CHINA TELECOM CORP LTD
Form 20-F
March 31, 2004

SECURITIES AND EXCHANGE COMMISSION

Washington, DC 20549

FORM 20-F

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

OR

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the fiscal year ended December 31, 2003
OR

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

Commission file number 1-31517

(Exact Name of Registrant as Specified in Its Charter)

China Telecom Corporation Limited
(Translation of Registrant's Name into English)

The People's Republic of China
(Jurisdiction of Incorporation or Organization)

31 Jinrong Street, Xicheng District
Beijing, China 100032
(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	New York Stock Exchange, Inc.
H shares, par value RMB1.00 per share	New York Stock Exchange, Inc.*

* Not for trading, but only in connection with the listing on the New York Stock Exchange, Inc. of American depositary shares, each representing 100 H 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, 2003, 67,586,776,503 domestic shares and 8,027,410,000 H shares, par value RMB1.00 per share, were issued and outstanding. H shares are ordinary shares of the Company listed on The Stock Exchange of Hong Kong Limited.

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

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

CHINA TELECOM CORPORATION LIMITED

TABLE OF CONTENTS

Back to Contents

Forward-Looking Statements

This annual report contains certain forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. These forward-looking statements are, by their nature, subject to significant risks and uncertainties, and include, without limitation, statements relating to:

- our business and operating strategies;
- our network expansion and capital expenditure plans;
- our operations and business prospects;
- our financial condition and results of operations;
- the industry regulatory environment as well as the industry outlook generally; and
- future developments in the telecommunications industry in China.

The words “anticipate,” “believe,” “could,” “estimate,” “expect,” “intend,” “may,” “plan,” “seek,” “will,” “would” and simila expressions, as they relate to us, are intended to identify a number of these forward-looking statements.

These forward-looking statements are subject to risks, uncertainties and assumptions, some of which are beyond our control. In addition, these forward-looking statements reflect our current views with respect to future events and are not a guarantee of future performance. We do not intend to update these forward-looking statements. Actual results may differ materially from the information contained in the forward-looking statements as a result of a number of factors, including, without limitation, the risk factors set forth in “Item 3. Key Information — D. Risk Factors” and the following:

- any changes in the regulatory policies of the Ministry of Information Industry and other relevant government authorities relating to, among other matters:
  - the granting and approval of licenses;
  - tariff policies;
  - interconnection and settlement arrangements;
  - capital investment priorities;
  - the provision of telephone services to rural areas in China; and
  - numbering resources allocation;
- the effects of competition on the demand for and price of our services;
- the development of new technologies and applications or services affecting our current and future businesses;

Back to Contents

- changes in political, economic, legal and social conditions in China, including the Chinese government's specific policies with respect to foreign investment in the telecommunications industry, economic growth, inflation, foreign exchange and the availability of credit; and

- changes in population growth and gross domestic product, or GDP, growth and the impact of those changes on the demand for our services.

Certain Definitions and Conventions

As used in this annual report, references to "us", "we", the "Company" and "China Telecom" are to China Telecom Corporation Limited and all of its consolidated subsidiaries except where we make clear that the term means China Telecom Corporation Limited or a particular subsidiary or business group only. References to matters relating to our H shares or ADSs or matters of corporate governance are to the H shares, ADSs and corporate governance of China Telecom Corporation Limited. In respect of any time prior to our incorporation, references to "us", "we" and "China Telecom" are to the telecommunications businesses in which our predecessors were engaged and which were subsequently assumed by us. All references to "China Telecom Group" are to China Telecommunications Corporation, our controlling shareholder. Unless the context otherwise requires, these references include all of its subsidiaries, including us and our subsidiaries.

On December 31, 2003, we acquired the entire equity interests in each of Anhui Telecom Company Limited, Fujian Telecom Company Limited, Jiangxi Telecom Company Limited, Guangxi Telecom Company Limited, Chongqing Telecom Company Limited and Sichuan Telecom Company Limited from China Telecom Group. As we and these acquired companies were under the common control of China Telecom Group, our acquisition of the acquired companies has been treated as a "combination of entities under common control", which was accounted for in a manner similar to a pooling-of-interests. As presented in this annual report, all data and information relating to our business and operations include the data and information relating to the business and operations of the acquired companies.

Back to Contents

PART I

Item 1. Identity of Directors, Senior Management and Advisers.

Not applicable.

Item 2. Offer Statistics and Expected Timetable.

Not applicable.

Item 3. Key Information.

A. Selected Financial Data

The following table presents our selected financial data. The selected balance sheet data as of December 31, 2002 and 2003, and the selected income statement data and cash flow data for each of the years ended December 31, 2001, 2002 and 2003, are derived from our audited financial statements included elsewhere in this annual report, and should be read in conjunction with our audited financial statements and operating and financial review and prospects included elsewhere in this annual report. The selected balance sheet data as of December 31, 1999, 2000 and 2001 and the selected income statement and cash flow data for each of the years ended December 31, 1999 and 2000 are derived from our audited financial statements, which are not included in this annual report. Our audited financial statements are prepared and presented in accordance with International Financial Reporting Standards, or IFRS, which differ in certain significant respects from accounting principles generally accepted in the United States, or US GAAP. Information relating to the nature and effect of significant differences between IFRS and US GAAP, as they relate to us, is presented in Note 33 to the audited financial statements included elsewhere in this annual report.

The selected financial data reflect the restructuring in 2001 and the acquisition in 2003 described under “Item 4. Information on the Company — A. History and Development of the Company — Our Restructuring and Initial Public Offering” and “ — The Acquisition in 2003”, respectively, and have been prepared as if our current structure had been in existence throughout the relevant periods.

Since China Telecom Group controlled the telecommunications operations and the related assets transferred to us prior to our restructuring and continues to control us after our restructuring, the financial data of the telecommunications operations in Shanghai Municipality, Guangdong Province, Jiangsu Province and Zhejiang Province transferred to us by China Telecom Group for periods prior to our incorporation have been combined in a manner similar to a pooling-of-interests. The assets and liabilities of the entities being combined are carried forward at their recorded historical amounts, and the book value of the assets and liabilities, as well as the revenue and expenses of each of these entities for the periods prior to our incorporation, are added together to prepare our financial statements.

On December 31, 2003, we acquired the entire equity interests in each of Anhui Telecom Company Limited, Fujian Telecom Company Limited, Jiangxi Telecom Company Limited, Guangxi Telecom Company Limited, Chongqing Telecom Company Limited and Sichuan Telecom Company Limited from China Telecom Group. As we and these acquired companies were under the common control of China Telecom Group, our acquisition of the acquired companies has been treated as a “combination of entities under common control”, which was accounted for in a manner similar to a pooling-of-interests. Accordingly, the assets and liabilities of the acquired companies have been accounted for at historical amounts and our financial statements for periods prior to the acquisition have been restated to include the financial position and results of operations of the acquired companies on a combined basis. Unless otherwise indicated in this section, our financial data for periods prior to the acquisition are presented based on those restated amounts.

Back to Contents

In connection with our restructuring in 2001, China Telecom Group retained the ownership of certain assets that were historically associated with our operations and primarily consisted of investments in non-telecommunications industries, inter-provincial optic fibers, international gateway and international transmission equipment, telecommunications equipment for special communications services, and certain office equipment, properties and buildings. In connection with our acquisition in 2003, China Telecom Group retained the ownership of certain assets that were historically associated with our operations and primarily consisted of investments in non-telecommunications industries and certain properties and buildings. Except for the income statement data for the year ended December 31, 2003, the income statement data for the other periods presented below include the results of the assets retained by China Telecom Group. The results of such assets are not reflected in our income statement for periods beginning after December 31, 2002. Except for the balance sheet data as of December 31, 2002 and 2003, the balance sheet data as of other dates presented below include data related to the assets retained by China Telecom Group. These assets are not reflected in our balance sheet as of and after December 31, 2002.

	As of or for the year ended December 31,					
	1999 RMB	**2000 RMB**	**2001 RMB**	**2002 RMB**	**2003 RMB**	**2003 US$**
	(in millions, except share numbers and per share and per ADS data)					
Income Statement Data:						
IFRS						
Operating revenue	92,107	101,433	100,497	109,564	118,451	14,311
Operating expenses	(60,046)	(72,170)	(77,881)	(83,567)	(86,003)	(10,391)
Operating income	32,061	29,263	22,616	25,997	32,448	3,920
Income before income tax and minority interests(2)	31,167	29,015	10,133	9,263	30,675	3,706
Income tax	(6,409)	(5,596)	(161)	582	(5,933)	(717)
Net income	24,657	23,344	9,986	9,773	24,686	2,983
Basic earnings per share(1)	0.36	0.34	0.15	0.14	0.33	0.04
Basic earnings per ADS(1)	36.09	34.17	14.62	14.11	32.65	3.95
U.S. GAAP						
Net income	24,657	23,344	17,888	18,545	22,006	2,659
Basic earnings per share(1)	0.36	0.34	0.26	0.27	0.29	0.04
Basic earnings per ADS(1)	36.09	34.17	26.18	26.78	29.10	3.52
Balance Sheet Data:						
IFRS						
Cash and cash equivalents	22,055	18,358	7,697	18,685	10,119	1,222
Accounts receivable, net	10,673	10,890	8,536	9,058	10,187	1,231
Property, plant and equipment, net(2)	180,807	202,659	221,333	220,761	235,211	28,418
Total assets(2)	276,544	301,250	299,088	303,611	305,605	36,923
Short-term debt(3)	19,600	23,454	33,914	40,336	40,097	4,845
Accounts payable	16,424	22,218	24,071	21,728	20,129	2,432
Long-term obligations	25,366	22,814	22,160	17,676	49,684	6,003
Deferred revenues (excluding current portion)	46,771	43,879	38,465	31,735	25,389	3,068
Total liabilities	156,494	166,101	162,944	149,577	173,064	20,910
Shareholders' equity(2)	119,128	134,158	135,156	152,848	131,272	15,860
U.S. GAAP						
Property, plant and equipment, net	180,807	202,659	229,109	240,870	251,320	30,365
Total assets	276,544	301,250	306,864	323,720	321,714	38,870
Shareholders' equity	119,128	134,158	140,274	166,229	141,973	17,153

Cash Flow Data:

IFRS

Cash flows from operating activities	50,483	49,641	46,648	52,158	46,884	5,665
Net cash used in investing activities[4]	(41,505)	(49,832)	(55,844)	(47,060)	(40,781)	(4,927)
Capital expenditures[4]	(41,999)	(48,507)	(54,625)	(45,807)	(41,825)	(5,053)
Net cash (used in) / from financing activities	(4,298)	(3,506)	(1,465)	5,890	(14,669)	(1,773)

Back to Contents

(1) The basic earnings per share has been calculated based on the net income of RMB24,657 million, RMB23,344 million, RMB9,986 million, RMB9,773 million and RMB24,686 million, respectively, for the years ended December 31, 1999, 2000, 2001, 2002 and 2003, and the weighted average number of shares in issue during the relevant year of 68,317,270,803, 68,317,270,803, 68,317,270,803, 69,241,674,942 and 75,614,186,503 shares, respectively, as if the 68,317,270,803 shares issued and outstanding upon our formation on September 10, 2002 had been outstanding for all periods presented. Basic earnings per ADS has been computed as if all of our issued and outstanding shares, including domestic shares and H shares, are represented by ADSs during each of the years presented. Each ADS represents 100 H shares.

(2) Includes the effect of the revaluation of property, plant and equipment as of December 31, 2001 in connection with our restructuring and as of December 31, 2002 in connection with our acquisition. See Note 7 to our audited financial statements.

(3) Excludes current portion of long-term debt.

(4) Capital expenditures are part of and not an addition to net cash used in investing activities.

We declared dividends for the year ended December 31, 2002 on the basis of HK$0.065 per share, pro-rated based on the number of days that our shares had been listed during 2002. Holders of our ADRs received a dividend of USD0.008 per share in 2002, pro-rated based on the number of days that our shares had been listed during 2002, based on the exchange rate of HK$7.8010=US$1.00.

Exchange Rate Information

Our financial statements are expressed in Renminbi. Solely for the convenience of the reader, this annual report contains translations of certain Renminbi and Hong Kong dollar amounts into U.S. dollars and vice versa at RMB8.2767 = US$1.00 and HK$7.7640 = US$1.00, the noon buying rates in New York City for cable transfers as certified for customs purposes by the Federal Reserve Bank of New York on December 31, 2003. These translations should not be construed as representations that the Renminbi or Hong Kong dollar amounts could have been or could be converted into U.S. dollars at such rates or at all.

The noon buying rates in New York City for cable transfers as certified for customs purposes by the Federal Reserve Bank of New York were RMB8.2771 = US$1.00 and HK$7.7963 = US$1.00, respectively, on March 30, 2004. 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 month during the previous six months:

Noon Buying Rate

	RMB per US$1.00			**HK$ per US$1.00**	
	High	**Low**		**High**	**Low**
September 2003	8.2775	8.2768	September 2003	7.7999	7.7444
October 2003	8.2776	8.2765	October 2003	7.7684	7.7085
November 2003	8.2772	8.2766	November 2003	7.7692	7.7475
December 2003	8.2772	8.2765	December 2003	7.7670	7.7628
January 2004	8.2772	8.2767	January 2004	7.7775	7.7632
February 2004	8.2773	8.2769	February 2004	7.7845	7.7686
March 2004 (as of March 30)	8.2774	8.2767	March 2004 (as of March 30)	7.7980	7.7842

The following table sets forth the average noon buying rates between Renminbi and U.S. dollars and between Hong Kong dollars and U.S. dollars for each of 1999, 2000, 2001, 2002 and 2003, calculated by averaging the noon buying rates on the last day of each month during each of the relevant years.

	Average Noon Buying Rate	
	RMB per US$ 1.00	**HK$ per US$1.00**
1999	8.2785	7.7599
2000	8.2784	7.7936
2001	8.2772	7.7996
2002	8.2772	7.7996
2003	8.2771	7.7864

B. Capitalization and Indebtedness

Not applicable.

Back to Contents

C. Reasons for the Offer and Use of Proceeds

Not applicable.

D. Risk Factors

Risks Relating to Our Business

We face increasing competition, which may adversely affect our business growth and results of operations.

The telecommunications industry in China is rapidly evolving. Until the mid-1990s, we were the sole provider of wireline telecommunications services in our service regions, which included Shanghai Municipality, Guangdong Province, Jiangsu Province, Zhejiang Province, Anhui Province, Fujian Province, Jiangxi Province, Guangxi Zhuang Autonomous Region, Chongqing Municipality and Sichuan Province. As a result, we had a dominant market position in our service regions. We began to operate in a competitive market as the Chinese government started to implement a number of measures to restructure the telecommunications industry and encourage fair and orderly competition in the industry in the mid-1990s. We face increasing competition from other telecommunications service providers in China. We expect our competitors to expand further their network coverage and increase their sales and marketing efforts in our service regions. See "Item 4. Information on the Company — B. Business Overview — Competition." In particular:

- we face indirect competition in our local wireline telephone services from China's two mobile telephone service providers, China Mobile Communications Corporation, or China Mobile, and China United Telecommunications Corporation, or China Unicom, and have begun to face direct competition from China Railway Communication Co., Ltd., or China Railcom, and China Network Communications Group Corporation, or China Netcom Group;

- we face increasingly intense competition in our long distance telephone services from other providers of long distance services using public switched telephone networks, including China Unicom, China Railcom and China Netcom Group, and other providers of long distance services using the voice-over-Internet-protocol, or VoIP, technology, including China Mobile, China Unicom, China Netcom Group and China Railcom;

- we face increasing competition in our Internet and managed data services from many competitors, including, primarily, China Unicom, China Netcom Group, China Mobile and China Railcom; and

- we may face additional competition from new entrants or providers of new telecommunications services, such as telephone and Internet services offered over cable TV networks.

Moreover, as a result of China's accession to the World Trade Organization, or the WTO, and China's commitment under its WTO Accession Protocol, the Chinese government will gradually open up the telecommunications market in China to foreign operators. See "Item 4. Information on the Company — B. Business Overview — Regulatory and Related Matters — Licensing." Foreign operators may have greater financial, managerial and technical resources and more expertise in network management and sales and marketing. Furthermore, advances in technology, as well as changes in the regulatory environment, may further intensify competition.

Back to Contents

Our ability to compete effectively may be constrained by a number of factors. For example, under the Chinese government’s policy of promoting fair and orderly competition in the telecommunications industry, certain competitors of ours, such as China Unicom and China Railcom, continue to enjoy certain preferential treatment from the Chinese government in tariff setting. They may set their respective tariffs for long distance services using public switched telephone networks and leased line services at levels below the tariffs of our company with the annual approval of the regulatory authorities. This preferential treatment is not available to us. As a result, our competitors who enjoy this preferential treatment may be able to provide their services at prices that are more competitive than ours. In addition, we are not yet permitted to provide mobile communications services. We, through China Telecom Group, are, however, actively seeking the issuance of a license for mobile communications in the PRC. We can provide no assurances, however, as to whether or when we may be able to receive any benefit of any license for mobile communications in China.

As a result, our customers may choose to use other providers’ services. Increased competition from those providers may force us to lower our tariffs to the extent permitted under relevant laws and regulations, may reduce or reverse the growth of our customer base and may reduce usage of our networks. Any of these developments could materially adversely affect our business growth and results of operations.

We will continue to be controlled by China Telecom Group, which could cause us to take actions that may conflict with the best interests of our other shareholders.

China Telecom Group currently owns approximately 77.78% of our outstanding shares. Accordingly, subject to our articles of association and applicable laws and regulations, China Telecom Group will continue to be able to exercise significant influence over our management and policies by:

- controlling the election of our directors and, in turn, indirectly controlling the selection of our senior management;
- determining the timing and amount of our dividend payments;
- approving our annual budgets;
- deciding on increases or decreases in our share capital;
- determining issuance of new securities;
- approving mergers and acquisitions; and
- amending our articles of association.

The interests of China Telecom Group as our controlling shareholder could conflict with our interests or the interests of our other shareholders. As a result, China Telecom Group may take actions with respect to our business that may not be in our or our other shareholders’ best interests.

The letter of undertakings provided to us by China Telecom Group contains vague terms that may not be implemented as we expect.

Back to Contents

China Telecom Group has provided us a letter of undertakings, under which it has undertaken to support us in our existing operations and future development in the following specific areas:

- to treat us equally with any other operators of wireline telephone, Internet and managed data, leased line and other related telecommunications services that are controlled by China Telecom Group;

- to give us the right to provide additional telecommunications services in our service regions that fall within the business scope of China Telecom Group; and

- to give us the preferential right to acquire China Telecom Group’s interest in companies or other entities that provide telecommunications services.

The current terms of the letter of undertakings do not obligate China Telecom Group to provide any financial support to us. The letter of undertakings may not be implemented as we expect due to the vagueness of its terms. Other than the letter of undertakings, we have not entered into any agreement with China Telecom Group to provide for potential allocation of business opportunities between China Telecom Group and us outside our service regions.

We depend on China Telecom Group and its other subsidiaries to provide certain services and facilities for which we currently have limited alternative sources of supply.

In addition to being our controlling shareholder, China Telecom Group, by itself and through its other subsidiaries, also provides us with services and facilities necessary for our business activities, including, but not limited to:

- use of international gateway facilities;

- provision of services in areas outside our service regions necessary to enable us to provide end-to-end services to our customers;

- use of nationwide inter-provincial optic fibers; and

- lease of properties.

The interests of China Telecom Group and its other subsidiaries as providers of these services and facilities may conflict with our interests. We currently have limited alternative sources of supply for these services. Therefore, we have limited leverage in negotiating with China Telecom Group and its other subsidiaries over the terms for the provision of these services. See “Item 7. Major Shareholders and Related Party Transactions — B. Related Party Transactions” for a detailed description of the services provided by China Telecom Group and its other subsidiaries.

Since our services require interconnection with networks of other operators, disruption in interconnections with those networks could have a material adverse effect on our business and results of operations.

Under the relevant telecommunications regulations, telecommunications operators are required to interconnect with networks of other operators. We have entered into interconnection arrangements with other telecommunications operators. Any disruption of our interconnection with the networks of those operators could have a material adverse effect on our business and results of operations. In particular, as a result of the restructuring of China’s wireline telecommunications sector, most wireline telecommunications assets except for the nationwide inter-provincial optic fibers, including the last-mile access network, formerly owned by China Telecom Group in ten northern provinces in China were allocated to China Netcom Group. As we and China Telecom Group have limited local access facilities in those ten provinces, we will need to interconnect, indirectly through China Telecom Group, with China Netcom Group in order to provide end-to-end services to our customers with operations in the ten northern provinces. Any interruption in our interconnection with China Netcom Group could have a material adverse effect on our business and results of operations.

Back to Contents

If we are not able to respond successfully to technological or industry developments, our business may be adversely affected.

The telecommunications market is characterized by rapid advancements in technology, evolving industry standards and changes in customer needs. We cannot assure you that we will be successful in responding to these developments. In addition, new services or technologies may render our existing services or technologies less competitive. In the event we do take measures to respond to technological developments and industry standard changes, the integration of new technology or industry standards or the upgrading of our networks may require substantial time, effort and capital investment. We cannot assure you that we will succeed in integrating these new technologies and industry standards or adapting our network system in a timely and cost-effective manner, or at all. Our inability to respond successfully to technological or industry developments may adversely affect our business, results of operations and competitiveness.

We face a number of risks relating to our Internet-related businesses.

We currently provide a range of Internet-related services, including dial-up and broadband Internet access and Internet-related applications. We face a number of risks in providing these services.

Our network may be vulnerable to unauthorized access, computer viruses and other disruptive problems. There is no assurance that the security measures we have implemented will not be circumvented or otherwise fail to protect the integrity of our network. Unauthorized access could jeopardize the security of confidential information stored in our customers' computer systems. Eliminating computer viruses and other security problems may also require interruptions, delays or suspension of our services, cause us to incur costs and divert management attention.

In addition, because we provide connections to the Internet and host websites for customers and develop Internet content and applications, we may be perceived as being associated with the content carried over our network or displayed on websites that we host. We cannot and do not screen all of this content and we may face litigation claims due to a perceived association with this content. These types of claims have been brought against other providers of online services in the past and can be costly to defend regardless of the merits of the lawsuit and may damage our reputation.

If the new applications adopted by us do not perform as expected, or if we are unable to deliver commercially viable services based on these applications, our revenue and profitability may not grow as we expect.

We are pursuing a number of new growth opportunities in the broader telecommunications industry, including advanced data and broadband information and application services. These opportunities relate to new services for which there are no established markets in China. Our ability to deploy and deliver these new services depends, in many instances, on the development of new applications, which may not be developed successfully or may not perform as we expect.

In addition, the success of our broadband Internet services is substantially dependent on the availability of content, applications and devices provided by third-party developers. If we are unable to deliver commercially viable new services, our revenue and profitability will not grow as we expect and our competitiveness may be adversely affected.

Back to Contents

Risks Relating to the Telecommunications Industry in China

Extensive government regulation of the telecommunications industry may limit our flexibility in responding to market conditions, competition or changes in our cost structure.

Our businesses are subject to extensive government regulation. The Ministry of Information Industry, which is the primary telecommunications industry regulator under China's State Council, regulates, among other things:

- industry policies and regulations;
- licensing;
- tariffs;
- competition;
- telecommunications resource allocation;
- service standards;
- technical standards;
- interconnection and settlement arrangements; and
- universal service obligations.

Other Chinese governmental authorities also take part in regulating tariff policies, capital investment and foreign investment in the telecommunications industry. Major capital investments, including telecommunications network development projects, are subject to the approval of relevant Chinese government authorities. See "Item 4. Information on the Company — B. Business Overview — Regulatory and Related Matters — Capital Investment." The regulatory framework within which we operate may constrain our ability to implement our business strategies and limit our flexibility to respond to market conditions or to changes in our cost structure.

Our revenues may be adversely affected by reductions in tariffs mandated by the Chinese government.

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. Currently, the relevant provincial communications administrations and provincial price bureaus determine the monthly fee and usage fee tariffs for our wireline local telephone services, based on a guidance tariff range set by the Ministry of Information Industry in consultation with the State Development and Reform Commission. The Ministry of Information Industry and the State Development and Reform Commission jointly set tariffs for all domestic and international, Hong Kong, Macau and Taiwan long distance services using public switched telephone networks, leased lines and data services. See "Item 4. Information on the Company — B. Business Overview — Regulatory and Related Matters — Tariff Setting." We derive a substantial portion of our revenues from services that are subject to tariffs determined by the Chinese government. In the past, our revenues have been adversely affected by reductions in tariffs mandated by the Chinese government. In September 2002, the Ministry of Information Industry indicated in writing that it does not intend to initiate any adjustment to tariffs for wireline local telephone services during the next three to five years. We believe therefore that the risk of adjustment of such tariffs in such period has been substantially reduced. However, we cannot predict with accuracy or assure you on the timing, likelihood or likely magnitude of tariff adjustments generally or the extent or potential impact on our business of future tariff adjustments. We cannot assure you that our business or results of operations will not be adversely affected by any government-mandated tariff adjustments in the future.

Back to Contents

Future changes to the regulations and policies governing the telecommunications industry in China may have a material adverse effect on our business and operations.

Possible future changes to regulations and policies of the Chinese government governing the telecommunications industry could adversely affect our business and operations. For example, to provide a uniform regulatory framework for the orderly development of the telecommunications industry, the Chinese government is currently preparing a draft telecommunications law. If and when the telecommunications law is adopted by the Standing Committee of the National People’s Congress, it is expected to provide a new regulatory framework for telecommunications regulation in China. The contents of the draft telecommunications law have not yet been made public. We cannot be certain how this law will affect our business and operations and whether it will contain provisions more stringent than the current telecommunications regulations.

As part of the comprehensive plan to restructure China Telecom Group, as approved by China’s State Council in November 2001, the Chinese government stated its intention to further adjust and improve its regulatory oversight of the telecommunications industry, including gradual further deregulation of telecommunications tariffs. We cannot assure you that future regulatory changes, such as those concerning tariff setting, interconnection and competition, will not have a material adverse effect on our business and operations.

The Chinese government may require us, along with other providers in China, to provide universal services with specified obligations, and we may not be compensated adequately for providing such services.

Under the Telecommunications Regulations promulgated by the State Council, telecommunications service providers in China are required to fulfill universal service obligations in accordance with relevant regulations to be promulgated by the Chinese government, and the Ministry of Information Industry has the authority to delineate the scope of universal service obligations. The Ministry of Information Industry may also select universal service providers through a tendering process. The Ministry of Information Industry, together with government 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.

We may not be able to realize adequate return on investments for expanding networks to, and providing telecommunications services in, those economically less developed areas due to potentially higher capital expenditure requirements, lower usage by customers and lack of flexibility in setting our tariffs. As a result, our financial condition and results of operations could be adversely affected.

Back to Contents

Risks Relating to the People's Republic of China

Substantially all of our assets are located in China and substantially all of our revenue is derived from our operations in China. Accordingly, our results of operations and prospects are subject, to a significant extent, to the economic, political and legal developments in China.

China's economic, political and social conditions, as well as government policies, could affect our business.

Substantially all of our businesses, assets and operations are located in China. The economy of China differs from the economies of most developed countries in many respects, including:

- government involvement;
- level of development;
- growth rate;
- control of foreign exchange; and
- allocation of resources.

While China's economy has experienced significant growth in the past twenty years, growth has been uneven, both geographically and among various sectors of the economy. The Chinese government has implemented various measures to encourage economic growth and guide the allocation of resources. 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 changes in tax regulations applicable to us.

The economy of China has been transitioning from a planned economy to a more market-oriented economy. Although in recent years the Chinese government has implemented measures emphasizing the utilization of market forces for economic reform, the reduction of state ownership of productive assets and the establishment of sound corporate governance in business enterprises, a substantial portion of productive assets in China is still owned by the Chinese government. In addition, the Chinese government continues to play a significant role in regulating industry development by imposing industrial policies. It also exercises significant control over China's economic growth through the allocation of resources, controlling payment of foreign currency-denominated obligations, setting monetary policy and providing preferential treatment to particular industries or companies. We cannot predict the purpose and effect of future economic policies of the PRC government or the impact of such economic policies on our business and operations.

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

We receive substantially all of our revenues in Renminbi, which currently is not a freely convertible currency. A portion of these revenues must be converted into other currencies to meet our foreign currency obligations. These foreign currency-denominated obligations include:

- payment of interest and principal on foreign currency-denominated debt;
- payment for equipment and materials purchased offshore; and
- payment of dividends declared, if any, in respect of our H shares.

Back to Contents

Under China's existing foreign exchange regulations, we will be able to pay dividends in foreign currencies without prior approval from the State Administration of Foreign Exchange by complying with certain procedural requirements. However, the Chinese government may take measures at its discretion in the future to restrict access to foreign currencies for both current account transactions and capital account transactions if foreign currencies become scarce in China. We may not be able to pay dividends in foreign currencies to our shareholders, including holders of our ADRs, if the Chinese government restricts access to foreign currencies for current account transactions.

Foreign exchange transactions under our capital account, including foreign currency-denominated borrowings from foreign banks, issuance of foreign currency-denominated debt securities, if any, and principal payments in respect of foreign currency-denominated obligations, continue to be subject to significant foreign exchange controls and require the approval of the State Administration of Foreign Exchange. These limitations could affect our ability to obtain foreign exchange through debt or equity financing, or to obtain foreign exchange to meet our payment obligations under the debt securities, if any, or to obtain foreign exchange for capital expenditures.

Fluctuation of the Renminbi could materially affect our financial condition and results of operations.

We receive substantially all of our revenues, and our financial statements are presented, in Renminbi. The value of the Renminbi fluctuates and is subject to changes in China's political and economic conditions. Since 1994, the conversion of Renminbi into foreign currencies, including Hong Kong and U.S. dollars, has been based on rates set by the People's Bank of China, which are set daily based on the previous day's interbank foreign exchange market rates and current exchange rates on the world financial markets. Fluctuations in exchange rates may adversely affect the value, translated or converted into United States dollars or Hong Kong dollars, of our net assets, earnings and any declared dividends payable on our H shares in foreign currency terms. Our financial condition and results of operations may also be affected by changes in the value of certain currencies other than the Renminbi, in which our obligations are denominated. In particular, a devaluation of the Renminbi is likely to increase the portion of our cash flow required to satisfy our foreign currency-denominated obligations. For further information on our foreign exchange risks and certain exchange rates, see "Item 3. Key Information — A. Selected Financial Data — Exchange Rate Information" and "Item 11. Quantitative and Qualitative Disclosure About Market Risk — Foreign Exchange Rate Risk." We cannot assure you that any future movements in the exchange rate of Renminbi against the United Sates dollar or other foreign currencies will not adversely affect our results of operations and financial condition.

The PRC legal system has inherent uncertainties that could limit the legal protections available to you.

We are organized under the laws of the PRC and are governed by our articles of association. 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 Chinese government has promulgated laws and regulations dealing with economic matters such as foreign investment, corporate organization and governance, commerce, taxation and trade. However, because these laws and regulations are relatively new, and because of the limited volume of published cases and their non-binding nature, interpretation and enforcement of these laws and regulations involve uncertainties.

Back to Contents

of the limited volume of published cases and their non-binding nature, interpretation and enforcement of these laws and regulations involve uncertainties.

The direct enforcement by our shareholders of any rights of shareholders in respect of violations of corporate governance procedures may be limited. In this regard, our articles of association provide that most disputes between holders of H shares and our company, directors, supervisors, officers or holders of domestic shares, arising out of our articles of association or the PRC Company Law and related regulations concerning the affairs of our company, are to be resolved through arbitration by arbitration tribunal in Hong Kong or China, rather than by a court of law. Awards that are made by Chinese arbitral authorities recognized under the Arbitration Ordinance of Hong Kong can be enforced in Hong Kong. Hong Kong arbitration awards are also enforceable in China. However, to our knowledge, no action has been brought in China by any holder of H shares to enforce an arbitral award, and we are uncertain as to the outcome of any action brought in China to enforce an arbitral award made in favor of holders of H shares. See “Item 10. Additional Information B. Articles of Association.”

To our knowledge, there has not been any published report of judicial enforcement in China by holders of H shares of their rights under articles of association or the PRC Company Law.

Unlike in the United States, under applicable laws of China, shareholders do not have the right to sue the directors, supervisors, officers or other shareholders on behalf of the corporation to enforce a claim against such party or parties that the corporation has failed to enforce itself. Our shareholders may have to rely on other means to enforce directly their rights, such as through administrative proceedings. Chinese laws and regulations applicable to overseas listed companies do not distinguish among minority, affiliated and unaffiliated shareholders in terms of their rights and protections. In addition, our minority shareholders may not have the same protections afforded to them by companies incorporated under the laws of the United States.

Although we will be subject to the Hong Kong Stock Exchange Listing Rules, or the Listing Rules, and the Hong Kong Codes on Takeovers and Mergers and Share Repurchases, or the Codes, the holders of H shares will not be able to bring actions on the basis of violations of the Listing Rules or the Codes, and must rely on the Hong Kong Stock Exchange and The Securities and Futures Commission of Hong Kong to enforce the Listing Rules or the Codes, as the case may be.

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

We are a company incorporated under the laws of the PRC, and substantially all of our assets and our subsidiaries are located in China. In addition, most of our directors and officers reside within China, and substantially all of the assets of our directors and officers are located within China. As a result, it may not be possible to effect service of process within the United States or elsewhere outside of China upon most of our directors or officers, including with respect to matters arising under U.S. federal securities laws or applicable state securities laws. Moreover, our Chinese counsel has advised us that China does not have treaties providing for the reciprocal recognition and enforcement of judgments of courts with the United States, the United Kingdom, Japan or most other Western countries. Our Hong Kong counsel 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 in the United States and any of the other jurisdictions mentioned above in relation to any matter not subject to a binding arbitration provision may be difficult or impossible.

Back to Contents

Holders of H shares may be subject to PRC taxation.

Under China's current tax laws, regulations and rulings, dividends paid by us to holders of our H shares outside the PRC are currently exempted from PRC income tax. In addition, gains realized by individuals or enterprises upon the sale or other disposition of our H shares are currently exempted from PRC capital gains tax. If the exemptions are withdrawn in the future, holders of our H shares may be required to pay withholding tax on dividends, which is currently imposed at the rate of 20%, or income tax, which may be imposed upon individuals at the rate of 20%, and holders of our H shares may be required to pay PRC capital gains tax upon the sale or other disposition of our H shares. See "Item 10. Additional Information — E. Taxation — People's Republic of China."

Item 4. Information on the Company.

A. History and Development of the Company

Restructuring of the Telecommunications Industry

Historically, the former Ministry of Posts and Telecommunications, through the former Directorate General of Telecommunications, provincial Posts and Telecommunications Administrations and their city- and county-level posts and telecommunications bureaus, controlled and operated public telecommunications networks and businesses in China.

As part of the Chinese government's restructuring of the telecommunications industry, the Ministry of Information Industry was formed in March 1998 to assume, among other matters, the regulatory responsibilities of the former Ministry of Posts and Telecommunications. One of the principal objectives of the restructuring was to separate the government's regulatory functions from its business management functions. As a result, the Ministry of Information Industry ceased to operate telecommunications networks and businesses, but continues as the principal regulator of the telecommunications industry, providing industry policy guidance as well as exercising regulatory authority over all telecommunications service providers in China.

In 1999, with the approval of the State Council, the telecommunications networks and businesses previously controlled and operated by the former Ministry of Posts and Telecommunications were separated along four business lines: wireline, mobile, paging and satellite communications. The Directorate General of Telecommunications was renamed China Telecommunications Corporation in May 2000 to operate the nationwide wireline telecommunications business resulting from such separation. China Mobile and China Satellite Communications Corporation, or China Satellite, were established in May 2000 and December 2001, respectively, as state-owned enterprises to assume the nationwide mobile business and satellite communications business, respectively, while the paging business was transferred to China Unicom.

Restructuring of China Telecom Group

In November 2001, the State Council approved a comprehensive restructuring plan relating to the wireline telecommunications sector. Under the restructuring plan, the telecommunications assets of our parent company, China Telecom Group, in ten northern provinces, autonomous regions and centrally administered municipalities in China were split off from China Telecom Group in May 2002 and were merged with China Netcom Corporation and Jitong Communications Co. Ltd. to form China Netcom Group. China Telecom Group retains the telecommunications assets in the remaining 21 provinces, autonomous regions and centrally administered municipalities (including Shanghai Municipality, Guangdong Province, Jiangsu Province, Zhejiang Province, Anhui Province, Fujian Province, Jiangxi Province, Guangxi Zhuang Autonomous Region, Chongqing Municipality and Sichuan Province in our service regions) and continues to own the brand name of "China Telecom."

Back to Contents

Under the restructuring plan, most telecommunications assets except for the nationwide inter-provincial optic fibers previously owned by China Telecom Group were divided between China Telecom Group and China Netcom Group based on their geographic locations. China Telecom Group and China Netcom Group own 70% and 30%, respectively, of the nationwide inter-provincial optic fibers. Under the restructuring plan, both China Telecom Group and China Netcom Group are permitted to operate nationwide wireline telecommunications networks and provide nationwide services.

In connection with the implementation of the restructuring plan, China Telecom Group and China Netcom Group entered into a number of framework agreements providing for the division of network resources, trademarks, network access codes and other assets and nationwide enterprise customers of China Telecom Group prior to the restructuring, and circuit leasing, network maintenance and other business arrangements. Under these framework agreements, we obtained, indirectly through China Telecom Group, access to local networks owned by China Netcom Group in the ten northern provinces, autonomous regions and centrally administered municipalities. China Telecom Group and China Netcom Group also entered into a couple of implementation agreements in 2002 and 2003 to implement those framework agreements, the provisions of which are consistent with those framework agreements.

Our Restructuring and Initial Public Offering

We were incorporated under the laws of China on September 10, 2002 as a joint stock company with limited liability under the name of China Telecom Corporation Limited. Our controlling shareholder, China Telecom Group, a wholly state-owned enterprise, directly owns approximately 77.78% of our issued capital as of March 30, 2004. To effect our restructuring, we entered into a restructuring agreement with China Telecom Group, under which the restructuring took effect as of December 31, 2001. As part of the restructuring, China Telecom Group's telecommunications operations in Shanghai Municipality, Guangdong Province, Jiangsu Province and Zhejiang Province, together with the related assets and liabilities, were transferred to us. These assets, liabilities and operations have been segregated and separately managed by us since December 31, 2001. As part of the restructuring, China Telecom Group retained certain assets historically associated with the businesses in Shanghai Municipality, Guangdong Province, Jiangsu Province and Zhejiang Province. These assets had a carrying amount of RMB11,285 million as of December 31, 2001 and primarily consisted of investments in non-telecommunications industries, the inter-provincial optic fibers, international gateway and international transmission equipment, telecommunications equipment for special communications services and certain office equipment, properties and buildings. In consideration of the net assets related to the telecommunications operations transferred to us, which had a carrying amount of RMB97,485 million as of December 31, 2001, we issued 68,317,270,803 of our shares to China Telecom Group.

The telecommunications operations that were transferred to us included:

- wireline telephone services, including local telephone, domestic and international, Hong Kong, Macau and Taiwan long distance and interconnection services as well as a range of related value-added services;

- Internet and managed data services, including dial-up Internet access, broadband Internet access, managed data, system integration and related value-added services; and

- leased line services.

Back to Contents

Under the restructuring agreement, China Telecom Group has undertaken to indemnify us against any actions, suits, proceedings, claims, losses, damages, payments or other expenses caused by or arising from any assets transferred to us by China Telecom Group due to events that occurred prior to the effective date of our restructuring.

In addition, under the restructuring agreement, China Telecom Group has undertaken to indemnify us against any liabilities or losses as a result of any adverse effect that agreements entered or to be entered into between China Telecom Group and China Netcom Group may have on our assets and operations or the implementation of our agreements with China Telecom Group.

Immediately prior to our initial public offering, China Telecom Group owned 87.01% of our outstanding shares. In addition, Guangdong Rising Assets Management Co., Ltd., Jiangsu Guoxin Investment Group Co., Ltd. and Zhejiang Financial Development Company each owned 8.37%, 1.43% and 3.19%, respectively, of our outstanding shares. As part of a reform plan approved by the State Council on the administration of rural telecommunications services in 2002, China Telecom Group transferred a portion of its interest in our company to these shareholders, which are state-owned enterprises owned and controlled by the provincial governments in each of Guangdong Province, Jiangsu Province and Zhejiang Province, as compensation for the financial support they have provided historically in the construction of rural telecommunications infrastructure in their provinces. See “Item 7. Major Shareholders and Related Party Transactions — B. Related Party Transactions.” Under a share transfer agreement each of these shareholders has entered into with China Telecom Group, each of Guangdong Rising Assets Management Co., Ltd., Jiangsu Guoxin Investment Group Co., Ltd. and Zhejiang Financial Development Company has agreed, unless otherwise agreed by China Telecom Group:

- not to sell, transfer or pledge any of our shares it obtained under the share transfer agreement during the three-year period after November 15, 2002, and

- following the expiry of the three-year period after November 15, 2002, not to sell or transfer more than 20% of our shares it obtained under the share transfer agreement during any six-month period for two years.

Following our restructuring, China Telecom Group retained the ownership of, and continues to operate, the wireline telecommunications networks, and provides telecommunications services in other provinces, autonomous regions and centrally administered municipalities that are outside our service regions. China Telecom Group has undertaken to give us a preferential right to acquire its interest in companies or other entities that provide telecommunications services. See “Item 7. Major Shareholders and Related Party Transactions — B. Related Party Transactions — Arrangements Relating to Our Restructuring and Initial Public Offering — Letter of Undertakings.”

Under a non-competition agreement between us and China Telecom Group, China Telecom Group has undertaken to us, for so long as our shares are listed on the Hong Kong Stock Exchange or another exchange, and China Telecom Group holds over 30% of our issued share capital or is regarded as our controlling shareholder under the Hong Kong Stock Exchange Listing Rules, China Telecom Group will not at any time, directly or indirectly, provide basic telecommunications services or selected value-added telecommunications services in our service regions that may compete with us. See “Item 7. Major Shareholders and Related Party Transactions — B. Related Party Transactions — Arrangements Relating to Our Restructuring and Initial Public Offering — Non-Competition Agreement.”

In connection with our restructuring, we entered into various arrangements with China Telecom Group and a number of its provincial subsidiaries relating to the mutual provision of ongoing telecommunications and other services. These agreements include agreements for trademark licensing, centralized services, interconnection arrangements, optic fiber leasing, property leasing and other services. See “Item 7. Major Shareholders and Related Party Transactions — B. Related Party Transactions” for a more detailed description of these arrangements.

Back to Contents

Following our restructuring, China Telecom Group continues to be the holder of the licenses required for operating our telecommunications business. In accordance with the approval of the Ministry of Information Industry, we derive our exclusive rights to operate our businesses from our status as a subsidiary controlled by China Telecom Group, and China Telecom Group must hold and maintain all licenses received from the Ministry of Information Industry in connection with our business for our benefit. The government currently does not charge license fees for the telecommunications licenses held by China Telecom Group. To the extent the government begins to charge such fees in the future, we will likely share the cost with China Telecom Group. In addition, we may not be able to benefit from the licenses held by China Telecom Group if we cease to remain its controlled subsidiary. See “Item 7. Major Shareholders and Related Party Transactions — B. Related Party Transactions.”

In 2002, we successfully completed our initial public offering of H shares and raised approximately RMB10,659 million in aggregate net proceeds for us. Upon completion of our initial public offering, our shares became listed on the Hong Kong Stock Exchange and ADSs representing our H shares are listed and traded on the New York Stock Exchange.

Back to Contents

The following chart sets forth our corporate organization and shareholders prior to the acquisition in 2003.

Back to Contents

Our Acquisition in 2003

On December 31, 2003, we acquired from China Telecom Group the entire equity interests in each of Anhui Telecom Company Limited, Fujian Telecom Company Limited, Jiangxi Telecom Company Limited, Guangxi Telecom Company Limited, Chongqing Telecom Company Limited and Sichuan Telecom Company Limited and certain network management and research and development facilities. These acquired companies are the leading providers of wireline telecommunications services, including wireline telephone, managed data, Internet and leased line services in Anhui Province, Fujian Province, Jiangxi Province, Guangxi Zhuang Autonomous Region, Chongqing Municipality and Sichuan Province, respectively.

The acquisition was negotiated and entered into on an arm’s length basis and on normal commercial terms. The purchase price of the acquisition amounted to RMB 46 billion. Of the purchase price, we paid an initial consideration of RMB 11 billion in cash upon the completion of the acquisition. The deferred consideration of the remaining RMB 35 billion is payable on December 31, 2013. We may prepay all or, from time to time, a part of the deferred consideration at any time within a ten-year period without penalty. We will pay interest to China Telecom Group at semi-annual intervals on the actual amount of the deferred consideration remaining outstanding at an annual rate of 5.184% for the first five years after December 31, 2003. This rate will be adjusted on the fifth anniversary of the completion of the acquisition on December 31, 2003 based on the then current Renminbi lending rate of the Chinese commercial banks for loans with tenure of more than five years.

In preparation for this acquisition, Chongqing Telecom Company Limited was incorporated on August 22, 2003, Anhui Telecom Company Limited was incorporated on August 26, 2003, Fujian Telecom Company Limited, Guangxi Telecom Company Limited and Sichuan Telecom Company Limited were incorporated on August 28, 2003 and Jiangxi Telecom Company Limited was incorporated on September 18, 2003, each as a wholly-owned subsidiary of China Telecom Group. China Telecom Group’s telecommunications operations in Anhui Province, Fujian Province, Jiangxi Province, Guangxi Zhuang Autonomous Region, Chongqing Municipality and Sichuan Province, together with related assets and liabilities were transferred to the respective acquired companies. The assets, liabilities and operations of these companies have been segregated and separately managed since December 31, 2002. As part of the reorganization in preparation of the acquisition, China Telecom Group has undertaken to indemnify these companies for any loss or damages suffered by them as a result of, or related to, the reorganization and/or in connection with events preceding the reorganization.

In connection with this acquisition and as part of the reform plan of rural telecommunications services, China Telecom Group has agreed to transfer to Fujian Electronic Information (Group) Co., Ltd., a state-owned enterprise owned by the provincial governments of the Fujian Province, 977,004,913 of our domestic shares, which represents 1.29% of our issued share capital as of March 30, 2004. Such transfer is subject to a number of conditions precedent and will not be made prior to September 10, 2005.

On December 31, 2003, China Telecom Corporation Limited, together with Shanghai Telecom Company Limited, its wholly-owned subsidiary, acquired from China Telecom Group the entire equity interest in China Telecom Group Yellow Pages Information Company Ltd., or China Telecom Yellow Page. The aggregate consideration of the transaction was RMB25 million, which falls below the de minimis provision under the Listing Rules, and therefore the transaction is exempt from the reporting, announcement and independent shareholders’ approval requirements. We are in the process of consolidating our telephone directory businesses under China Telecom Yellow Pages to enhance operating efficiency.

Back to Contents

Set out below is our corporate structure as of March 30, 2004.

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(1) The percentages may not add up to 100% due to rounding discrepancies.

(2) Denotes the companies acquired pursuant to the acquisition.

(3) Includes 977,004,913 of our domestic shares (representing 1.29% of our issued share capital as of March 30, 2004) that China Telecom Group has agreed to transfer to Fujian Electronic Information (Group) Co., Ltd., a state-owned enterprise owned by the provincial governments of the Fujian Province as part of the reform plan of rural telecommunications services. Such transfer is subject to a number of conditions precedent and will not be made prior to September 10, 2005.

(4) On December 31, 2003, China Telecom Corporation Limited, together with Shanghai Telecom Company Limited, its wholly-owned subsidiary, acquired from China Telecom Group the entire equity interest in China Telecom Group Yellow Pages Information Company Ltd., which is not shown in the chart above. The aggregate consideration of the transaction was RMB25 million, which falls below the de minimis provision under the Listing Rules, and therefore the transaction is exempt from the reporting, announcement and independent shareholders' approval requirements.

Back to Contents

Preliminary Discussion with China Telecom Group with respect to A Potential Acquisition

We have commenced discussions with China Telecom Group with respect to a potential acquisition of certain telecommunications assets currently held by China Telecom Group in Hubei Province, Hunan Province, Hainan Province, Guizhou Province, Yunnan Province, Shaanxi Province, Gansu Province, Qinghai Province, Ningxia Hui Autonomous Region and Xinjiang Uygur Autonomous Region. Our board of directors expects that we may be in a position to reach the final agreement with China Telecom Group on the terms of the potential acquisition in April 2004. However, at the moment, no understanding or contractual terms have been agreed between China Telecom Group and us. The acquisition may or may not proceed and is subject to factors beyond the control of our company, including, among others, the approvals of the shareholders' meeting and the approvals of the relevant regulatory authorities.

We distributed a circular, dated March 17, 2004, to all of our shareholders to seek our shareholders' approval of an authorization to our board of directors to issue and allot up to 8,317,560,515 new H shares, including up to 756,141,865 new H shares to be converted from existing domestic shares held by our state-owned shareholders. The issuance of new H shares is subject to certain conditions set forth in the shareholders circular, which is filed on Form 6-K with the Securities and Exchange Commission on March 19, 2004. The maximum number of the new H shares that may be issued and allotted under the authorization, if approved by our shareholders, will represent 11% of our total issued share capital as of March 30, 2004. While we have not made a decision on the offering structure of any new issuance and allotment, we currently plan to use the net proceeds from the issuance to fund our potential acquisition of telecommunications assets from China Telecom Group. If the potential acquisition does not proceed, we currently plan to use the net proceeds from the issuance of new H shares for other similar strategic acquisitions.

General Information

Our principal executive offices are located at 31 Jinrong Street, Xicheng District, Beijing, China 100032 and our telephone number is (86-10) 6642-8166. Our web site address is www.chinatelecom-h.com. The information on our web site is not a part of this annual report. We have appointed CT Corporation System at 111 Eighth Avenue, New York, New York 10011 as our agent for service of process in the United States.

B. Business Overview

We are the leading provider of wireline telephone, Internet and managed data and leased line services in ten regions in China. Our service regions consist of Shanghai Municipality, Guangdong Province, Jiangsu Province, Zhejiang Province, Anhui Province, Fujian Province, Jiangxi Province, Guangxi Zhuang Autonomous Region, Chongqing Municipality and Sichuan Province. The wireline penetration rate in our service regions was 22.8% as of December 31, 2003, which was relatively low compared to those in more developed markets in Asia and elsewhere. We believe this presents significant growth potential for us. The population in our service regions was approximately 528 million as of December 31, 2003. Our service regions are also home to the headquarters of many large domestic corporations and governmental agencies and the regional headquarters of many multinational corporations. In addition, there are a large number of small- and medium-sized enterprises in our service regions.

In 2003, we maintained our business growth and market leadership through the implementation of our business strategies, including, among others, market segmentation, improvement of our services quality and development of differentiated product portfolios, more value-added services and application services. We have also improved our distribution channels and our responsiveness to market changes. We continued to implement our internal restructuring and business re-engineering. As a result, we have effectively improved our cost control and operating efficiency.

Back to Contents

On December 31, 2003, we completed the acquisition from China Telecom Group of telecommunications assets in Anhui Province, Fujian Province, Jiangxi Province, Guangxi Zhuang Autonomous Region, Chongqing Municipality and Sichuan Province as well as certain network management, research and development facilities. The acquisition expanded the geographic coverage of our telecommunications operations and our subscriber base and provided us with full control over the network management, research and development facilities that we acquired. We believe that the acquisition enhanced our ability to centralize the management of our network operations and coordinate our research and development efforts.

The following table sets forth the percentages of contribution by our different services to our total operating revenue for the periods indicated:

	Year Ended December 31,		
	2001	2002	2003
	(as a percentage of total operating revenue)		
Wireline telephone services:			
Local			
Installation fees	1.3	1.4	1.5
Monthly fees	15.2	17.4	17.3
Local usage fees	32.3	31.4	30.2
Domestic long distance(1)	20.5	18.4	16.8
International, Hong Kong, Macau and Taiwan long distance(1)	3.8	3.4	3.2
Interconnection	5.3	5.4	5.4
Upfront connection fees	8.9	7.8	6.7
Sub-total	87.3	85.2	81.1
Internet and managed data services:			
Internet(2)	2.8	4.5	6.9
Managed data(3)	2.0	2.2	2.1
Sub-total	4.8	6.7	9.0
Leased line services	4.0	3.8	3.3
Other services(4)	3.9	4.3	6.6
Total operating revenue	100.0	100.0	100.0

(1) Includes revenue from our VoIP long distance services.

(2) Includes revenue from dial-up and broadband Internet access services.

(3) Includes revenue from DDN, frame relay and ATM services.

(4) Includes revenue from value-added telecommunications services, sale, repair and maintenance of customer-end equipment, and lease of telecommunications network facilities.

Wireline Telephone Services

Our telephone services consist of local telephone, domestic long distance, international, Hong Kong, Macau and Taiwan long distance, value-added voice and information services and interconnection.

Wireline telephone services are our main services, generating 81.1% of our total operating revenue in 2003, compared to 85.2% in 2002. Revenue generated by these services increased from RMB93,298 million in 2002 to RMB96,008 million in 2003. We believe that our wireline telephone services will continue to provide steady revenue stream and drive the overall revenue growth of our company.

Back to Contents

Local Telephone Services

Our local telephone services provide the largest revenue source for our wireline telephone services. Revenue derived from our local telephone services in 2003 accounted for 49.0% of our total operating revenue, compared to 50.2% in 2002. We enjoy a dominant market position in local telephone services with a market share of 97.97% in terms of the number of access lines in service within our service regions as of December 31, 2003.

Access lines. The following table sets forth selected information regarding our local telephone services as of the dates indicated:

	As of December 31,		
	2001	**2002**	**2003**
	(in thousands, except percentages)		
Number of access lines in service: (1)			
Residential	64,262	72,266	79,407
Enterprise	10,694	12,456	13,639
Public telephones	3,182	4,822	6,700
Wireless local access	2,696	7,243	18,346
Total	80,834	96,788	118,091
Wireline telephone penetration rate	15.6%	18.6%	22.8%

(1) Includes ISDN lines as measured by the number of bearer channels.

The number of our access lines in service increased by 21.3 million, or 22.0%, from 96.8 million as of December 31, 2002 to 118.1 million as of December 31, 2003. The wireline penetration rate in our service regions increased from 18.6% as of December 31, 2002 to 22.8% as of December 31, 2003.

We also provide to our customers wireless local access services with limited mobility based on the Personal Handyphone System, or PHS, technology, as an extension and supplement to our wireline local access services. The demand for our wireless local access services has increased rapidly in recent years. The number of subscribers for our wireless local access service increased from approximately 7.24 million as of December 31, 2002 to approximately 18.35 million as of December 31, 2003. Our wireless local access service played a positive role in boosting our overall local call volume and revenue growth. Wireless local access service reduced the diversion to mobile telephone services by satisfying the needs of some subscriber groups. The average cost of investment per line for our wireless local access services decreased 12% from that of 2002 which further increased our return on investment. The average cost of investment per line was calculated by dividing the additional capacity of our wireless local access networks by the additional capital expenditure on our wireless local access networks for the relevant period.

We also operate an extensive network of public telephones in our service regions. As of December 31, 2003, the number of public telephones in our service regions reached approximately 6.7 million. We provide public telephone services mainly to the large and fast growing non-resident population in our service regions. We believe that the demand for our public telephone services in our service regions will continue to increase.

Service usage.The following table sets forth certain usage information regarding our local telephone services for the periods indicated:

Back to Contents

	Year Ended December 31,		
	2001	**2002**	**2003**
Total usage (pulses in billions)(1)	323.8	346.4	346.9
Total usage (minutes in billions)(2)	290.7	320.6	322.0

(1) Pulses are the billing units for calculating local telephone usage fees. The definition of a pulse for intra-district calls changed in connection with the tariff adjustments mandated by the Chinese government and implemented by us in 2001. See "— Tariffs" for the respective definitions of a pulse before and after the tariff adjustments in 2001.

(2) Minutes reported were calculated from pulses through a statistical sampling of calling patterns.

As the number of access lines in service has increased, the total usage of our local telephone services, including local telephone usage associated with dial-up Internet access and VoIP long distance calls, increased from 320.6 billion minutes in 2002 to 322.0 billion minutes in 2003. Local voice usage continued to grow steadily and reached 294.2 billion pulses in 2003, an increase of 7.2% from 2002. As some customers of our dial-up Internet services began to use our broadband Internet services, dial-up Internet usage, including dial-up usage of customers of other Internet service providers, decreased from 71.9 billion minutes in 2002 to 52.7 billion minutes in 2003. Tariffs for dial-up Internet access were much lower than the usage fees for voice services.

Tariffs. For our local telephone services, we charge an upfront installation fee, a fixed monthly fee and local call usage fees based on call duration. The tariffs are regulated by the Chinese government. The local call usage fees are either intra-district or inter-district, depending upon whether a call is within a single service district or between service districts. We implemented the tariff adjustments mandated by the Chinese government in the first half of 2001. The mandated tariff adjustments changed the tariff levels for many telecommunications services, including local and long distance telephone, data and leased line services. See "—Regulatory and Related Matters—Tariff Setting" included elsewhere under this Item.

The following table sets forth the changes in our tariffs before and after the tariff adjustments we implemented in 2001 for local telephone services:

	Before Tariff Adjustments	**After Tariff Adjustments**
	(RMB)	
Monthly fee:(1)		
Residential customers	7.6 – 25.0	10.0 – 25.0
Enterprise customers	12.0 – 37.0	15.0 – 35.0
Usage fee:		
Intra-district	0.16 – 0.22 per pulse (three minute intervals)	0.18 – 0.22 for the first two pulses (first three minutes or less) and 0.09 – 0.11 for each additional pulse (one minute intervals)
Inter-district	0.20 – 0.50 per pulse (one minute intervals)	0.20 – 0.50 per pulse (one minute intervals)
Communications fee:		
Internet dial-up	0.08 – 0.11 per pulse (three minute intervals)	0.02 per pulse (one minute intervals)

(1) Monthly fees for customers vary depending on whether a subscriber is located in the provincial capital, a city, a county or rural areas.

Prior to July 2001, we charged an upfront connection fee for basic access services. State guidance rates for connection fees for basic access services varied from time to time and were adjusted from a range of RMB2,500 to RMB5,000 in 1999 to a range of RMB500 to RMB1,000 in 2001, and the connection fees were eliminated entirely in July 2001. The decrease in and ultimate elimination of the connection fees have stimulated customer growth, especially for residential customers. In addition, all previous surcharges on telephone services, which were mostly levied by provincial and local governments, were eliminated in July 2001.

26

Back to Content

Domestic Long Distance Services

We offer long distance services through our public switched telephone network as well as VoIP long distance services. We are the largest provider of domestic long distance services using public switched telephone networks in our service regions. We had a market share of approximately 50.6% in our service regions in 2003, as measured by total minutes carried through our networks divided by total minutes carried through networks of all wireline and mobile operators in our service regions, compared to 54.4% in 2002. Total revenue from our domestic long distance services represented 16.8% of our total operating revenue in 2003, compared to 18.4% in 2002. In addition, we commenced offering VoIP long distance services in 1999 and continued to be the largest provider of these services in our service regions in 2003, with a market share of approximately 62.9% in 2003. Access to VoIP long distance services requires the subscriber to dial a pre-set access number and/or personal identification number in the case of prepaid cards.

Service usage. The following table shows the total minutes of domestic long distance calls carried through our long distance network for the periods indicated:

	Year Ended December 31,		
	2001	2002	2003
Total minutes of usage (in millions):(1)			
Public switched telephone networks	27,806	23,535	24,658
VoIP	14,894	23,258	29,151
Total	42,700	46,793	53,809

(1) Includes calls originated by mobile subscribers that are carried over our long distance networks.

Our VoIP services have experienced rapid growth since we began providing the services in 1999. The usage of our VoIP domestic long distance services as a percentage of the total usage of domestic long distance services increased from 49.7% in 2002 to 54.2% in 2003, mainly because of the lower tariffs for VoIP long distance services compared to those for long distance services using public switched telephone networks. However, the average VoIP call duration is generally longer than that of long distance calls using public switched telephone networks. We provide VoIP services primarily to price sensitive customers, such as small businesses, certain residential customers and non-resident persons. We offer our VoIP services selectively to small businesses or other non-resident persons in response to market demand and offer flexible VoIP service packages in response to competition.

Tariffs. The tariff adjustments that we implemented in 2001 abolished the distance-based tariff structure, reduced the unit of billing from one minute to six seconds and eliminated long distance call surcharges.

Back to Contents

The following table sets forth the tariffs for our domestic long distance telephone services before and after the tariff adjustments in 2001, which are based on state tariff rates:

	Before Tariff Adjustments	After Tariff Adjustments
	(RMB)	
Public switched telephone network services		All at the unified rate of 0.07 per six seconds(1)
Intra-provincial less than 300 km	0.50-0.60 per minute(2)	
Intra-provincial more than 300 km	0.60 per minute(2)	
Inter-provincial less than 800 km	0.80 per minute(2)	
Inter-provincial more than 800 km	1.00 per minute(2)	
VoIP services(3)	0.30 per minute	Not regulated

(1) A discount rate of up to 40% applies to calls made during off-peak hours, which are from 12:00 am to 7:00 am every day.

(2) A discount rate of 50% applies to calls made during off-peak hours, which are from 9:00 pm to 12:00 am for weekdays and from 7:00 am to 12:00 am on public holidays and weekends; a discount rate of 70% applies to calls made during 12:00 am to 7:00 am everyday.

(3) Does not include separate usage fees for local services when a VoIP call is placed. The local usage fee of a VoIP call is the same as the local usage fee of an intra-district local voice call.

VoIP long distance services are charged at lower tariff rates than those for long distance services using public switched telephone networks. However, we also charge local usage fees on VoIP long distance calls. The tariff adjustments in 2001 deregulated the tariffs for VoIP services, which provides us the flexibility in setting tariffs for our VoIP services.

International, Hong Kong, Macau and Taiwan Long Distance Services

We are the largest provider of international, Hong Kong, Macau and Taiwan long distance services in our service regions, in terms of both public switched telephone network services and VoIP services. We had a 61.5% market share in 2003, compared to 59.7% in 2002, as measured by the total number of outgoing call minutes generated in our service regions and carried through international gateways of all wireline and mobile operators. Our international, Hong Kong, Macau and Taiwan long distance telephone services contributed 3.2% to our total operating revenue in 2003, compared to 3.4% in 2002. We also provide VoIP international, Hong Kong, Macau and Taiwan long distance services, similar to our VoIP domestic long distance services in our service regions.

Service usage. The following table sets forth certain information related to the usage of our international, Hong Kong, Macau and Taiwan long distance services, including usage of international, Hong Kong, Macau and Taiwan long distance services by mobile subscribers, for the periods indicated:

	Year Ended December 31,		
	2001	2002	2003
Outgoing call minutes (in millions)(1):			
Public switched telephone networks	457	763	992
VoIP	1,104	730	626

Total	1,561	1,493	1,618

(1) Includes calls originated by subscribers of other operators that are carried through the international gateways of China Telecom Group.

The total usage of our international, Hong Kong, Macau and Taiwan long distance services increased by 8.4% in 2003, from 1.49 billion minutes in 2002 to 1.62 billion minutes in 2003.

Back to Contents

Tariffs. The tariff adjustments in 2001 reduced the basic unit of billing from one minute to six seconds and simplified the rate schedule by abolishing the distance-based tariff structure. The following table sets forth our international, Hong Kong, Macau and Taiwan long distance tariffs before and after the tariff adjustments:

	Before Tariff Adjustments	**After Tariff Adjustments**
	(RMB)	
Public switched telephone networks services:		
To Hong Kong, Macau and Taiwan	2.55 – 5.00 per minute[1]	0.20 per 6 seconds
To all international destinations	5.30 – 15.00 per minute[2]	0.80 per 6 seconds[3]
VoIP services:[4]		
To Hong Kong, Macau and Taiwan	1.50 – 2.50 per minute[5]	Not regulated
To all international destinations	2.40 – 4.80 per minute	Not regulated

(1) A discount rate of 40% applies to calls made during off-peak hours.

(2) Rates of RMB5.30-12.00 per minute apply to calls made to Asian countries and regions and a rate of RMB15.00 per minute applied to calls to all other international destinations. A discount rate of 40% applied to calls made during off-peak hours.

(3) A discount rate of up to 40% applies to calls made during off-peak hours.

(4) Does not include separate usage fees for local services when a VoIP call is placed. The local usage fee of a VoIP call is the same as the local usage fee of an intra-district local voice call.

Since the tariff adjustments in 2001, we charge RMB 1.50 per minute for VoIP long distance calls to Hong Kong, Macau and Taiwan and RMB 2.40-4.60 per minute for VoIP long distance calls to international destinations, but offer various incentive programs and discounts from time to time.

We offer international, Hong Kong, Macau and Taiwan long distance services through the international gateways of China Telecom Group. China Telecom Group negotiates bilateral settlement arrangements and rates based on the international settlement standards in the telecommunications industry, and those settlement arrangements and rates also apply to us.

Value-added Voice and Information Services

In addition to basic local and long distance voice services, we offer a variety of value-added voice and information services. Significant usage growth of our value-added services in 2003 contributed to our overall revenue growth.

Value-added voice services. Our value-added voice services include caller ID, call forwarding, conference call and toll-free services. As of December 31, 2003, 63.4 million, or 53.7%, of our customers used our caller ID services. Based on our extensive network resources, customer base and distribution channels, we cooperate with other service providers and continue to develop new value-added voice services. In recent years, we gradually introduced new services such as call-center out-sourcing, video conferencing, direct dial VoIP services with a pre-set access number of 17901, wireline chat room called “Telephone QQ”, wireline short messaging services and PHS short messaging services. We also launched a service called “Walk with Me”, an account-based calling card service, in 2003. Through our intensive marketing efforts, our customers became familiar with these services and increased their usage. We believe that these value-added voice services allow us to enhance customer satisfaction and increase our revenue. As subscribers in our service regions become more accustomed to these value-added voice services, we believe there is significant growth potential in these areas.

Back to Contents

Telephone information services. We have significantly expanded the scope of our automated and operator-assisted telephone information and applications services in recent years. Our general information services allow users to access information at our standard telephone usage rates plus information usage fees. We also provide other specialized telephone information and application services, such as telephone banking, telephone advertising, telephone lottery and telephone stock trading services. Total usage of our telephone information services was 1,335 billion minutes in 2003, an increase of 112.9% from 2002. We intend to further expand the scope and usage of these services and develop flexible revenue sharing arrangements with content and application service providers.

Telephone directory services. We publish telephone directories, known as Yellow Pages, in our service regions. In addition, we have introduced online yellow pages and other related information services. We derive advertising revenue from our printed and on-line yellow pages services.

Tariffs. Value-added voice and information services are classified as “market-based” for purpose of tariff determination by relevant regulatory authorities. See “− Regulatory and Related Matters − Tariff Setting.” We determine tariffs for our value-added voice and information services according to market conditions. Tariffs for these services vary to a large extent based on types of services and geographical locations.

Interconnection

Interconnection services accounted for 5.4% of our total operating revenue in 2003. Under relevant regulations, we are exempt from any interconnection payment for outbound local traffic to mobile operators. See “—Regulatory and Related Matters—Interconnection” for tariff details. As a result of our expanding customer base and the growth of the telecommunications market in China, the volume of inbound local calls carried through our networks reached 53.6 billion minutes in 2003, an increase of 34.4% from 2002. The volume of inbound long distance calls also significantly increased from 2002.

We have interconnection arrangements with other telecommunications operators, including China Telecom Group, China Netcom Group, China Mobile and China Unicom. All interconnection and settlement arrangements among public wireline telephone, mobile, and Internet networks in China are governed by the Telecommunications Regulations and the rules on interconnection arrangements and settlement promulgated by the Ministry of Information Industry. See “— Regulatory and Related Matters — Interconnection” included elsewhere under this item.

China Telecom Group entered into interconnection agreements with other telecommunications service providers in Shanghai Municipality, Guangdong Province, Jiangsu Province and Zhejiang Province, prior to our incorporation in 2002, and with other telecommunications service providers in Anhui Province, Fujian Province, Jiangxi Province, Guangxi Zhuang Autonomous Region, Chongqing Municipality and Sichuan Province, prior to our acquisition in 2003. These agreements provide for interconnection settlement with respect to local calls and domestic and international, Hong Kong, Macau and Taiwan long distance calls involving our networks. In connection with our initial public offering in 2002 and the acquisition in 2003, China Telecom Group has assigned to us, and we have assumed, its rights and obligations under these agreements in relation to our service regions. We also entered into an interconnection agreement with China Telecom Group. The economic terms and the settlement procedures under that agreement are in accordance with the standards set forth in the interconnection rules and regulations, which are described in more details under “— Regulatory and Related Matters — Interconnection” included elsewhere under this item. See also “Item 7. Major Shareholders and Related Party Transactions — B. Related Party Transactions — Apportionment of International Settlement; — Ongoing Related Party Transactions between Us and China Telecom Group — Interconnection Agreement.”

Back to Contents

Internet and Managed Data Services

We are the leading provider of Internet and managed data services in our service regions. Our Internet and managed data services are supported by extensive local access networks in our service regions and the largest nationwide fiber optic backbone transmission network jointly operated by China Telecom Group and us. Revenue from our Internet services was RMB8,160 million in 2003, representing 6.9% of our total operating revenue for that year. Revenue from our managed data services was RMB2,540 million in 2003, representing 2.1% of our total operating revenue for that year.

The following table sets forth selected information regarding our Internet, managed data and related services as of the dates or for the periods indicated:

	As of or for the Year Ended December 31,		
	2001	**2002**	**2003**
Dial-up Internet access services:			
Dial-up subscribers (in thousands)	14,000	17,607	16,291
Dial-up on-line usage (minutes in billions)	64.7	57.1	38.5
Broadband access services (in thousands):			
DSL subscribers	336.7	1,426.1	4,146.8
FTTx + LAN subscribers	138.2	429.9	1,461.4
Others(1)	8.4	18.1	22.2
Managed data services:			
Number of ports:			
DDN services	219.4	240.3	218.5
Frame relay services	26.6	52.3	63.2
ATM services	1.5	5.8	7.6
Bandwidth leased:			
DDN services (x64Kbps)	222.4	278.3	366.1
Frame relay services (x128Kbps)	27.7	39.8	76.8
ATM services (x2Mbps)	8.0	15.9	16.9

(1) Include wireless LAN services.

Dial-up Internet Access Services

We are the largest provider of dial-up Internet access services in our service regions in terms of the number of subscribers. We classify our dial-up Internet access users into registered users, non-registered users and prepaid users. In addition, we provide Internet transit and access services to some international and domestic telecommunications operators. We also provide many business customers with direct fiber optic links between their local area networks and the Internet.

Our dial-up Internet access subscribers decreased by 7.5%, from approximately 17.6 million as of December 31, 2002 to approximately 16.3 million as of December 31, 2003. Total usage of our dial-up Internet access services by our subscribers decreased from 57.1 billion minutes in 2002 to 38.5 billion minutes in 2003, or 32.6%. We believe the decline was mainly due to migration of customers from our dial-up Internet services to our broadband Internet services.

To further develop our dial-up Internet access services, we have improved our content application services by introducing a new value-added Internet dial-up service known as “D-net”. Based on our extensive dial-up network resources, access number resources and billing channels, “D-net” provides our dial-up Internet subscribers access to the value-added services provided by Internet content providers based on a dedicated platform. The launch of the “D-net” services received immediate positive reactions from our dial-up Internet subscribers and Internet content providers, which helped us maintain the subscriber base for our dial-up Internet services.

Back to Contents

Dial-up Internet access services and application services fostered subscriber interest in the Internet services. We will continue to foster customer reliance on our Internet services through various fee plans and our “D-net” value-added services, turning dial-up Internet service into an “incubator” for our broadband services.

Tariffs. Registered dial-up Internet access users pay an Internet access fee as well as local communications fees. In 2003, the Ministry of Information Industry liberalized the tariff regulations and lifted state guidance tariffs for Internet services. Currently, there are no pre-set tariff rates promulgated by the Chinese government or other regulatory authorities on Internet services.

Broadband Internet Access

We began offering broadband Internet access services in 2000. In 2003, our broadband Internet access services grew significantly due to strong demand. Our subscribers for these services grew from approximately 1.9 million as of December 31, 2002 to approximately 5.6 million as of December 31, 2003. We promoted our services and recognition of our brand name through a series of promotion campaigns, and took various measures to increase the penetration of our broadband services and to expand our broadband customer base and coverage. These measures included packaging broadband services with other services that we offer, packaging our broadband services with other companies’ sales of personal computers, and enhancing our long-term cooperation with Internet cafes and other owners of local access facilities. In addition, we have actively sought opportunities to work with other content and application providers to promote the integration of our broadband access services with their contents and applications. We continue to expect significant growth in our broadband Internet access services.

Equipment costs related to our broadband Internet access services decreased due to economies of scale, efficient operation and application of advanced technologies. We reduced the average cost of investment per line by approximately 20% from that of 2002 through our centralized purchasing program. The average cost of investment per line was calculated by dividing the additional capacity of our broadband Internet access networks by the additional capital expenditure on our broadband Internet access networks for the relevant period.

DSL services. In 2003, we leveraged on our dominant position in local access networks, extensive distribution network and high quality customer services in promoting our DSL services. We promote DSL services as the primary broadband Internet access means for our residential customers and small- and medium-sized enterprise customers. DSL services can be offered over existing copper wires and are suitable for high-speed Internet access. We had approximately 1.4 million DSL subscribers as of December 31, 2002 and approximately 4.1 million DSL subscribers as of December 31, 2003.

Fiber-Ethernet access services. We offer broadband access services through fiber optic cables that directly link Ethernet technology-based LANs in office buildings or high-end residential complexes to the Internet. Fiber-Ethernet access uses optic fiber technology and Ethernet protocol to connect residential users and business users to a telecommunications network and greatly expands capacity of the access network. As of December 31, 2002 and 2003, we had approximately 429,900 customers and 1.5 million customers, respectively, using fiber-Ethernet access services.

Wireless LAN services. We provide fast and convenient wireless LAN services through our wireless local area networks in public places, such as airports, hotels, conference centers and office buildings.

Broadband application services. We continue to leverage our broadband access networks and distribution channels to develop various broadband application services such as distance education, distance medical services, video conferencing, on-line games, entertainment and video-on-demand services.

Back to Contents

Based on our large subscriber base, network resources, application platforms and reliable supporting systems, as well as our customer management and billing system, we cooperated with other service providers and launched ChinaVnet to promote our broadband Internet access services. ChinaVnet offers billing platforms and channels for Internet content and application providers and provides subscribers with convenient access to the comprehensive content and application services provided by those service providers. We believe that the introduction of ChinaVnet will stimulate growth in the subscriber base and revenue from our broadband Internet services.

In 2003, we introduced a service known as “Broadband New Vision”, which is a multimedia service that allows the transmission of video, v