. Accounting Pronouncements (continued)

EITF 05-06

In June 2005, the Emerging Issues Task Force (EITF) issued EITF 05-06, `Amortization periods for leasehold improvements purchased after lease inception or acquired in a business combination'. EITF 05-06 provides guidance on determining amortization periods for leasehold improvements purchased after lease inception or acquired in a business combination. Effective for leasehold improvements (within the scope of this Issue) purchased or acquired in reporting periods beginning after June 29 2005. The Company is required to adopt EITF 05-06 in the fiscal year beginning January 1, 2006. The Company is in the process of assessing the impact of EITF 05-06.

SFAS No. 154

SFAS No. 154 replaces APB Opinion No. 20, Accounting Changes, and FASB Statement No. 3, Reporting Accounting Changes in Interim Financial Statements, and changes the requirements for the accounting for and reporting of a change in accounting principle. The statement establishes, unless impracticable, retrospective application as the required method for reporting a change in accounting principle in the absence of explicit transition requirements specific to the newly adopted accounting principle. Effective for accounting changes and corrections of errors made in fiscal years beginning after December 15, 2005. The Company is required to adopt SFAS No. 154 in the fiscal year beginning January 1, 2006. The Company considered the effects of adoption SFAS No. 154 does not have material impact on its financial statements.

FSP No. FAS 13-1

In October 2005, FASB Staff Positions (FSP) issued FSP No. FAS 13-1, `Accounting for Rental Costs Incurred during a Construction Period' which addresses the accounting for rental costs associated with operating leases that are incurred during a construction period. Given that there is no distinction between the right to use a leased asset during the construction period and the right to use that asset after the construction period, rental costs associated with ground or building operating leases that are incurred during a construction period shall be recognized as rental expense. The rental costs shall be included in income from continuing operations. The guidance in this FSP shall be applied to the first reporting period beginning after December 15, 2005. The Company is required to adopt FSP No. FAS 13-1 in the fiscal year beginning January 1, 2006. The Company is in the process of assessing the impact of this guidance.