



中国电信  
CHINA TELECOM

**China Telecom (Hong Kong) Limited**

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



Annual Report 1997

China Telecom (Hong Kong) Limited 中國電信(香港)有限公司



Annual Report 1997 一九九七年年報

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## Financial Highlights

	<b>Proforma combined 1997 RMB'000</b>	Proforma combined 1996 RMB'000
Turnover	<b>15,487,779</b>	10,367,241
Profit before tax and minority interests	<b>5,953,325</b>	4,940,759
Net profit	<b>4,955,381</b>	4,509,158
Proforma earnings per share	<b>RMB52 cents</b>	RMB50 cents

## Company Profile

China Telecom (Hong Kong) Limited is the leading cellular telecommunications services provider in Guangdong province and in Zhejiang province. Guangdong province and Zhejiang province are two of the most economically developed provinces in China, with the highest numbers of cellular telephone subscribers in the country. The Company deploys both TACS and GSM technologies in its cellular telecommunications network in Guangdong province and in Zhejiang province, covering all cities, counties and major villages in the two provinces. As at 31 December 1997, the Company had an aggregate cellular telecommunications subscriber base of 3.405 million, which accounted for over 97.5 per cent of the total cellular telecommunications subscribers in the two provinces and about 26 per cent of the total cellular telecommunications subscribers in China at that date. The Group had 8,582 employees as at 31 December 1997.

The Company's shares were listed on the New York Stock Exchange and the Hong Kong Stock Exchange on 22 October 1997 and 23 October 1997 respectively. It has a 100 per cent interest in Guangdong Mobile Communication Company Limited and a 99.63 per cent interest in Zhejiang Mobile Communication Company Limited. The remaining 0.37 per cent interest in Zhejiang Mobile Communication Company Limited is held by three local companies in Zhejiang province. The Company's cellular telecommunications services are provided through its two subsidiaries.

The major shareholder of the Company is China Telecom Hong Kong (BVI) Limited, which holds an equity interest of 76.48 per cent in the Company. China Telecom Hong Kong (BVI) Limited is in turn wholly-owned by China Telecom (Hong Kong) Group Limited which is controlled by the Ministry of Information Industry. The remaining 23.52 per cent equity interest in the Company is held by public investors, including investors in Hong Kong, Asia, North America and Europe.

China Telecom (Hong Kong) Limited became a constituent stock of the Hang Seng Index in Hong Kong on 27 January 1998.

Note: "The Company" means China Telecom (Hong Kong) Limited. "The Group" means the Company together with its subsidiaries, which include Guangdong Mobile Communication Company Limited and Zhejiang Mobile Communication Company Limited.

## Corporate Information

### Executive directors

Mr. SHI Cuiming  
(Chairman & Chief Executive Officer)  
Mr. CHEN Zhaobin (Vice Chairman & President)  
Mr. LI Ping (Vice Chairman & Executive Vice  
President, Chief Operating Officer)  
Mr. DING Donghua  
(Director & Chief Financial Officer)  
Mr. LU Errui (Director & Vice President)  
Mr. ZHU Jianhua (Director & Vice President)

### Non-executive directors

Mr. CUI Xun (Vice Chairman)  
Mr. HU Wangshan (Vice Chairman)

### Independent non-executive directors

Professor Arthur LI Kwok Cheung  
Mr. Antony LEUNG Kam Chung

### Joint company secretaries

Mr. CHEN Zhaobin  
Mr. Jacky YUNG Shun Loy

### Auditors

KPMG Peat Marwick

### Legal advisers

Linklaters & Paines  
Livasiri & Co.  
Sullivan & Cromwell

### Registered office

16/F Dah Sing Financial Centre  
108 Gloucester Road, Wanchai, Hong Kong

### Share registrar

HKSCC Registrars Limited  
2/F Vicwood Plaza  
199 Des Voeux Road Central, Hong Kong

### American Depositary Receipts depositary

Bank of New York  
101 Barclay Street, New York, NY 10286, USA  
Telephone: 1 888 269 2377 (toll free in USA)

### Publications

As required by the United States securities laws, the Company will file an annual report on Form 20-F with the US Securities and Exchange Commission before 30 June 1998. Copies of the annual reports as well as the Form 20-F, once filed, will be available at:

#### *Hong Kong:*

China Telecom (Hong Kong) Limited  
16/F Dah Sing Financial Centre  
108 Gloucester Road, Wanchai, Hong Kong

#### *United States:*

Bank of New York  
101 Barclay Street, New York, NY 10286, USA

## Biographical Details of Directors and Senior Management

### Executive directors

Mr. Shi Cuiming, age 58, Chairman and Chief Executive Officer of the Company. Mr. Shi is in charge of the overall management of the Company. He is also Chairman and President of Telpo Communications (Group) Limited. Mr. Shi has served as Director-General of the Department of Finance of the Ministry of Posts and Telecommunications (the "MPT"), Director-General and Deputy Director-General of the Bureau of Finance of the MPT and Deputy Director of the Division of Economic Research of the Research Institute of Posts and Telecommunications of the MPT. Mr. Shi graduated from the Beijing University of Posts and Telecommunications in 1963 and has over 35 years' experience in the telecommunications industry, including considerable management experience.

Mr. Chen Zhaobin, age 41, Vice Chairman, President and Company Secretary of the Company. Mr. Chen is responsible for day to day management and administration, external relations and market development of the Company. He is also Director and Vice President of Telpo Communications (Group) Limited. Mr. Chen has served as the Deputy Director of the Office of Coordination Production of the General Office of the MPT as well as teaching assistant and lecturer at the Beijing University of Posts and Telecommunications. He graduated from the Beijing University of Posts and Telecommunications in 1982. Mr. Chen has many years' experience in the telecommunications industry and in corporate management.

Mr. Li Ping, age 44, Vice Chairman and Executive Vice President of the Company. Mr. Li is responsible for business development and operation of the Company. He has served as Deputy Director General of the Directorate General of Telecommunications of the MPT as well as Deputy Director General and Deputy Chief Engineer of the Heilongjiang Posts and Telecommunications Administration. He graduated in 1976 from the Beijing University of Posts and Telecommunications and received an MBA degree from the State University of New York in 1989. Mr. Li has nearly 20 years' operational and management experience in the telecommunications industry.

Mr. Ding Donghua, age 61, Director and Chief Financial Officer of the Company. Mr. Ding is in charge of overall financial management of the Company. He was previously the Chief Economist, Chief Accountant, Deputy Chief Economist and Director of the Guangdong Posts and Telecommunications Administration. He graduated from the Beijing University of Posts and Telecommunications in 1961, has 37 years' experience in the telecommunications industry and is experienced in economic and financial management.

Mr. Lu Errui, age 58, Director and Vice President of the Company. Mr. Lu is responsible for the mobile telecommunications operations in Guangdong province. He is also Director and President of Guangdong Mobile Communication Company Limited. He previously held the positions of Director of the MPT's Mobile Telecommunications Equipment Testing Centre, Director of the Wireless Telecommunications Research Office of the MPT's Research Institute of Telecommunications and Transmission and Leader of the Engineering Group at the Satellite Assembly Factory of the Ministry of Aerospace. Mr. Lu graduated from the Chinese University of Science and Technology. He has over 20 years' experience in the telecommunications industry.

## Biographical Details of Directors and Senior Management (cont'd)

Mr. Zhu Jianhua, age 44, Director and Vice President of the Company. Mr. Zhu is responsible for the operations of mobile telecommunications operations in Zhejiang province. He is also Director and President of Zhejiang Mobile Communication Company Limited. Mr. Zhu previously served as Deputy Director and Chief Engineer of the Hangzhou Municipal Posts and Telecommunications Bureau. He graduated from the Nanjing Institute of Posts and Telecommunications in 1985 and received a master's degree in computer science from Zhejiang University in 1992. Mr. Zhu has many years of experience in the telecommunications industry.

### **Non-executive directors**

Mr. Cui Xun, age 59, Vice Chairman of the Company. Mr. Cui is currently Director General of the Guangdong Posts and Telecommunications Administration and Chairman of Guangdong Mobile Communication Company Limited. He has served as Deputy Director-General and Chief Engineer of the Guangdong Posts and Telecommunications Administration as well as Chief Engineer, Deputy Director and Deputy Chief Engineer of the Guangzhou Municipal Posts and Telecommunications Bureau. Mr. Cui graduated from the Beijing University of Posts and Telecommunications in 1962. He has 36 years' experience in the telecommunications industry.

Mr. Hu Wangshan, age 54, Vice Chairman of the Company. Mr. Hu is the Director General of Zhejiang Posts and Telecommunications Administration and Chairman of Zhejiang Mobile Communication Company Limited. He previously served as Deputy Director-General of Zhejiang Posts and Telecommunications Administration as well as Director and Deputy Director of Shaoxing Municipal Posts and Telecommunications Bureau in Zhejiang province. Mr. Hu graduated from the Beijing University of Posts and Telecommunications in 1968. He has over 30 years' experience in the posts and telecommunications industry.

### **Independent non-executive directors**

Professor Arthur Li Kwok Cheung, age 53, Director. Professor Li is Vice Chancellor of the Chinese University of Hong Kong, a non-executive Director of Glaxo Wellcome plc and a Director of the Bank of East Asia Limited. He holds a doctorate in medicine from Cambridge University. He previously served as board member of the Hong Kong Hospital Authority and President of the College of Surgeons of Hong Kong. Professor Li is an Advisor on Hong Kong Affairs to the People's Republic of China, a member of the Basic Law Consultative Committee, a member of the Preparatory Committee of the Special Administration Region of the National People's Congress, Member of the Selection Committee of the First Government of the Hong Kong Special Administrative Region and Committee Member of the Ninth Annual Chinese People's Political Consultative Conference.

Mr. Antony Leung Kam Chung, age 46, Director. Mr. Leung is Managing Director and Regional Manager for Greater China and the Philippines of Chase Manhattan Bank. He graduated from the University of Hong Kong and completed the Program for Management Development at the Harvard Business School. Mr. Leung's public service appointments include member of the Executive Council of the Hong Kong Special Administrative Region, Chairman of the Education Commission, member of the Exchange Fund Advisory Committee and board member of the Airport Authority. He also serves as Director of the Hong Kong Policy Research Institute, Trustee of the Hong Kong Centre for Economic Research and Trustee of the Queen Mary Hospital Charitable Trust.

## Chairman's Statement

1997 was an important year in the history of China Telecom (Hong Kong) Limited. The Company's shares were successfully listed on both the New York Stock Exchange and The Stock Exchange of Hong Kong Limited in October of that year. The Company achieved significant development in its operations during the year, laying a solid foundation from which to exploit new and significant market opportunities in the telecommunications industry in China.

Following its incorporation and restructuring in September 1997, the Company is now the leading provider of cellular telecommunications services in Guangdong province and in Zhejiang province in China. Although China Telecom (Hong Kong) Limited's initial public offering and listing in October last year coincided with the Asian economic turmoil which presented a major challenge to, and caused extreme volatility in, the Hong Kong stock market, the confidence in and the support for the Company by investors were not hampered. The reaction to the offering was extremely positive.

The Company's initial public offering was approximately 35 times over-subscribed, while the institutional placing was approximately 18 times over-subscribed. The offering succeeded in raising a total of approximately HK\$32 billion, a record for funds raised in public offerings in Asia (excluding Japan).

The listing of the Company attracted major interest and goodwill from international financial markets. It was selected as "The Best Transaction in Asia of 1997" by *Global Securities*, and as "The Best Securities Transaction in Asia" by *Euroweek*. The Company also became a constituent stock of the Hang Seng Index in Hong Kong after being listed for only three months.

The overwhelmingly positive response from investors, the high regard paid by the finance industry and the strong support from the market

have been very encouraging to the management and employees of the Company. This successful beginning serves as a solid foundation for the long-term development of the Company as we approach the new millennium.

I am pleased to report that, as at 31 December 1997, the Group had an aggregate subscriber base of 3.405 million in Guangdong province and Zhejiang province. This represented a growth rate of approximately 67 per cent from the subscriber base of 2.043 million as at 31 December 1996. The Group's subscriber base accounted for over 97.5 per cent of total cellular subscribers in the two provinces and about 26 per cent of total cellular subscribers in China as at the end of 1997.

For the year ended 31 December 1997, the Group's proforma combined turnover was RMB15.488 billion (HK\$14.471 billion), an increase of RMB5,121 million (HK\$4,785 million) from RMB10.367 billion (HK\$9.686 billion) in 1996. This represented an increase of approximately 49 per cent. Proforma combined profit after tax for the year ended 31 December 1997 increased by RMB446 million (HK\$417 million) to RMB4.955 billion (HK\$4.630 billion) from RMB4.509 billion (HK\$4.213 billion) in 1996. This represented a 10 per cent increase. Proforma earnings per share for the year ended 31 December 1997 were RMB0.52 (HK\$0.49), which is higher than the RMB0.46 (HK\$0.43) forecast in the prospectus issued at the time of listing of the Company's Shares. This was mainly due to the rapid growth of subscribers and the effective use of capital by the Company.

The Board of Directors observe that the Company was established in September and listed in October 1997 and had therefore been listed for only two full months as at 31 December 1997. Moreover, the Group is experiencing a period of rapid growth and the retention of capital for future investment, expansion of the Company's telecommunications network and acquisition of



## Chairman's Statement (cont'd)

quality assets could provide a better return to shareholders. The Board therefore recommends that no final dividend should be paid for the 1997 financial year.

The continued opening up of China and its aggressive pursuit of reform, the high level of social economic activities and the continuing growth in its people's income created favourable conditions for the Group. The rapid development of the cellular telecommunications industry in China and the enormous potential of the telecommunications market provides the Group with substantial room for further development.

I am fully confident about the future prospects of the telecommunications market in China. The Group is committed to increasing capital investment substantially, introducing advanced technologies, enhancing corporate management, improving the quality of its employees, promoting production efficiency and improving customer service in order to reinforce our competitive advantage, accelerate the expansion of the subscriber base and encourage telecommunications usage, thereby further enhancing the revenues of the Group.

The Group will actively explore strategic investment opportunities in the telecommunications industry in China to acquire quality telecommunications assets. The Group is currently in discussions with relevant parties about acquiring the assets of the cellular telecommunications network in Jiangsu province.

At the first session of the Ninth National People's Congress in March 1998, a motion was passed to implement the restructuring of government bodies. The Ministry of Information Industry was established to assume all the government functions of the previous Ministry of Posts and Telecommunications. The Group believes that this institutional reform, which created a demarcation between government and enterprise functions,

will help to establish a fairer and a more orderly competitive environment. This is not only beneficial to the overall development of the telecommunications industry in China, but will also contribute towards improving the management, operations and service quality of the Group. The Group has received reassurance that the Ministry of Information Industry will assume all undertakings given by the previous Ministry of Posts and Telecommunications at the time of listing of the Company's shares.

The Company accepted an invitation from the government of the Hong Kong Special Administrative Region to jointly sponsor the Chinese New Year fireworks display in early 1998 in conjunction with Hongkong Telecom to convey our thanks and best wishes to the people of Hong Kong.

Finally, I would like to take this opportunity to express my sincere thanks for the loyal support of our shareholders and investors, the valued contribution of our Board of Directors and the hard work of all our employees.

**Shi Cuiming**

*Chairman and Chief Executive Officer*

14 April 1998

## President's Report

1997 was a significant year in the history of China. The whole country was excited to witness the reunification of Hong Kong with China, an event that attracted global attention.

1997 was also a year in which China Telecom (Hong Kong) Limited achieved a number of milestones. This year, the Group completed its corporate restructuring to unify its cellular telecommunications businesses in Guangdong province and Zhejiang province under China Telecom (Hong Kong) Limited, thereby making them a part of the Hong Kong community. In addition, the Company successfully accessed the international capital markets by listing on both the New York and Hong Kong stock exchanges. Management and staff of the Group intend to pursue future business developments in a similarly positive and innovative manner.

It is evident from the 1997 annual report that the Company has achieved impressive results both in its performance in the international capital markets and in its business development.

As a publicly listed company offering public cellular telecommunications services, China Telecom (Hong Kong) Limited has as its goals the provision of quality telecommunications services for its subscribers and the creation of the best possible return for its investors.

Through the continued opening up of its market, and the aggressive pursuit of reform, China has maintained a stable and fast-growing economy. We believe that the continuing improvement in the overall living standards of the people in China will stimulate stronger demand for cellular telecommunications services. The country is beginning to benefit from economies of scale after a 10-year effort to develop its cellular telecommunications industry. Although we have secured a subscriber base of one quarter of all cellular users in China, the current penetration rates in Guangdong province and Zhejiang

province are only 3.57 per cent and 2.04 per cent respectively. There is therefore much scope for future development. To meet the demand for cellular telecommunications, the Company will continue to increase its investment in both Guangdong province and Zhejiang province to expand network capacity.

The Group believes that our subscribers are the key to creating the best return for our shareholders. Our goals are to actively expand our subscriber base, while simultaneously encouraging higher network usage. We will build on the strong financial results achieved in 1997 to further improve the quality of customer services and to actively introduce advanced technology. We will also strive to improve and enhance our management systems in the areas of sales and distribution, maintenance and repairs and after-sales service, in order to provide flexibility in registering new subscribers, accuracy in billing and efficiency in resolving network and service problems. We are determined to establish a world-class network with excellent customer service, so as to maximise our appeal to new subscribers, to significantly increase the subscriber base and to promote subscriber loyalty and minimise churn.

In addition to our aggressive plan to expand network capacity and increase our subscriber base, the Company will make full use of the creativity and enthusiasm of our employees to promote the use of cellular services. We will implement comprehensive network optimisation to improve the connection rate during peak hours and we will follow international standards closely in developing value-added services to stimulate usage.

The management team unanimously believes that the effective use of capital, coupled with tight cost control, is the key to achieving maximum profitability. Although operating expenses rose in 1997 as a result of the business growth, the corporate restructuring and the growing

## **President's Report** (cont'd)

competition among mainland cellular operations, the Company's balance sheet was maintained within prudent limits. This is attributable in large part to our strong management team, whose efficiency, devotion and leadership is matched by the professionalism, responsibility and hard work of our staff.

Cultivating our unique position as the first telecommunications provider in China to access the international capital markets, the Company will seek opportunities to acquire cellular and other telecommunications businesses so as to expand the areas of our service and produce better results.

The Group's management and its staff are motivated by the pursuit of excellence. The Group intends to actively introduce advanced management information technologies and operating systems to match the standard of international cellular service providers, to provide world-class services to subscribers, to provide satisfactory return on investment to shareholders, and to create real value.

Finally, I would like to thank the Board of Directors for their excellent leadership as well as the management and all members of staff for their hard work and their contributions to our success.

**Chen Zhaobin**

*President*

14 April 1998

## Operational Review

### Introduction

In 1997, the Group achieved significant development of its cellular telecommunications operations in Guangdong and Zhejiang provinces. The subscriber base recorded impressive growth of 67 per cent from 2.043 million in 1996 to 3.405 million in 1997. This laid a solid foundation for the future development of the Group.

The Company was incorporated and completed its corporate restructuring in September 1997. After the corporate restructuring, the Company has 100 per cent ownership of Guangdong Mobile Communication Company Limited and 99.63 per cent ownership of Zhejiang Mobile Communication Company Limited. The Company's cellular telephone operations in Guangdong and Zhejiang provinces are vested in these two subsidiaries. The remaining 0.37 per cent interest in Zhejiang Mobile Communication Company Limited is held by three local companies in Zhejiang province.

The shares of the Company were listed on the New York Stock Exchange and the Hong Kong Stock Exchange on 22 October 1997 and 23 October 1997, respectively. After being listed for only three months, the Company became a constituent stock of the Hang Seng Index in Hong Kong.

### Maintaining subscriber growth and high cellular usage

As at 31 December 1997, the Group had an aggregate subscriber base of 3.405 million. This represented substantial growth of approximately 67 per cent over 1996. Among these, 2.502 million cellular subscribers are in Guangdong, of which new subscribers comprised 934,000, an increase of 59.6 per cent over 1996. Zhejiang recorded dramatic growth of 90 per cent, with 428,000 new subscribers, taking the total subscriber base to 903,000.

During the year, the Group not only achieved strong growth in new subscribers, but also successfully maintained a high level of network usage. In 1997, total minutes of usage amounted to 14.4 billion minutes, an increase of 43.4 per cent over the previous year. Guangdong and Zhejiang contributed 10.7 billion minutes and 3.7 billion minutes respectively, showing growth rates of 39 per cent for Guangdong and 57.8 per cent for Zhejiang. During the year, the monthly average usage per subscriber of the Group was 440.5 minutes while the monthly average usage per subscriber for Guangdong province was 438.2 minutes and that for Zhejiang province was 447.5 minutes. The monthly average usage for 1997 was lower than that for the previous year.

## Operational Review (cont'd)

The impressive increase in total minutes of usage and the decrease in average usage per subscriber resulted directly from the substantial growth in total subscribers, changes in subscriber demographics and improvement in telecommunications infrastructure. It also indicates the promising potential for future growth in subscriber usage. The development of more value-added services is an effective way to improve customer service and encourage increased use of cellular telecommunications.

In 1997, in order to meet international standards in this respect, the Group developed and introduced value-added services such as international roaming, caller display, call forwarding, call waiting, conference calling, call filtering, mobile fax/data, stored value cards and public mobile phone cards. The Group's "Global Access Network" now extends to 22 countries and regions covering Singapore, Malaysia, Germany, Finland, Australia, the United Kingdom, Indonesia, Sweden, Italy, Switzerland, Turkey, Spain, Belgium, Lebanon, Denmark, France, the Netherlands, Austria, Poland, Hong Kong, Macau and Taiwan, realising our goal of "Accessing the whole country and roaming all over the world with a cellular phone".

The introduction of stored value cards was well received by the market. This proved to be a convenient and efficient service for users with an intermittent need for cellular telecommunications. The Group's innovative Mobile Office service not only offers subscribers a quality voice service, but also the convenience of mobile fax/data communication. In 1997, through attractive packaging, pricing and active marketing efforts, Mobile Office proved to be popular with business subscribers. The Group is optimistic about the potential of Mobile Office for further development.

### **Expanding the network to meet growing demand**

To facilitate fast growth in its subscriber base, the Group dramatically expanded its GSM digital network in addition to improving and optimising its TACS analogue network. As of 31 December 1997, total network capacity had reached 5.58 million, of which 3.74 million came from GSM and 1.84 million from TACS. Base stations were increased to 4,980, 3,185 of which were base stations for the GSM digital network and 1,795 were base stations for the TACS analogue network. The number of channels expanded to 198,600 with digital comprising 124,200 and analogue 74,400.

## Operational Review (cont'd)

Through network expansion and improvements, the Group improved the operations of its networks and extended its network coverage to rural villages and manufacturing plants as well as high usage areas such as commercial buildings, shopping malls and specialty markets. This helped to improve the network's connection rate and to maintain the drop-out rate at a relatively low level.

### **Customer service the focus of marketing strategies**

The Group believes that its business is wholly controlled by market conditions which in turn are driven by subscribers. As a result, the Group is a highly customer-oriented organisation. The Group endeavours to offer high-quality and efficient services to subscribers. While improving and optimising the infrastructure of its mobile telecommunications network, the Group also enhanced its computerised management information system.

In Guangdong province, the computerised management information system has been extended to cover all cities, counties and major villages with consequent improvements in service efficiency that have enabled the Group to keep pace with the rapid growth in its business. In Zhejiang province, the Group has also introduced a computerised management information system. A pilot scheme has been completed in Jiaxing and preparatory work is actively under way in cities such as Hangzhou, Wenzhou, Jinhua and Zhaoxing.

The Group has set up a subscriber service monitoring centre in Guangdong province and has established a hotline service. The service monitoring centre also provides major customers with prioritised services such as account opening, payments, enquiries and service directory. The Group has also established dedicated subscriber service desks for major customers in cities such as Guangzhou and Shenzhen. These services have proved to be very popular with major customers.

## Operational Review (cont'd)

The Group has conducted extensive research into market demand. Subscribers from a wide spectrum were analysed on the basis of various subjects including subscriber demographics, income patterns and geographical distribution. This research and analysis has enabled the Group to develop appropriate marketing strategies which have successfully attracted new subscribers. As a result of the complete deregulation of terminal equipment, subscribers can now register to use the Group's services with their own cellular phones. This has stimulated significant market demand. A record was set when the subscriber base in Guangdong province increased by 100,000 in a single month.

The Group also leveraged special opportunities such as World Telecom Day on 17 May 1997 as well as its corporate restructuring and listing to introduce promotional packages targeted at attracting subscribers to use the well-developed and flexible network services provided by "Global

Access Network". In Zhejiang province alone, the World Telecom Day promotion secured 51,000 new subscribers, while the latter promotion also achieved impressive results with a further 70,000 new subscribers registered during the one-and-a-half month promotion period.

To cater for subscriber demand, the Group has been actively expanding its distribution channels by aggressively developing its own cellular telecommunication sales outlets and representative sales arrangements, in addition to making full use of the extensive network of Posts and Telecommunications Administrations' sales outlets. In 1997, the Group successfully introduced the 138 prefix to relieve pressure on available numbering resources and to provide scope for future growth in subscriber base.

As a result of these efforts, the Group maintained a combined market share of more than 97.5 per cent of the mobile telecommunications market in Guangdong province and in Zhejiang province.

\* Average revenue per subscriber per month is calculated by dividing the usage fees, monthly fees, connection fees and other receipts during the year by the average number of subscribers during the year and dividing the result by the number of months in the year

## Operational Review (cont'd)

### Community service

The Group recognises that corporate growth is closely linked to community development. In 1997, the Group participated in a number of social welfare activities to actively contribute towards the progress of the community.

In 1997, the Group donated RMB1.5 million to construct the "Global Access Hope Primary School" in the poor mountainous regions in Guangdong province, promoting education in regions of limited means in China.

In addition, the Company accepted an invitation from the government of the Hong Kong Special Administrative Region to jointly sponsor the 1997 Chinese New Year fireworks display with Hongkong Telecom to celebrate the Chinese New Year and to bring happiness to Hong Kong people during the festive season.

### Looking into the future

In recent years, China has undergone rapid economic growth, expanded its open-door policy and embarked on intensive economic reform. This has contributed to a significant increase in investment and upgrading of technology standards, as well as to a significant improvement in service quality in the telecommunications business. The telecommunications industry is now one of the fastest growing business sectors in China. Based on subscriber numbers, China boasts one of the largest telecommunications networks in the world.

Although the subscriber base for both fixed-line and cellular telecommunications has witnessed dramatic growth in the last five years, the average telephone penetration rate in China remains low in comparison with other Asian countries and developed countries. As a result, the telecommunications industry in China has the potential to continue to grow rapidly. Even in Guangdong and Zhejiang provinces, the cellular penetration rates are still low, being only 3.57 per

cent and 2.04 per cent respectively. The Group believes that the market still has potential for major growth.

In 1998, the Group will continue to expand its cellular telecommunications infrastructure. The focus is to extend GSM coverage and to increase network capacity while optimising the TACS network, and further improving the efficiency of the usage of GSM network spectrum. The Group is also planning to adopt the DCS 1800 system. More importantly, the Group will actively open up the potential market by offering new telephone number ranges with the prefixes "135", "136" and "137". New value-added services are planned, including short message service, voicemail and a Chinese language secretarial service to meet the needs of a wide spectrum of subscribers.

The Group will actively adopt advanced management information systems to enhance its management to meet international standards and to improve its operating efficiency, as well as to expedite the development of the huge potential market in China. This is so that the Group can provide top-quality services to subscribers, to maximise return on investment to shareholders and to offer the best value for their money. The Group will also explore strategic investment opportunities in China's telecommunications market, including opportunities to acquire quality telecommunications businesses. The Group is currently in discussions with relevant parties about acquiring a cellular telecommunications business in Jiangsu Province.

At the first session of the Ninth National People's Congress in March 1998, a motion was passed to implement the restructuring of government bodies. The Ministry of Information Industry was established to assume all the government functions of the previous Ministry of Posts and Telecommunications. The Group believes that this institutional reform, which created a demarcation between government and enterprise functions,



## Operational Review (cont'd)

will help to establish a fairer and a more orderly competitive environment. This is not only beneficial to the overall development of the telecommunications industry in China, but will also contribute towards improving the management, operations and service quality of the Group. The Group has received reassurance that the Ministry of Information Industry will

assume all undertakings given by the previous Ministry of Posts and Telecommunications at the time of listing of the Company's shares.

The year 2000 date-change problem has always been a major concern to senior management of the Group. To avoid any adverse impact created by the year 2000 problem the Group has already set up a dedicated team to address this issue.

### Summary of operating statistics

Operating Data	Year ended 31 December			
	1994	1995	1996	1997
Cellular Penetration (%)	0.53	1.13	1.81	<b>2.97</b>
Cellular Subscriber Base ('000)	576	1,256	2,043	<b>3,405</b>
Market Share (%)	100	99	98	<b>97.6</b>
Annual Churn Rate (%)	0.5	0.7	1.3	<b>1.64</b>
Total Minutes of Use (millions)	2,760	5,798	10,042	<b>14,400</b>
Average MOU per Sub per Month	539	527	507	<b>441</b>
ARPU per Month — RMB	897	691	524	<b>474</b>
— US\$	108	83	63	<b>57</b>
Cellular Subscriber Capacity ('000)	719	1,845	3,272	<b>5,580</b>
Base Stations	673	1,992	3,217	<b>4,980</b>

## Financial Review

The information set out below presents the results of the Group with effect from 1 January 1996 or since the respective dates of incorporation of the Company, Guangdong Mobile Communication Corporation and Zhejiang GSM Mobile Communication Company Limited (before restructuring), where this is a shorter period on a proforma combined basis as if the current group structure had been in existence throughout the years ended 31 December 1996 and 1997.

	<b>Proforma combined 1997 RMB'000</b>	Proforma combined 1996 RMB'000	Percentage change
Turnover	<b>15,487,779</b>	10,367,241	49
Operating expenses	<b>(10,073,592)</b>	(5,404,804)	86
Operating profit	<b>5,414,187</b>	4,962,437	9
Other income	<b>84,954</b>	48,976	73
Non-operating income	<b>629,519</b>	96,490	552
Interest expense	<b>(175,335)</b>	(167,144)	5
Profit before tax and minority interests	<b>5,953,325</b>	4,940,759	20
Income tax	<b>(991,019)</b>	(427,543)	132
Profit before minority interests	<b>4,962,306</b>	4,513,216	10
Minority interests	<b>(6,925)</b>	(4,058)	71
Net profit	<b>4,955,381</b>	4,509,158	10

Proforma earnings per share	<b>RMB52 cents</b>	RMB50 cents	4
EBITDA (RMB million)	<b>8,180</b>	6,436	27
Capital expenditure (RMB million)	<b>8,719</b>	5,778	51

### Management's discussion and analysis

The current structure of the Group was established pursuant to the corporate restructuring completed in September 1997. As part of the corporate restructuring, the Group entered into certain arrangements to improve the Group's overall operational efficiency. Most of these arrangements became effective during 1997 and the Group's financial results for 1997 reflect the impact of such arrangements as from the dates they became effective. Turnover and profit after tax and minority interests for 1997 are well above those of

the preceding year and the forecast included in the prospectus issued at the time of the Company's listing.

### Turnover

Proforma combined turnover for 1997 was RMB15,488 million. This represented an increase of 49 per cent from RMB10,367 million in 1996. It was also 3 per cent higher than the RMB14,970 million forecast in the prospectus issued at the time of the Company's listing. This increase is primarily due to the rapid subscriber growth, leading to corresponding increases in usage fees, connection fees and monthly fees. The Group's total number of subscribers increased by 67 per cent from 2.043 million at the end of 1996 to 3.405 million at the end of 1997.

Usage fees increased by 58 per cent from RMB5,528 million in 1996 to RMB8,718 million in 1997. This increase is mainly due to the increase in the number of subscribers and the continuing growth in total subscriber usage as a result of the expansion and improvement of fixed line and cellular networks in China. In addition, effective from 20 October 1997, the Group's accounts reflected amounts billed to its subscribers for calls interconnected with the posts and telecommunications system's PSTN fixed-line network as operating revenue. This also contributed to the rise in usage fees.

Revenue from connection fees in 1997 was RMB3,174 million, an increase of 19 per cent from RMB2,673 million in 1996. This is due to the increase in total subscribers. Average connection fee for each new subscriber decreased by 31 per cent from RMB3,396\* in 1996 to RMB2,330\* in 1997. The management believes that reduction of connection fees has helped to expand the Group's subscriber base and has resulted in increased total subscriber usage of the Group's cellular services.

\* net of PRC business tax, government surcharges and central irrigation construction levy

## Financial Review (cont'd)

As a result, usage fees as a percentage of turnover increased from 53 per cent in 1996 to 56 per cent in 1997.

Revenue from monthly fees increased 62 per cent from RMB1,658 million in 1996 to RMB2,692 million in 1997. This is due to the increase in total subscribers.

Other operating revenue amounted to RMB904 million for 1997, a 78 per cent increase from RMB508 million in 1996. This is largely the result of the increase in revenue from fees charged to non-subscribers for roaming into the Group's service areas, interconnection income and fees charged to subscribers for value-added services such as call forwarding and incoming call display functions.

### Operating expenses

Operating expenses increased from RMB5,405 million in 1996 to RMB10,074 million in 1997. This is primarily due to the increase in leased line charges, depreciation charges, interconnection expenses, personnel expenses as well as selling, general and administrative and other expenses.

Total leased line charges increased by 42 per cent from RMB2,214 million in 1996 to RMB3,134 million in 1997. This is mainly due to network expansion to include new coverage areas and the leasing of more transmission lines to increase network capacity within existing coverage areas. Leased line charges represented 31 per cent of the total operating expenses for 1997.

## Financial Review (cont'd)

Depreciation charges for 1997 amounted to RMB2,681 million, an 88 per cent increase from RMB1,424 million in 1996. This reflects the additional depreciation charges resulting from network expansion and the valuation of the subsidiaries' fixed assets as at 31 May 1997. Depreciation charges represented 27 per cent of the total operating expenses for 1997.

Interconnection expenses (including roaming out expenses) amounted to RMB1,214 million for 1997, as compared with the RMB196 million reported in 1996. This increase is mainly due to the Group recording approximately RMB739 million payable to the provincial posts and telecommunications administrations for calls made by the Group's subscribers which interconnected with the posts and telecommunications system's PSTN as interconnection expenses in accordance with the new interconnection agreement. As a percentage of operating expenses, interconnection expenses increased from 4 per cent in 1996 to 12 per cent in 1997.

Personnel expenses increased by 81 per cent from RMB416 million in 1996 to RMB756 million in 1997. This is primarily due to the hiring of additional employees and the maintenance of competitive salary packages to retain experienced employees to support network expansion and operation growth in 1997. As a percentage of operating expenses, personnel expenses remained at approximately 8 per cent in 1996 and 1997.

The Group's selling, general and administrative and other expenses ("SG&A") for 1997 were RMB2,289 million, 98 per cent higher than the RMB1,154 million reported in 1996. This is primarily due to the increase in selling and promotion expenses, provision for doubtful accounts as well as network maintenance costs.

As a percentage of operating expenses, SG&A expenses increased from 21 per cent in 1996 to 23 per cent in 1997.

Selling and promotion expenses for 1997 amounted to RMB623 million, a 44 per cent increase from RMB434 million reported in 1996. This is the result of the Group's increased efforts in strengthening marketing and distribution. A successful marketing programme introduced during 1997 in Zhejiang province has added 130,000 new subscribers to the subscriber base of Zhejiang Mobile Communication Company Limited. As a percentage of turnover, selling and promotion expenses remained at approximately 4 per cent in 1996 and 1997.

Provision for doubtful accounts increased by 97 per cent from RMB227 million in 1996 to RMB449 million in 1997, primarily due to the increase in illegal cloning activities on the TACS network. Despite this, provision for doubtful accounts as a percentage of turnover only increased slightly from 2.2 per cent in 1996 to 2.9 per cent in 1997 which is still low compared with other international cellular telephone operators. In order to minimise losses on doubtful accounts as a result of cloning activities, the Group has implemented various procedures on admission of subscribers such as identity and background checking for subscribers and imposing credit limits for high usage subscribers. Further, the Group has started to implement procedures to monitor regular high usage subscribers to reduce potential losses caused by cloning activities. As a result, as a percentage of turnover, provision for doubtful accounts decreased from 3.1 per cent for the first five months ended 31 May 1997 to 2.9 per cent for the year ended 31 December 1997.

## Financial Review (cont'd)

### Other income, non-operating income and interest expense

Other income increased by 73 per cent, primarily due to increased sales of SIM cards resulting from the increase in the number of GSM subscribers.

Non-operating income mainly included interest income and penalty income on overdue accounts. The substantial increase from RMB96.49 million in 1996 to RMB630 million in 1997 is primarily due to the interest income arising from the proceeds from the initial public offering ("IPO") of the Company's shares in October 1997.

The Group's interest expense amounted to RMB175 million, 5 per cent higher than the RMB167 million in 1996. This is primarily due to increased borrowings to finance the network expansion plan prior to the Company's IPO. Capitalised interest amounted to RMB112 million in 1997, compared with RMB46.58 million in 1996.

### Income tax

Income tax rose by 132 per cent from RMB428 million in 1996 to RMB991 million in 1997. This is primarily due to full tax liability being imposed on connection fees and certain surcharges of the Group upon completion of the Company's IPO.

### Net profit

Net profit increased by 10 per cent from RMB4,509 million in 1996 to RMB4,955 million in 1997. This increase is primarily attributable to the expanded subscriber base resulting from the increased efforts on promotion and marketing activities undertaken by the Group and the high quality services offered to subscribers. Further, in order to maximise return, the Group adopted a prudent but effective cash management policy with regard to the proceeds from the Company's IPO which led to the increase in profit attributable

to shareholders. Proforma earnings per share increased by 4 per cent from RMB50 cents in 1996 to RMB52 cents in 1997. This also represented a 13 per cent increase of RMB6 cents compared with the forecast included in the prospectus issued at the time of the Company's listing.

### EBITDA

EBITDA represents earnings before interest income, interest expense, non-operating income, income tax, depreciation and amortisation. While EBITDA is commonly used in the telecommunications industry worldwide as an indicator of operating performance, leverage and liquidity, it is not presented as a measure of operating performance in accordance with generally accepted accounting principles and should not be considered as representing net cash flows from operating activities.

EBITDA increased 27 per cent from RMB6,436 million in 1996 to RMB8,180 million in 1997. This is primarily due to the increase in income from strong subscriber growth.

### Liquidity and capital resources

Due to the receipt of the proceeds from the Company's IPO, net current assets of the Group increased from RMB1.5 billion in 1996 to RMB36.5 billion as at 31 December 1997. The Group's short term and long term borrowings as at 31 December 1997 were RMB2,148 million and RMB2,870 million respectively. The ratio of total borrowings to total assets as at 31 December 1997 was 8 per cent, lower than the ratio of 19 per cent at the end of 1996. The ratio for 1997 is low compared with the ratio of other rapidly growing cellular telephone operators. The Group's borrowings are primarily denominated in Renminbi and US dollars.

The Group's cash and bank balances (including fixed deposits with banks at year end), amounting to RMB40.1 billion, are denominated in Hong Kong dollars, Renminbi and US dollars.

## **Financial Review** (cont'd)

The Group's capital expenditures in 1997 amounted to RMB8,719 million, representing a 51 per cent increase over the RMB5,778 million reported in 1996. Given the Group's healthy financial position and stable business growth, the management believes that the Group will be able to raise capital to finance its cash requirements for network expansion and business development.

Looking forward, the Group will continue to maintain a sound and prudent financial management strategy and funding policies in relation to its liquidity and capital resources to support the continuing network expansion and business development, and to maximise the return on shareholders' funds.

## Report of the Directors

The directors have pleasure in submitting their first annual report together with the audited accounts for the period from 3 September 1997 (date of incorporation) to 31 December 1997.

### Group restructuring

The Company was incorporated in Hong Kong on 3 September 1997. In preparation for the public listing of the Company's shares, as part of the Group restructuring, the Company acquired the subsidiaries listed in Note 13 to the accounts on 27 September 1997.

The shares of the Company were listed on the New York Stock Exchange and The Stock Exchange of Hong Kong Limited on 22 October 1997 and 23 October 1997 respectively.

### Principal activities

The principal activity of the Company is investment holding. The principal activities of the Group are the provision of cellular telephone and related services in Guangdong province and in Zhejiang province of the People's Republic of China ("PRC").

The turnover of the Group during the financial period is solely made up by the income generated from the provision of cellular telecommunication services.

### Major customers and suppliers

The Group's five largest customers combined did not exceed 30 per cent of the Group's total turnover in 1997.

Purchases from the largest supplier for the current year represent 69 per cent of the Group's total purchases of network equipment. The five largest suppliers accounted for an aggregate of 95 per cent of the Group's network equipment purchases in 1997. Purchases from suppliers, other than suppliers of network equipment, were not a material component of the Group's total purchases.

At no time during the period have the directors, their associates or any shareholder of the Company (whom to the knowledge of the directors owns more than 5 per cent of the Company's share capital) had any interest in these major suppliers.

### Subsidiaries and associated companies

Particulars of the Company's subsidiaries and associated companies at 31 December 1997 are set out in Note 13 and Note 14 respectively to the accounts.

### Accounts

The profit of the Group for the period from 3 September 1997 (date of incorporation) to 31 December 1997 and the state of the Company's and the Group's financial affairs as at 31 December 1997 are set out in the accounts on pages 31 to 63.

The directors do not recommend the payment of a final dividend for the period ended 31 December 1997.

### Charitable donations

Donations made by the Group during the period amounted to RMB230,265.

### Fixed assets

Movements in fixed assets of the Group and the Company during the period are set out in Note 11 to the accounts.

### Share capital and share option scheme

Details of changes in the share capital of the Company are set out in Note 19 to the accounts. Shares were issued during the period pursuant to the Group restructuring in preparation for the listing of the Company's shares on the New York Stock Exchange and The Stock Exchange of Hong Kong Limited.

## Report of the Directors (cont'd)

The Group raised approximately RMB33,570,231,000 net of related expenses from the issue of shares. As at 31 December 1997, such proceeds have been placed with banks as short term deposits and will be applied as planned to fund the expansion of the Group's cellular networks in Guangdong province and in Zhejiang province, the implementation of a new management information system and billing, clearance and collection systems and strategic investments in the PRC telecommunications industry.

Details of the share option scheme of the Company are set out in Note 20 to the accounts.

### Reserves

Movements in the reserves of the Group and the Company during the period are set out in Note 21 to the accounts.

### Directors

The directors during the financial period were:

#### Executive directors:

Shi Cuiming (Chairman)	(appointed on 4 September 1997)
Chen Zhaobin	(appointed on 4 September 1997)
Li Ping	(appointed on 4 September 1997)
Ding Donghua	(appointed on 4 September 1997)
Lu Errui	(appointed on 4 September 1997)
Zhu Jianhua	(appointed on 4 September 1997)

#### Non-executive directors:

Cui Xun	(appointed on 4 September 1997)
Hu Wangshan	(appointed on 4 September 1997)

#### Independent non-executive directors:

Professor Arthur Li Kwok Cheung	(appointed on 17 September 1997)
Antony Leung Kam Chung	(appointed on 17 September 1997)

In accordance with Article 97 of the Company's Articles of Association, Chen Zhaobin, Li Ping and Ding Donghua retire by rotation and, being eligible, offer themselves for re-election. In accordance with Article 101 of the Company's Articles of Association, Professor Arthur Li Kwok Cheung and Antony Leung Kam Chung will retire at the annual general meeting of the Company and shall offer themselves for re-election.

#### Directors' service contracts

None of those directors proposed for re-election at the forthcoming annual general meeting have an unexpired service contract which is not determinable by the Company or any of its subsidiaries within one year without payment of compensation, other than normal statutory obligations.

#### Directors' interests in contracts

No contract of significance to which the Company or any of its subsidiaries was a party and in which a director of the Company had a material interest, whether directly or indirectly, subsisted at the end of the period or at any time during the period.



## Report of the Directors (cont'd)

### Directors' interests in shares

As at 31 December 1997, one of the directors of the Company, Li Ping, personally had an interest in 100 American depositary shares (representing 2,000 ordinary shares) in the Company. Apart from the foregoing, none of the directors had any personal, family, corporate or other interests in the securities of the Company or any of its associated corporations as defined in the Securities (Disclosure of Interests) Ordinance.

### Directors' rights to acquire shares

On 8 October 1997, the Company adopted a share option scheme pursuant to which the directors of the Company may, at their discretion, invite employees, including executive directors, of the Company or any of its subsidiaries, to take up options to subscribe for shares up to a maximum aggregate number of shares equal to 10 per cent of the total issued share capital of the Company. According to the share option scheme, the consideration payable by a participant for the grant of an option will be HK\$1.00. The price of a share payable by a participant upon the exercise of an option will be determined by the directors of the Company at their discretion, except that such price may not be set below a minimum price which is the higher of:

- (i) the nominal value of a share; and
- (ii) 80 per cent of the average of the closing prices of shares on The Stock Exchange of Hong Kong Limited on the five trading days immediately preceding the date of grant of the option.

The period during which an option may be exercised will be determined by the directors at their discretion, except that no option may be exercised later than 10 years after the adoption date of the scheme.

During the period, no options were granted to the directors of the Company or any of its subsidiaries under the share option scheme.

On 9 March 1998, the Company granted options in favour of the following directors:

Directors	Number of share options
Shi Cuiming	2,900,000
Chen Zhaobin	2,600,000
Li Ping	2,400,000
Ding Donghua	2,100,000
Lu Errui	1,000,000
Zhu Jianhua	1,000,000

The share options are exercisable at a price of HK\$11.1 per share during the period from 9 March 1998 to 8 March 2006.

Other than the share option scheme adopted by the Company, at no time during the period was the Company, or any of its holding companies or subsidiaries, a party to any arrangement to enable the directors of the Company or any of their spouses or children under eighteen years of age to acquire benefits by means of the acquisition of shares in or debentures of the Company or any other body corporate.

## Report of the Directors (cont'd)

### Substantial interests in the share capital of the Company

The Company has been notified of the following interests in the Company's issued shares at 31 December 1997 amounting to 10 per cent or more of the ordinary shares in issue:

		Ordinary shares held	Percentage of total issued shares
(i)	The Ministry of Posts and Telecommunications of the PRC ("MPT")*	9,010,000,000	76.48
(ii)	Telpo Communications (Group) Limited ("Telpo")	9,010,000,000	76.48
(iii)	The Directorate General of Posts and Telecommunications ("DGT")	9,010,000,000	76.48
(iv)	China Telecom (Hong Kong) Group Limited ("CTHK (Group)")	9,010,000,000	76.48
(v)	China Telecom Hong Kong (BVI) Limited ("CTHK (BVI)")	9,010,000,000	76.48

Note: The register of substantial shareholders indicates that the interest disclosed by CTHK (BVI) includes the 9,010,000,000 shares disclosed by MPT, Telpo, DGT and CTHK (Group).

\* At the first session of the Ninth National People's Congress in March 1998, a motion was passed to implement the restructuring of government bodies. All government functions of the previous MPT were assumed by the newly established Ministry of Information Industry ("MII"). The MII became the Company's ultimate controlling entity.

Save as disclosed above, no person or corporation had any interest in the share capital of the Company as recorded in the registers required to be kept under section 16(1) of the Securities (Disclosure of Interests) Ordinance as having an interest in 10 per cent or more of the issued share capital of the Company.

### Connected transactions which are the subject of exemption under the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited ("the Listing Rules")

Details of the transactions as set out in rule 14.23(2) of the Listing Rules are set out in Note 22 to the accounts. In the opinion of the independent non-executive directors, these transactions were entered into by the Group:

- (i) in the ordinary and usual course of its business;
- (ii) on terms that are fair and reasonable so far as the shareholders of the Company are concerned; and
- (iii) on normal commercial terms and either:
  - (1) in accordance with the terms of the agreements governing such transactions; or
  - (2) (where there is no such agreement) on terms no less favorable than terms available to third parties.

The Company has received from the auditors a letter stating that the above connected transactions have received the approval of the Directors and have been conducted in the manner as stated in (iii) above.

### Purchase, sale or redemption of the Company's listed securities

During the period, neither the Company nor any of its subsidiaries has purchased, sold or redeemed any of the Company's listed securities.

### Bank and other loans

Particulars of bank and other loans of the Group as at 31 December 1997 are set out in Note 17 to the accounts.

## **Report of the Directors** (cont'd)

### **Financial summary**

A summary of the proforma combined results of the Group for each of the four years ended 31 December 1994, 1995, 1996 and 1997 and the audited statements of the Group's assets and liabilities as at 31 December 1997, together with the proforma combined statements of the Group's assets and liabilities as at 31 December 1995 and 1996 are set out on pages 67 and 68.

### **Compliance with the code of best practice**

The Company has complied throughout the period with the Code of Best Practice issued by The Stock Exchange of Hong Kong Limited as set out in Appendix 14 to the Listing Rules except that the non-executive directors were not appointed for a specific term but are subject to retirement by rotation and re-election at the Company's annual general meeting in accordance with the Company's Articles of Association.

### **Auditors**

A resolution for the reappointment of KPMG Peat Marwick as auditors of the Company is to be proposed at the forthcoming annual general meeting.

By order of the board

**Shi Cuiming**

Chairman

Hong Kong, 14 April 1998

## Notice of Annual General Meeting

Notice is hereby given that the Annual General Meeting of China Telecom (Hong Kong) Limited will be held on 3 June 1998 at 11:00 a.m. in the Conference Room, 8th Floor, New World Harbour View Hotel, 1 Harbour Road, Wanchai, Hong Kong, for the following purposes:

As Ordinary Business:

1. To receive and consider the financial statements for the period ended 31 December 1997 and the Reports of the Directors and the Auditors.
2. To elect Directors and fix their remuneration.
3. To re-appoint Auditors and authorise the Directors to fix their remuneration.

And as Special Business, to consider and, if thought fit, to pass the following as ordinary resolutions:

### ORDINARY RESOLUTIONS

4. **“THAT:**
  - (a) subject to paragraph (b) below, the exercise by the Directors during the Relevant Period of all the powers of the Company to purchase shares of HK\$0.10 each in the capital of the Company including any form of depositary receipt representing the right to receive such shares (“Shares”) be and is hereby generally and unconditionally approved;
  - (b) the aggregate nominal amount of Shares which may be purchased on The Stock Exchange of Hong Kong Limited or any other stock exchange on which securities of the Company may be listed and which is recognised for this purpose by the Securities and Futures Commission of Hong Kong and The Stock Exchange of

Hong Kong Limited pursuant to the approval in paragraph (a) above shall not exceed or represent more than 10 per cent of the aggregate nominal amount of the share capital of the Company in issue at the date of passing this Resolution, and the said approval shall be limited accordingly;

- (c) for the purpose of this Resolution “Relevant Period” means the period from the passing of this Resolution until whichever is the earlier of:
  1. the conclusion of the next annual general meeting of the Company;
  2. the expiration of the period within which the next annual general meeting of the Company is required by law to be held; and
  3. the revocation or variation of the authority given under this Resolution by ordinary resolution of the shareholders of the Company in general meeting.”
5. **“THAT** a general mandate be and is hereby unconditionally given to the Directors to exercise full powers of the Company to allot, issue and deal with additional shares in the Company (including making and granting offers, agreements and options which might require shares to be allotted whether during the continuance of such mandate or thereafter) provided that, otherwise than pursuant to (i) a rights issue where shares are offered to shareholders on a fixed record date in proportion to their then holdings of shares, (ii) the exercise of options granted under any share option scheme adopted by the Company or (iii) any scrip dividend or similar arrangement providing for the allotment of

## Notice of Annual General Meeting (cont'd)

shares in lieu of the whole or part of a dividend as shares of the Company in accordance with the Articles of Association of the Company, the aggregate nominal amount of the shares allotted shall not exceed the aggregate of:

- (a) 20 per cent of the aggregate nominal amount of the share capital of the Company in issue at the date of passing this Resolution, plus
- (b) (if the Directors are so authorised by a separate ordinary resolution of the shareholders of the Company) the nominal amount of the share capital of the Company repurchased by the Company subsequent to the passing of this Resolution (up to a maximum equivalent to 10 per cent of the aggregate nominal amount of the share capital of the Company in issue at the date of passing this Resolution), and the said mandate shall be limited accordingly.

Such mandate shall expire at the earlier of:

1. the conclusion of the next annual general meeting of the Company;
2. the expiration of the period within which the next annual general meeting of the Company is required by law to be held; and
3. the revocation or variation of the mandate given under this Resolution by ordinary resolution of the shareholders of the Company in general meeting."

6. **"THAT** the Directors of the Company be and they are hereby authorised to exercise the powers of the Company referred to in the resolution set out in item 5 in the notice of this meeting in respect of the share capital of the Company referred to in paragraph (b) of such resolution."

By order of the board  
**Chen Zhaobin    Yung Shun Loy Jacky**  
Joint Company Secretaries

14 April 1998

### Notes:

1. Any member entitled to attend and vote at the above Meeting is entitled to appoint one or more proxies to attend and, on a poll, vote in his stead. A proxy need not be a member of the Company.
2. In order to be valid, a form of proxy together with the power of attorney or other authority (if any) under which it is signed, or a notarially certified copy thereof, must be deposited at the Company's registered office at 16/F, Dah Sing Financial Centre, 108 Gloucester Road, Wanchai, Hong Kong at least 36 hours before the time for holding the above Meeting. Completion and return of a form of proxy will not preclude a member from attending and voting in person if he is subsequently able to be present.
3. Concerning item 4 above, the Directors wish to state that they will exercise the powers conferred thereby to repurchase shares of the Company in circumstances which they deem appropriate for the benefits of the shareholders. The Explanatory Statement containing the information necessary to enable the shareholders to make an informed decision on whether to vote for or against the resolution to approve the repurchase by the

## Notice of Annual General Meeting (cont'd)

Company of its own shares, as required by the Listing Rules, will be set out in a separate letter from the Company to be enclosed with the 1997 Annual Report.

4. Concerning item 5 above, the Directors wish to state that they have no immediate plans to issue any new shares of the Company. Approval is being sought from the Members as a general mandate for the purposes of Section 57B of the Companies Ordinance and the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited ("the Listing Rules").

## Auditors' Report



**Auditors' report to the shareholders of  
China Telecom (Hong Kong) Limited**  
(Incorporated in Hong Kong with limited liability)

We have audited the accounts on pages 31 to 63 which have been prepared in accordance with accounting principles generally accepted in Hong Kong.

### **Respective responsibilities of directors and auditors**

The Companies Ordinance requires the directors to prepare accounts which give a true and fair view. In preparing accounts which give a true and fair view it is fundamental that appropriate accounting policies are selected and applied consistently, that judgements and estimates are made which are prudent and reasonable and that the reasons for any significant departure from applicable accounting standards are stated.

It is our responsibility to form an independent opinion, based on our audit, on those accounts and to report our opinion to you.

### **Basis of opinion**

We conducted our audit in accordance with Statements of Auditing Standards issued by the Hong Kong Society of Accountants. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the accounts. It also includes an assessment of the significant estimates and judgements made by the directors in the preparation of the accounts, and of whether the accounting policies are appropriate to the Company's and the Group's circumstances, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance as to whether the accounts are free from material misstatement. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the accounts. We believe that our audit provides a reasonable basis for our opinion.

### **Opinion**

In our opinion, the accounts give a true and fair view, in all material respects, of the state of affairs of the Company and of the Group as at 31 December 1997 and of the Group's profit and cash flows for the period from 3 September 1997 (date of incorporation) to 31 December 1997 and have been properly prepared in accordance with the Companies Ordinance.

**KPMG Peat Marwick**  
Certified Public Accountants

Hong Kong, 14 April 1998

## Consolidated Profit and Loss Account

for the period from 3 September 1997  
(date of incorporation) to 31 December 1997  
(Expressed in Renminbi)

	Note	Period from 3 September 1997 (date of incorporation) to 31 December 1997 RMB'000	(Note 1) Proforma combined 1997 RMB'000	(Note 1) Proforma combined 1996 RMB'000
<b>Turnover</b>	3	<u>4,696,333</u>	<u>15,487,779</u>	<u>10,367,241</u>
<b>Profit before tax and minority interests</b>	4	<b>1,942,557</b>	5,953,325	4,940,759
<b>Income tax</b>	7(a)	<u>(427,836)</u>	<u>(991,019)</u>	<u>(427,543)</u>
<b>Profit before minority interests</b>		<b>1,514,721</b>	4,962,306	4,513,216
<b>Minority interests</b>		<u>(998)</u>	<u>(6,925)</u>	<u>(4,058)</u>
<b>Net profit</b>	8	<b>1,513,723</b>	<u>4,955,381</u>	<u>4,509,158</u>
<b>Appropriations</b>				
<b>Transfer to general reserve</b>	21	<b>(72,463)</b>		
<b>Transfer to PRC statutory reserves</b>	21	<u>(110,946)</u>		
		<u>1,330,314</u>		
<b>Earnings per share</b>	10	<u>RMB17 cents</u>		
<b>Proforma earnings per share</b>	10		<u>RMB52 cents</u>	<u>RMB50 cents</u>

The notes on pages 39 to 63 form part of these accounts.



## Consolidated Balance Sheet

at 31 December 1997  
(Expressed in Renminbi)

	Note	1997 RMB'000	(Note 1) Proforma combined 1996 RMB'000
<b>Fixed assets</b>	11	<u>18,634,237</u>	<u>11,536,029</u>
<b>Construction in progress</b>	12	<u>3,557,665</u>	<u>1,001,499</u>
<b>Interest in associated companies</b>	14	<u>30,430</u>	<u>—</u>
<b>Amounts due from related parties</b>	15	<u>72,546</u>	<u>570,097</u>
<b>Deferred tax assets</b>	16	<u>24,140</u>	<u>22,131</u>
<b>Current assets</b>			
Inventories		77,138	234,447
Accounts receivable		1,591,919	1,087,350
Other receivables		786,449	514,639
Prepaid expenses and other current assets		104,923	18,931
Tax recoverable	7(b)	—	174,372
Deposits with banks		33,912,852	—
Cash and bank balances		<u>6,157,805</u>	<u>2,976,240</u>
		<u>42,631,086</u>	<u>5,005,979</u>
<b>Less: Current liabilities</b>			
Bank and other loans	17(a)	2,147,558	1,504,256
Amounts due to intermediate holding company		31,613	—
Amounts due to related parties		221,786	5,549
Accounts payable		1,769,134	246,375
Accrued expenses and other payables		1,720,432	1,756,047
Taxation	7(b)	<u>272,440</u>	<u>—</u>
		<u>6,162,963</u>	<u>3,512,227</u>
<b>Net current assets</b>		<u>36,468,123</u>	<u>1,493,752</u>
<b>Bank and other loans</b>	17(b)	<u>(2,870,326)</u>	<u>(1,946,444)</u>
<b>Deferred revenue</b>	18	<u>(1,352,863)</u>	<u>(198,607)</u>
		<u>54,563,952</u>	<u>12,478,457</u>

## Consolidated Balance Sheet (cont'd)

at 31 December 1997  
(Expressed in Renminbi)

	Note	1997 RMB'000	(Note 1) Proforma combined 1996 RMB'000
Representing:			
<b>Share capital</b>	19	<b>1,261,419</b>	480,322
<b>Reserves</b>	21	<b><u>53,288,250</u></b>	<u>11,990,777</u>
<b>Shareholders' equity</b>		<b>54,549,669</b>	12,471,099
<b>Minority interests</b>		<b><u>14,283</u></b>	<u>7,358</u>
		<b><u>54,563,952</u></b>	<u>12,478,457</u>

Approved by the board of directors on 14 April 1998.

**Shi Cuiming**  
Director

**Ding Donghua**  
Director

The notes on pages 39 to 63 form part of these accounts.

## Balance Sheet

at 31 December 1997  
(Expressed in Renminbi)

	Note	1997 RMB'000
<b>Fixed assets</b>	11	<u>2,049</u>
<b>Interest in subsidiaries</b>	13	<u>18,333,765</u>
<b>Current assets</b>		
Other receivables		243,289
Deposits with banks		33,912,852
Cash and bank balances		<u>6,650</u>
		<u>34,162,791</u>
<b>Less: Current liabilities</b>		
Amounts due to intermediate holding company		31,613
Accrued expenses and other payables		71,749
Taxation	7(b)	<u>8,161</u>
		<u>111,523</u>
<b>Net current assets</b>		<u>34,051,268</u>
		<u>52,387,082</u>
Representing:		
<b>Share capital</b>	19	1,261,419
<b>Reserves</b>	21	<u>51,125,663</u>
<b>Shareholders' equity</b>		<u>52,387,082</u>

Approved by the board of directors on 14 April 1998.

**Shi Cuiming**

Director

**Ding Donghua**

Director

The notes on pages 39 to 63 form part of these accounts.

## Consolidated Cash Flow Statement

for the period from 3 September 1997  
(date of incorporation) to 31 December 1997  
(Expressed in Renminbi)

	Note	1997 RMB'000	(Note 1) Proforma combined 1996 RMB'000
<b>Net cash inflows from operating activities</b>	(a)	<u>8,825,543</u>	<u>6,418,422</u>
<b>Returns on investments and servicing of finance</b>			
Interest received		413,958	72,648
Interest paid		(268,424)	(205,844)
Distributions		<u>(221,812)</u>	<u>(1,304,655)</u>
<b>Net cash outflow from returns on investments and servicing of finance</b>		<u>(76,278)</u>	<u>(1,437,851)</u>
<b>Taxation</b>			
PRC income tax paid		<u>(546,216)</u>	<u>(767,258)</u>
<b>Investing activities</b>			
Capital expenditures		(5,806,798)	(5,510,931)
Investment in associated companies		(30,430)	—
Proceeds from disposal of fixed assets		12,591	26,991
Decrease in amounts due from related parties		<u>497,551</u>	<u>220,353</u>
<b>Net cash outflow from investing activities</b>		<u>(5,327,086)</u>	<u>(5,263,587)</u>
<b>Net cash inflow/(outflow) before financing activities</b>		<u>2,875,963</u>	<u>(1,050,274)</u>
<b>Financing activities</b>			
Proceeds from issue of shares, net of expenses	(d)	33,570,231	—
Proceeds from bank and other loans	(d)	710,139	1,189,404
Repayments of bank and other loans	(d)	(523,853)	(520,094)
Increase in amounts due to related parties	(d)	216,237	1,315
Minority interest contribution		—	3,300
Proceeds from capital contribution		<u>245,700</u>	<u>225,000</u>
<b>Net cash inflow from financing activities</b>		<u>34,218,454</u>	<u>898,925</u>
<b>Increase/(decrease) in cash and cash equivalents</b>	(b)	37,094,417	(151,349)
<b>Cash and cash equivalents at beginning of year</b>		<u>2,976,240</u>	<u>3,127,589</u>
<b>Cash and cash equivalents at end of year</b>	(c)	<u>40,070,657</u>	<u>2,976,240</u>

## Consolidated Cash Flow Statement (cont'd)

for the period from 3 September 1997  
(date of incorporation) to 31 December 1997  
(Expressed in Renminbi)

### Notes to the Consolidated Cash Flow Statement

#### (a) Reconciliation of profit before tax and minority interests to net cash inflows from operating activities

	1997 RMB'000	(Note 1) Proforma combined 1996 RMB'000
Profit before tax and minority interests	5,953,325	4,940,759
Depreciation of fixed assets	2,680,538	1,424,306
Provision for doubtful accounts	449,124	227,430
Loss/(gain) on disposal of fixed assets	12,668	(72)
Interest income	(656,607)	(72,648)
Interest expense	175,335	167,144
Unrealised exchange gain, net	(1,497)	(2,407)
Decrease/(increase) in inventories	157,309	(17,864)
Increase in accounts receivable	(953,693)	(507,512)
Increase in other receivables	(29,161)	(71,218)
Increase in prepaid expenses and other current assets	(85,992)	(8,230)
Increase in amounts due to intermediate holding company	31,613	—
(Decrease)/increase in accounts payable	(7,175)	149,548
Decrease in accrued expenses and other payables	(54,500)	(9,421)
Increase in deferred revenue	<u>1,154,256</u>	<u>198,607</u>
Net cash inflows from operating activities	<u><u>8,825,543</u></u>	<u><u>6,418,422</u></u>

#### (b) Increase in cash and cash equivalents

Increase in cash and cash equivalents of RMB37,094,417,000 for the year ended 31 December 1997 includes RMB34,656,469,000 which relates to the increase in cash and cash equivalents for the period from 3 September 1997 to 31 December 1997.

## Consolidated Cash Flow Statement (cont'd)

for the period from 3 September 1997  
(date of incorporation) to 31 December 1997  
(Expressed in Renminbi)

### Notes to the Consolidated Cash Flow Statement (cont'd)

#### (c) Analysis of the balances of cash and cash equivalents

	1997 RMB'000	(Note 1) Proforma combined 1996 RMB'000
Deposits with banks maturing within three months	33,912,852	—
Cash and bank balances	<u>6,157,805</u>	<u>2,976,240</u>
	<u>40,070,657</u>	<u>2,976,240</u>

#### (d) Analysis of changes in financing during the year

	Share capital RMB'000	Share premium RMB'000	Minority interests RMB'000	Bank and other loans RMB'000	Amounts due to related parties RMB'000
Balance at 1 January 1997	480,322	—	7,358	3,450,700	5,549
Effect of Group restructuring	484,649	17,368,794	—	—	—
Proceeds from issue of shares	296,448	34,330,114	—	—	—
Expenses incurred in connection with the issue of shares	—	(1,056,331)	—	—	—
Share of reserves by minority shareholders	—	—	6,925	—	—
Proceeds from new loans	—	—	—	710,139	—
Repayments of loans	—	—	—	(523,853)	—
Loan from ultimate holding company	—	—	—	1,382,395	—
Advance during the year	—	—	—	—	216,237
Effect of changes in foreign exchange rates	—	—	—	(1,497)	—
Balance at 31 December 1997	<u>1,261,419</u>	<u>50,642,577</u>	<u>14,283</u>	<u>5,017,884</u>	<u>221,786</u>

**Consolidated Cash Flow Statement** (cont'd)

for the period from 3 September 1997  
(date of incorporation) to 31 December 1997  
(Expressed in Renminbi)

**Notes to the Consolidated Cash Flow Statement** (cont'd)**(e) Significant non-cash transactions**

The Group incurred payables of RMB1,529,934,000 from equipment suppliers and a loan of RMB1,382,395,000 from its ultimate holding company for additions of construction in progress during the year ended 31 December 1997.

In addition, the Group incurred loans of RMB266,976,000 from equipment suppliers for additions of construction in progress during the year ended 31 December 1996.

## Notes to the Accounts

(Expressed in Renminbi)

### 1 Restructuring and basis of presentation of accounts

The Company was incorporated in Hong Kong under the Companies Ordinance on 3 September 1997. Through a restructuring in preparation for the listing of the Company's shares on the New York Stock Exchange and The Stock Exchange of Hong Kong Limited on 22 October 1997 and 23 October 1997, respectively, the MPT transferred its 100 per cent interest in Guangdong Mobile Communication Corporation and 99.63 per cent interest in Zhejiang GSM Mobile Communication Company Limited to the Company. 9,010,000,000 ordinary shares of HK\$0.10 each were issued by the Company to China Telecom Hong Kong (BVI) Limited, a wholly-owned subsidiary of the MPT, as consideration for this transfer. Following the transfer, Guangdong Mobile Communication Corporation became a wholly-owned foreign enterprise, Guangdong Mobile Communication Company Limited ("Guangdong Mobile") and Zhejiang GSM Mobile Communication Company Limited became a sino-foreign joint venture company, Zhejiang Mobile Communication Company Limited ("Zhejiang Mobile").

The consolidated profit and loss account for the period ended 31 December 1997 includes the results of the Company for the period from 3 September 1997 to 31 December 1997 and the post-acquisition results of its subsidiaries for the period from 27 September 1997 to 31 December 1997. The consolidated cash flow statement for the period ended 31 December 1997 is prepared based on the consolidated balance sheet at 31 December 1997 and the proforma combined balance sheet at 31 December 1996. A separate note is included in the notes to the consolidated cash flow statement which shows the increase in the amount of cash and cash equivalents for the period from 3 September 1997 to 31 December 1997.

The proforma combined profit and loss accounts (including notes to the accounts) for the years ended 31 December 1996 and 1997 include the results of the subsidiaries with effect from 1 January 1996 or since their respective dates of incorporation, where this is a shorter period, on a combined basis as if the current group structure had been in existence throughout the years ended 31 December 1996 and 1997. The proforma combined balance sheet at 31 December 1996 is a combination of the balance sheets of the subsidiaries of the Company as at 31 December 1996. The proforma combined cash flow statement for the year ended 31 December 1996 includes the results of the subsidiaries with effect from 1 January 1996 or since their respective dates of incorporation, where this is a shorter period, on a combined basis as if the current group structure had been in existence throughout the year ended 31 December 1996. These proforma combined accounts are presented for information only.

In the opinion of the directors, the resulting presentation of the accounts gives a more meaningful view of the results and the state of affairs of the Group as a whole.

### 2 Principal accounting policies

These accounts have been prepared in accordance with Hong Kong Statements of Standard Accounting Practice, accounting principles generally accepted in Hong Kong and the disclosure requirements of the Hong Kong Companies Ordinance. A summary of the significant accounting policies is set out below.



## Notes to the Accounts (cont'd)

(Expressed in Renminbi)

### 2 Principal accounting policies (cont'd)

#### (a) Basis of consolidation

- (i) The consolidated accounts include the accounts of the Company and both of its subsidiaries made up to 31 December 1997. The results of subsidiaries acquired during the period are included in the consolidated profit and loss account from the date of their acquisition. All material intercompany transactions are eliminated on consolidation.
- (ii) The excess of the Group's share of the fair value of the separable net assets of subsidiaries acquired over the cost of investments in these companies is credited to capital reserve.

#### (b) Interest in subsidiaries

Interest in subsidiaries in the Company's balance sheet is stated at cost less any provisions for permanent diminution in value, if necessary, as determined by the directors.

#### (c) Associated companies

An associated company is a company, not being a subsidiary, in which the Group's interest is for the long term and the Group is in a position to exercise significant influence over the company in which the investment is made.

The Group's share of the post-acquisition results of its associated companies for the period is not considered material and therefore is not included in the consolidated profit and loss account. In the consolidated balance sheet, interest in associated companies is stated at cost less any provisions for permanent diminution in value, if necessary, as determined by the directors.

#### (d) Fixed assets and depreciation

- (i) Fixed assets are stated at cost/revalued amount less accumulated depreciation.
- (ii) The cost of fixed assets comprises the purchase price and any directly attributable costs of bringing the asset to its working condition and location for its intended use. Expenditures incurred after the fixed asset has been put into operation, such as repairs and maintenance and overhaul costs, are normally charged to the profit and loss account in the period in which it is incurred. In situations where it can be clearly demonstrated that the expenditure has resulted in an increase in the future economic benefits expected to be obtained from the use of the fixed asset, the expenditure is capitalised as an additional cost of the fixed asset.
- (iii) Gains or losses arising from the retirement or disposal of fixed assets are determined as the difference between the net disposal proceeds and the carrying amount of the asset and are recognised as income or expense in the profit and loss account on the date of retirement or disposal.

## Notes to the Accounts (cont'd)

(Expressed in Renminbi)

### 2 Principal accounting policies (cont'd)

#### (d) Fixed assets and depreciation (cont'd)

- (iv) The carrying amount of fixed assets carried at depreciated cost is reviewed periodically in order to assess whether the recoverable amount has declined below the carrying amount. When such a decline has occurred, the carrying amount is reduced to the recoverable amount. The amount of the reduction is recognised as an expense in the profit and loss account. In determining the recoverable amount, expected future cash flows generated by the fixed assets are discounted to their present values.

A subsequent increase in the recoverable amount of an asset carried at depreciated cost is written back to the profit and loss account when the circumstances and events that led to the write-down or write-off cease to exist. The amount written back is reduced by the amount that would have been recognised as depreciation had the write-down or write-off not occurred.

- (v) Depreciation is calculated to write off the cost, or revalued amount where appropriate, of fixed assets on a straight-line basis over their estimated useful lives, to residual values, as follows:

	Depreciable life	Residual value
Land use rights	Over the period of grant	—
Buildings	8 – 35 years	3%
Telecommunications transceivers, switching centres and other network equipment	7 years	3%
Office equipment, furniture and fixtures and others	4 – 18 years	3%

#### (e) Construction in progress

Construction in progress is stated at cost. Cost comprises direct costs of construction as well as interest expense and exchange differences capitalised during the periods of construction and installation. Capitalisation of these costs ceases and the construction in progress is transferred to fixed assets when substantially all the activities necessary to prepare the assets for their intended use are completed. No depreciation is provided in respect of construction in progress until it is completed and ready for its intended use.

## Notes to the Accounts (cont'd)

(Expressed in Renminbi)

### 2 Principal accounting policies (cont'd)

(f) Inventories

Inventories, which consist primarily of handsets, SIM cards and accessories, are stated at the lower of cost and net realisable value. Cost represents purchase cost of goods calculated using the weighted average cost method. Net realisable value is determined by reference to the sales proceeds of items sold in the ordinary course of business after the balance sheet date or to management's estimates based on prevailing market conditions.

(g) Deferred revenue

Deferred revenue from assignment of rights to income from subscribers with distributors of telecommunications services is stated in the balance sheet at the amount of consideration received according to the relevant assignment contracts less income recognised in the profit and loss account up to the balance sheet date.

Income is deferred and recognised on a straight-line basis over the relevant assignment period. For assignment contracts which the distributors surrender for early cancellation, the balance of the Group's deferred revenue in respect of those contracts is recognised as income when the assignment contracts are cancelled.

(h) Borrowing costs

Borrowing costs are expensed in the profit and loss account in the period in which they are incurred, except to the extent that such costs are capitalised as being directly attributable to the acquisition or construction of an asset which necessarily takes a substantial period of time to get ready for its intended use.

(i) Revenue recognition

Revenue is recognised when it is probable that the economic benefits will accrue to the Group and when the revenue can be measured reliably on the following bases:

- (i) usage fees are recognised as revenue when the service is rendered;
- (ii) monthly fees are recognised as revenue in the month during which the service is rendered;
- (iii) connection fees are recognised as revenue when received;
- (iv) deferred revenue from assignment of rights to income from subscribers is recognised on a straight-line basis over the duration of the assignment period;
- (v) interest income is recognised on a time proportion basis on the principal outstanding and at the rate applicable; and
- (vi) sales of handsets and SIM cards are recognised on delivery of goods to the buyer. Such revenue, net of cost of goods sold, is included in other income due to its insignificance.

## Notes to the Accounts (cont'd)

(Expressed in Renminbi)

### 2 Principal accounting policies (cont'd)

(j) Allowance for doubtful accounts

An allowance for doubtful accounts is provided based upon evaluation of the recoverability of the receivables at the balance sheet date.

(k) Translation of foreign currencies

Foreign currency transactions during the period are translated into Renminbi at the exchange rates ruling at the transaction dates. Monetary assets and liabilities denominated in foreign currencies are translated into Renminbi at the exchange rates ruling at the balance sheet date. Exchange differences attributable to the translation of borrowings denominated in foreign currencies and used for financing the construction of fixed assets, are included in the cost of the related construction in progress. Exchange differences capitalised to construction in progress are immaterial for the periods presented. Other exchange gains and losses are recognised in the profit and loss account.

(l) Deferred taxation

Deferred taxation is provided in respect of the tax effect arising from all significant timing differences which are expected with reasonable probability to crystallise in the foreseeable future and is calculated under the liability method. Future deferred tax benefits are not recognised unless their realisation is assured beyond reasonable doubt.

(m) Retirement benefits

The employees of the subsidiaries participate in a defined benefit retirement plan managed by the MPT whereby the subsidiaries are required to contribute to the scheme at a fixed rate of 19.1 per cent of the employees' salary costs. The subsidiaries have no obligation for the payment of retirement and other post-retirement benefits of staff other than the contributions described above.

(n) Operating leases

Operating lease payments are charged to the profit and loss account on a straight-line basis over the periods of the respective leases.

## Notes to the Accounts (cont'd)

(Expressed in Renminbi)

### 3 Turnover

Turnover primarily represents usage fees, monthly fees and connection fees for the use of the Group's cellular telephone networks, net of PRC business tax and government surcharges and, in 1997, central irrigation construction levy. Business tax and government surcharges are charged at approximately 3.3 per cent of the corresponding revenue and central irrigation construction levy was charged at approximately 3 per cent of certain connection and surcharge revenue. Turnover is analysed as follows:

	Period from 3 September 1997 (date of incorporation) to 31 December 1997 RMB'000	(Note 1) Proforma combined 1997 RMB'000	(Note 1) Proforma combined 1996 RMB'000
Usage fees	2,760,412	8,718,056	5,527,875
Monthly fees	771,414	2,692,166	1,658,188
Connection fees	851,057	3,173,529	2,673,425
Others	313,450	904,028	507,753
	<u>4,696,333</u>	<u>15,487,779</u>	<u>10,367,241</u>

Prior to 20 October 1997, International Direct Dial ("IDD") and certain Domestic Direct Dial ("DDD") call charges receivable from subscribers are not reflected as revenue. Pursuant to the new interconnection agreements, with effect from 20 October 1997, Guangdong Mobile and Zhejiang Mobile reflect IDD and DDD calls charges receivable from subscribers and the amounts payable by relevant Posts and Telecommunications Administrations ("PTA") to the Group for inbound calls to the Group's subscribers which originate from the MPT System's fixed line Public Switched Telephone Network ("PSTN") as revenue.

## Notes to the Accounts (cont'd)

(Expressed in Renminbi)

### 4 Profit before tax and minority interests

Profit before tax and minority interests is arrived at

	Period from 3 September 1997 (date of incorporation) to 31 December 1997 RMB'000	(Note 1) Proforma combined 1997 RMB'000	(Note 1) Proforma combined 1996 RMB'000
<b>after crediting:</b>			
Amortisation of deferred revenue from assignment of rights to income from subscribers	49,710	119,255	2,393
Interest income on bank deposits	599,915	653,645	68,692
Interest income on amounts due from related parties	—	2,962	3,956
Penalty income on overdue accounts	23,738	92,992	40,019
Exchange gain, net	—	—	1,596
Gain on disposal of fixed assets	—	—	72
	<u>          </u>	<u>          </u>	<u>          </u>
<b>and after charging:</b>			
Interest on bank advances and other borrowings repayable within five years	11,834	46,942	78,746
Interest on other loans	81,715	240,367	134,982
Less: Amount capitalised as construction in progress (Note)	<u>(55,176)</u>	<u>(111,974)</u>	<u>(46,584)</u>
Interest expense	38,373	175,335	167,144
Depreciation	854,268	2,680,538	1,424,306
Operating lease charges in respect of			
— properties	60,735	211,015	111,876
— leased lines	791,512	3,134,260	2,213,563
— others	6,061	16,759	11,885
Exchange loss, net	57,877	60,902	—
Loss on disposal of fixed assets	12,476	12,668	—
Contribution to retirement scheme	26,916	100,770	40,660
Provision for doubtful accounts	139,662	449,124	227,430
Provision for obsolete inventories	3,086	6,083	67,954
Auditors' remuneration	<u>10,703</u>	<u>10,703</u>	<u>—</u>

Note: The borrowing costs have been capitalised at a rate of 7.5 per cent to 11.03 per cent for construction in progress during the period ended 31 December 1997.

**Notes to the Accounts** (cont'd)

(Expressed in Renminbi)

**5 Directors' remuneration**

Directors' remuneration disclosed pursuant to section 161 of the Companies Ordinance is as follows:

## (a) Executive directors

	Period from 3 September 1997 (date of incorporation) to 31 December 1997 RMB'000	(Note 1) Proforma combined 1997 RMB'000
Fees	385	385
Salaries, allowances and benefits in kind	2,829	3,113
Retirement benefits	33	94
Bonuses	<u>30</u>	<u>66</u>
	<u><u>3,277</u></u>	<u><u>3,658</u></u>

## (b) Non-executive directors

	Period from 3 September 1997 (date of incorporation) to 31 December 1997 RMB'000	(Note 1) Proforma combined 1997 RMB'000
Fees	<u>257</u>	<u>257</u>

## Notes to the Accounts (cont'd)

(Expressed in Renminbi)

### 5 Directors' remuneration (cont'd)

The number of directors whose remuneration from the Group falls within the following band is set out below:

	Period from 3 September 1997 (date of incorporation) to 31 December 1997	(Note 1) Proforma combined 1997
Nil to RMB1,000,000	<u>10</u>	<u>10</u>

### 6 Five highest paid individuals

Of the five highest paid individuals in this period, four are directors of the Company and their remuneration has been included in Note 5 above. The remuneration of the remaining highest paid individual is as follows:

	Period from 3 September 1997 (date of incorporation) to 31 December 1997 RMB'000	(Note 1) Proforma combined 1997 RMB'000
Salaries, allowances and benefits in kind	<u>231</u>	<u>231</u>

During the period/year, no emoluments were paid by the Group to the five highest paid individuals, including directors, as an inducement to join or upon joining the Group or as compensation for loss of office.



**Notes to the Accounts** (cont'd)

(Expressed in Renminbi)

**7 Income tax**

(a) Income tax in the consolidated profit and loss account represents:

	<b>Period from 3 September 1997 (date of incorporation) to 31 December 1997 RMB'000</b>	<b>(Note 1) Proforma combined 1997 RMB'000</b>	<b>(Note 1) Proforma combined 1996 RMB'000</b>
Provision for Hong Kong profits tax for the period/year	8,161	8,161	—
Provision for PRC income tax on the estimated taxable profits for the period/year	421,684	984,867	449,566
Deferred tax asset (Note 16(a))	<u>(2,009)</u>	<u>(2,009)</u>	<u>(22,023)</u>
	<u><b>427,836</b></u>	<u><b>991,019</b></u>	<u><b>427,543</b></u>

- (i) The provision for Hong Kong profits tax is calculated at 16.5 per cent of the estimated assessable profits for the period ended 31 December 1997.
- (ii) Pursuant to the income tax rules and regulations of the PRC, the Group's subsidiaries in the PRC are subject to the statutory income tax rate of 33 per cent for the period ended 31 December 1997. According to a notice from the PRC Ministry of Finance, connection fees and certain surcharges, which were previously not subject to income tax, are subject to income tax rate of 33 per cent with effect from 23 October 1997.

## Notes to the Accounts (cont'd)

(Expressed in Renminbi)

### 7 Income tax (cont'd)

(b) Taxation in the balance sheet represents:

	The Group (Note 1) Proforma combined 1997 RMB'000	1996 RMB'000	The Company 1997 RMB'000
Provision for Hong Kong profits tax for the period	8,161	—	8,161
Provision for PRC income tax for the year	984,867	449,566	—
Balance of PRC income tax recoverable relating to prior year	(174,372)	—	—
PRC income tax paid	<u>(546,216)</u>	<u>(623,938)</u>	<u>—</u>
	<u>272,440</u>	<u>(174,372)</u>	<u>8,161</u>

### 8 Net profit for the period

The net profit for the period attributable to shareholders includes a profit of RMB483,086,000 which has been dealt with in the accounts of the Company.

### 9 Dividends

The board of directors of the Company do not recommend the payment of a final dividend for the period ended 31 December 1997.

### 10 Earnings per share

The calculation of earnings per share for the period from 3 September 1997 to 31 December 1997 is based on the consolidated net profit of RMB1,513,723,000 and the weighted average number of 8,802,944,500 shares in issue during the period ended 31 December 1997.

The calculation of proforma earnings per share for the year ended 31 December 1997 is based on the proforma combined net profit for the year of RMB4,955,381,000 and the proforma weighted average number of 9,534,365,315 shares in issue during the year. The calculation of proforma earnings per share for the year ended 31 December 1996 is based on the proforma combined net profit for the year of RMB4,509,158,000 and the proforma 9,010,000,000 shares in issue during the year.

**Notes to the Accounts** (cont'd)

(Expressed in Renminbi)

**11 Fixed assets**

(a) The Group

	<b>Land use rights and buildings</b> RMB'000	<b>Telecommunications transceivers, switching centres and other network equipment</b> RMB'000	<b>Office equipment, furniture and fixtures and others</b> RMB'000	<b>Total</b> RMB'000
<b>Cost:</b>				
Acquired on acquisition of subsidiaries	609,904	14,808,572	488,301	15,906,777
Additions	445	66,525	95,559	162,529
Transferred from construction in progress	165,540	4,237,155	—	4,402,695
Disposals	—	(28,903)	—	(28,903)
At 31 December 1997	<u>775,889</u>	<u>19,083,349</u>	<u>583,860</u>	<u>20,443,098</u>
<b>Accumulated depreciation:</b>				
Acquired on acquisition of subsidiaries	7,251	921,044	31,141	959,436
Charge for the period	6,230	822,152	25,886	854,268
Written back on disposals	—	(4,843)	—	(4,843)
At 31 December 1997	<u>13,481</u>	<u>1,738,353</u>	<u>57,027</u>	<u>1,808,861</u>
<b>Net book value:</b>				
At 31 December 1997	<u><u>762,408</u></u>	<u><u>17,344,996</u></u>	<u><u>526,833</u></u>	<u><u>18,634,237</u></u>

(b) The Company

	<b>Office equipment, furniture and fixtures and others</b> RMB'000
<b>Cost:</b>	
Additions during the period and balance at 31 December 1997	2,350
<b>Accumulated depreciation:</b>	
Charge for the period and balance at 31 December 1997	<u>301</u>
<b>Net book value:</b>	
At 31 December 1997	<u><u>2,049</u></u>

## Notes to the Accounts (cont'd)

(Expressed in Renminbi)

### 11 Fixed assets (cont'd)

(c) The analysis of net book value of land use rights is as follows:

	<b>The Group 1997 RMB'000</b>
Long leases	<b>85,691</b>
Medium-term leases	<b><u>77,950</u></b>
	<b><u><u>163,641</u></u></b>

All of the Group's buildings are located elsewhere in the PRC.

As part of the Group restructuring, the cellular telephone business of Guangdong Mobile and Zhejiang Mobile together with the relevant assets and liabilities were transferred to the Company. As required by the relevant PRC rules and regulations, a valuation of the assets and liabilities to be injected into the Group was carried out at 31 May 1997 and approved by the State-owned Assets Administration Bureau on 5 September 1997 and the injected assets and liabilities were reflected in the accounts on this basis. This 1997 valuation was a one-off exercise which established the deemed cost of the fixed assets purchased by the Group.

The effect of this valuation on the fixed assets of Guangdong Mobile and Zhejiang Mobile is to increase the depreciation charges reflected in the proforma combined profit and loss account for the year ended 31 December 1997 by approximately RMB379,813,000.

### 12 Construction in progress

Construction in progress comprises expenditure incurred on the network expansion projects, construction of office buildings and construction of staff quarters not yet completed at 31 December 1997.

### 13 Interest in subsidiaries

	<b>1997 RMB'000</b>
Capital contributions, at cost	<b><u><u>18,333,765</u></u></b>

**Notes to the Accounts** (cont'd)

(Expressed in Renminbi)

**13 Interest in subsidiaries** (cont'd)

Details of the subsidiaries are as follows:

<b>Name of company</b>	<b>Place of incorporation and operation</b>	<b>Particulars of issued and paid up capital</b>	<b>Attributable interest held directly</b>	<b>Principal activities</b>
Guangdong Mobile	PRC	RMB5,594,840,700	100%	Cellular telephone operator
Zhejiang Mobile	PRC	RMB2,117,790,000	99.63%	Cellular telephone operator

**14 Interest in associated companies**

	<b>The Group 1997 RMB'000</b>
Unlisted shares, at cost	<b>21,430</b>
Capital contributions, at cost	<b>9,000</b>
	<b><u>30,430</u></b>

Details of the associated companies are as follows:

<b>Name of company</b>	<b>Place of incorporation</b>	<b>Attributable interest held by the Group</b>	<b>Principal activities</b>
China Motion United Telecom Limited	Hong Kong	30%	Provision of telecommunication services
Shenzhen China Motion Telecom United Limited	PRC	30%	Provision of telecommunication services

## Notes to the Accounts (cont'd)

(Expressed in Renminbi)

### 15 Amounts due from related parties

Amounts due from related parties primarily represent amounts due from Guangdong PTA and Zhejiang PTA. Such amounts are unsecured, non-interest bearing, repayable on demand and arose in the ordinary course of business.

### 16 Deferred taxation

(a) Movements on deferred taxation comprise:

	<b>The Group</b>	
		(Note 1)
		Proforma
		combined
	<b>1997</b>	1996
	<b>RMB'000</b>	RMB'000
Balance at 1 January	—	108
Acquired on acquisition of subsidiaries	<b>22,131</b>	—
Transfer to the profit and loss account (Note 7(a))	<u><b>2,009</b></u>	<u>22,023</u>
Balance at 31 December	<u><b>24,140</b></u>	<u>22,131</u>

(b) Deferred tax asset of the Group consists of provision for obsolete inventories.

(c) Deferred tax asset/(liability) of the Group not provided for is as follows:

	<b>The Group</b>	
		(Note 1)
		Proforma
		combined
	<b>1997</b>	1996
	<b>RMB'000</b>	RMB'000
Provision for doubtful accounts	<b>228,082</b>	82,606
Fixed assets basis differences	<u>—</u>	<u>(444,155)</u>
	<u><b>228,082</b></u>	<u>(361,549)</u>

As described in Note 11, in connection with the restructuring, the fixed assets of Guangdong Mobile and Zhejiang Mobile have been revalued at 31 May 1997. As a result of such valuation, the fixed assets basis differences that gave rise to the potential deferred tax liabilities of the subsidiaries were eliminated.

**Notes to the Accounts** (cont'd)

(Expressed in Renminbi)

**17 Bank and other loans**

## (a) Short-term

	<b>The Group</b>	
	<b>1997</b>	(Note 1) Proforma combined 1996
	<b>RMB'000</b>	RMB'000
Bank loans	<b>600,000</b>	103,000
Loans from related parties	<b>227,000</b>	932,700
	<b>827,000</b>	1,035,700
Current portion of long-term bank and other loans (Note 17(b))	<b>1,320,558</b>	468,556
	<b>2,147,558</b>	1,504,256

All of the above short-term loans are unsecured. Loans from related parties mainly represent short-term loans from Zhejiang PTA, bearing interest at 7.65 per cent per annum.

## (b) Long-term

	<b>The Group</b>	
	<b>1997</b>	(Note 1) Proforma combined 1996
	<b>RMB'000</b>	RMB'000
Bank loans	<b>413,990</b>	426,910
Loans from related parties	<b>800,000</b>	—
Loan from ultimate holding company	<b>1,382,395</b>	—
Other loans	<b>1,594,499</b>	1,988,090
	<b>4,190,884</b>	2,415,000
Less: Current portion (Note 17(a))	<b>(1,320,558)</b>	(468,556)
	<b>2,870,326</b>	1,946,444

**Notes to the Accounts** (cont'd)

(Expressed in Renminbi)

**17 Bank and other loans** (cont'd)

## (b) Long-term (cont'd)

All of the above long-term loans are unsecured. Loans from related parties represent long-term loans from Zhejiang PTA, bearing interest at 10.98 per cent per annum with maturities in 1998 to 1999. Loan from ultimate holding company bears interest at 7.5 per cent per annum with maturities in 1998 to 2000. Other loans bear interest at various rates between 6.4 per cent to 10.98 per cent per annum with maturities in 1998 to 2004.

## (c) The Group's long-term bank and other loans were repayable as follows:

At 31 December 1997:

	<b>The Group</b>		
	<b>Bank loans</b>	<b>Other loans</b>	<b>Total</b>
	RMB'000	RMB'000	RMB'000
On demand or within one year	103,498	1,217,060	1,320,558
After one year but within two years	103,498	1,248,236	1,351,734
After two years but within five years	206,994	997,005	1,203,999
After five years	—	314,593	314,593
	<u>310,492</u>	<u>2,559,834</u>	<u>2,870,326</u>
	<u>413,990</u>	<u>3,776,894</u>	<u>4,190,884</u>

At 31 December 1996:

**(Note 1) Proforma combined**

	<b>Bank loans</b>	<b>Other loans</b>	<b>Total</b>
	RMB'000	RMB'000	RMB'000
On demand or within one year	7,000	461,556	468,556
After one year but within two years	108,726	452,256	560,982
After two years but within five years	311,184	651,644	962,828
After five years	—	422,634	422,634
	<u>419,910</u>	<u>1,526,534</u>	<u>1,946,444</u>
	<u>426,910</u>	<u>1,988,090</u>	<u>2,415,000</u>



**Notes to the Accounts** (cont'd)

(Expressed in Renminbi)

**18 Deferred revenue**

Deferred revenue from assignment of rights to income from subscribers represents the unamortised portion of proceeds received by Guangdong Mobile from certain distributors of telecommunications services pursuant to agreements under which Guangdong Mobile sold certain mobile phone numbers to these distributors at RMB9,167 each, in return for assigning to such distributors the rights to certain revenue such as usage fees, monthly fees, connection fees, telephone number selection fees and 50 per cent value-added services fees from those subscribers over a period of seven years. The distributors have no recourse to the Group under the relevant agreements and the Group maintains no credit risk from such subscribers during the seven-year period. The proceeds received by Guangdong Mobile have been accounted for as deferred revenue and are amortised over a period of seven years. After the expiration of the relevant agreements, the rights to income from these subscribers will revert to the Group.

	<b>The Group</b>	
		(Note 1)
		Proforma
		combined
	<b>1997</b>	1996
	<b>RMB'000</b>	RMB'000
Acquired on acquisition of subsidiaries	<b>1,174,573</b>	—
Additions	<b>228,000</b>	201,000
Recognised in profit and loss account	<b>(49,710)</b>	(2,393)
Balance at 31 December	<b><u>1,352,863</u></b>	<u>198,607</u>

**19 Share capital**

	<b>Number of ordinary shares</b>	<b>Nominal amount of each ordinary share</b>	<b>Amount HK\$'000</b>
<b>Authorised:</b>			
Authorised share capital on incorporation	100,000	HK\$0.1	10
Increase in authorised share capital	<u>15,999,900,000</u>	HK\$0.1	<u>1,599,990</u>
Balance at 31 December 1997	<u>16,000,000,000</u>		<u>1,600,000</u>

**Notes to the Accounts** (cont'd)

(Expressed in Renminbi)

**19 Share capital** (cont'd)

	Number of ordinary shares	Nominal amount of each ordinary share	Amount HK\$'000
<b>Issued and fully paid:</b>			
Issue of shares on incorporation	2	HK\$0.1	—
Issue of new shares in connection with the restructuring	<u>9,009,999,998</u>	HK\$0.1	<u>901,000</u>
	9,010,000,000		901,000
Issue of new shares in the offering to the public and placing of new shares to professional and institutional investors	<u>2,770,788,000</u>	HK\$0.1	<u>277,079</u>
Balance at 31 December 1997	<u><u>11,780,788,000</u></u>		<u><u>1,178,079</u></u>
		RMB'000 equivalent	<u><u>1,261,419</u></u>
Balance at 31 December 1996		RMB'000 equivalent	<u><u>480,322</u></u>

The Company was established in Hong Kong on 3 September 1997 as a limited company, with a registered share capital of HK\$10,000 divided into 100,000 shares of HK\$0.10 each, two of which were issued and credited as fully paid.

At an extraordinary general meeting of the Company held on 27 September 1997,

- (i) the authorised share capital of the Company was increased from HK\$10,000 to HK\$1,600,000,000 by the creation of an additional 15,999,900,000 shares of HK\$0.10 each; and
- (ii) 9,009,999,998 shares were credited as fully paid and issued to China Telecom Hong Kong (BVI) Limited for the transfer of interests in Guangdong Mobile and Zhejiang Mobile to the Company.

## Notes to the Accounts (cont'd)

(Expressed in Renminbi)

### 19 Share capital (cont'd)

Pursuant to the resolutions passed on 21 October 1997, the Company issued 2,600,000,000 shares of HK\$0.1 each at HK\$11.68 per share and the shares were listed on the New York Stock Exchange and The Stock Exchange of Hong Kong Limited on 22 October 1997 and 23 October 1997 respectively. On 7 November 1997, the Company issued 170,788,000 shares of HK\$0.1 each at HK\$11.68 per share by way of a placing among professional and institutional investors.

The 1996 comparative figure represents the combined share capital of the subsidiaries as at 31 December 1996 on the basis set out in Note 1.

### 20 Share option scheme

On 8 October 1997, the Company adopted a share option scheme to which the directors of the Company may, at their discretion, invite employees, including executive directors, of the Company or any of its subsidiaries, to take up options to subscribe for shares up to a maximum aggregate number of shares equal to 10 per cent of the total issued share capital of the Company. The consideration payable by a participant for the grant of an option under the share option scheme will be HK\$1.00. The price of a share payable by a participant upon the exercise of an option will be determined by the directors of the Company at their discretion, except that such price may not be set below a minimum price which is the higher of:

- (i) the nominal value of a share; and
- (ii) 80 per cent of the average of the closing prices of shares on The Stock Exchange of Hong Kong Limited on the five trading days immediately preceding the date of grant of the option.

The period during which an option may be exercised will be determined by the directors at their discretion, except that no option may be exercised later than 10 years after the adoption date of the scheme.

As at 31 December 1997, no options were granted by the Company under the share option scheme.

On 9 March 1998, share options for a total of 12,000,000 shares at an exercise price of HK\$11.1 per share (which can be exercised during the period from 9 March 1998 to 8 March 2006) were granted under the share option scheme to certain eligible employees, including executive directors of the Company.

## Notes to the Accounts (cont'd)

(Expressed in Renminbi)

### 21 Reserves

	Share premium RMB'000	Capital reserve RMB'000	General reserve RMB'000	PRC statutory reserves RMB'000	Retained profits RMB'000	Total RMB'000
<b>The Group</b>						
Premium arising on issue of shares	51,698,908	—	—	—	—	51,698,908
Expenses incurred in connection with the issue of shares	(1,056,331)	—	—	—	—	(1,056,331)
Capital reserve arising on acquisition of subsidiaries	—	1,131,950	—	—	—	1,131,950
Net profit for the period	—	—	—	—	1,513,723	1,513,723
Transfer to general reserve	—	—	72,463	—	(72,463)	—
Transfer to PRC statutory reserves, net of minority interests' share	—	—	—	110,946	(110,946)	—
	<u>50,642,577</u>	<u>1,131,950</u>	<u>72,463</u>	<u>110,946</u>	<u>1,330,314</u>	<u>53,288,250</u>
At 31 December 1997						
<b>The Company</b>						
Premium arising on issue of shares	51,698,908	—	—	—	—	51,698,908
Expenses incurred in connection with the issue of shares	(1,056,331)	—	—	—	—	(1,056,331)
Net profit for the period (Note 8)	—	—	—	—	483,086	483,086
Transfer to general reserve	—	—	72,463	—	(72,463)	—
	<u>50,642,577</u>	<u>—</u>	<u>72,463</u>	<u>—</u>	<u>410,623</u>	<u>51,125,663</u>
At 31 December 1997						

At 31 December 1997, the amount of distributable reserves of the Company amounted to RMB483,086,000.

#### PRC statutory reserves

In accordance with the Articles of Association and Regulations on Posts and Telecommunications Enterprises, Guangdong Mobile and Zhejiang Mobile are required to transfer a certain percentage of profit after taxation to the statutory surplus reserve and statutory public welfare reserve as determined by accounting principles generally accepted in the PRC ("PRC GAAP"). At 31 December 1997, the balances of statutory surplus reserve and statutory public welfare reserve were RMB73,964,000 and RMB36,982,000 respectively.

Statutory surplus reserve can be used to make good previous years' losses, provided that the balance after such offset is not less than 25 per cent of the registered capital. Statutory public welfare reserve can only be utilised on capital items for the collective benefits of the employees such as the construction of staff quarters and other staff welfare facilities. This reserve is non-distributable other than in liquidation.

In connection with the restructuring, Guangdong Mobile became a wholly-owned foreign enterprise while Zhejiang Mobile became a sino-foreign joint venture company. In accordance with the Regulations on Enterprises with Foreign Investment, both Guangdong Mobile and Zhejiang Mobile are required to transfer a certain percentage of profit after taxation, as determined under PRC GAAP, to the general reserve fund and the enterprise expansion fund. In the case of Guangdong Mobile, since it is a wholly-owned foreign enterprise, at least 10 per cent of its profit after taxation determined under the PRC GAAP should be transferred to the general reserve fund until its balance is equal to 50 per cent of the registered capital. The general reserve fund can be used to make good losses and to increase capital while enterprise expansion fund can be used to increase capital.

## Notes to the Accounts (cont'd)

(Expressed in Renminbi)

### 22 Connected and related party transactions

The Group's operations are subject to extensive regulation by the PRC government. The MPT, pursuant to the authority delegated to it by the PRC State Council, directly or indirectly regulates licensing, competition, interconnection, technology and equipment standards, and other aspects of the PRC telecommunications industry. The MPT, together with other PRC government entities, also regulates tariff policy, foreign investment and spectrum allocation and spectrum usage fees. Specifically, the Group's tariffs are subject to the regulation by various Government authorities, including the State Planning Commission ("SPC"), the MPT, the PTAs and the relevant Provincial Price Bureaus ("PPBs"). The connection fees charged by the Group are based on a guidance price range set jointly by the MPT and SPC, with each actual fee determined by the relevant PTA in consultation with the relevant PPB. In general, the Group's base usage charges and domestic roaming usage charges are set by the MPT and SPC. International roaming charges are set by the MPT pursuant to agreements between the DGT and other cellular operators. The principal connected and related party transactions, which were entered into with the MPT and other entities under the control of MPT, are as follows:

	Note	Proforma combined 1997 RMB'000
Interconnection charges	(i)	738,520
Leased line charges	(ii)	3,134,260
Roaming revenue	(iii)	470,258
Roaming expenses	(iv)	475,709
Spectrum fees	(v)	20,138
Operating lease charges	(vi)	151,691
Purchase of mobile phones and equipment		1,743,286
Sales commission	(vii)	151,614
Debt collection service fees	(vii)	60,239
Billing service fees	(vii)	506
Interest paid/payable	(viii)	106,020
Interest received		2,962
Capital contributions	(ix)	245,700
Distributions	(x)	221,812

Notes:

- (i) Interconnection charges represent the amounts paid or payable to the Guangdong PTA and the Zhejiang PTA in respect of calls made between the Total Access Communication Systems ("TACS") / Global System for Mobile Communications ("GSM") networks and the PSTN in Guangdong and Zhejiang respectively. Prior to 20 October 1997, no interconnection fees were charged to the Group for the TACS network in Zhejiang and TACS and GSM networks in Guangdong and the interconnection fees charged for the GSM networks in Zhejiang were calculated pursuant to Zhe You Ju Cai (1996) No. 13. Pursuant to the new interconnection agreements, with effect from 20 October 1997, the Group records the amounts payable by the Group for outbound calls from the Group's subscribers which terminate on the MPT System's PSTN as interconnection charges.

## Notes to the Accounts (cont'd)

(Expressed in Renminbi)

### 22 Connected and related party transactions (cont'd)

Notes: (cont'd)

- (ii) Leased line charges represent expenses paid or payable to the Guangdong PTA/Posts and Telecommunications Bureaus ("PTBs") and the Zhejiang PTA/PTBs for the use of leased lines between the base transceiver stations, base station controllers, base stations, fixed line network connectors, long distance network connectors and main switches.
- (iii) A cellular telephone user using roaming services is charged at the respective roaming usage rate for roaming in calls, in addition to applicable long distance charges. Roaming revenue represents domestic and international roaming in usage charges from non-subscribers received or receivable from the relevant PTAs and international cellular telephone operators through MPT.
- (iv) A cellular telephone user using roaming services is charged at the respective roaming usage rate for roaming out calls, in addition to applicable long distance charges. Roaming expenses represent the amount of domestic and international roaming out charges received or receivable from subscribers which is to be remitted to the relevant PTAs and international cellular telephone operators for their share of the roaming revenue through MPT.
- (v) Spectrum fees represent the spectrum usage fees paid or payable through DGT to the State Radio Regulatory Commission for the usage of the frequency bands allocated to Guangdong Mobile and Zhejiang Mobile.
- (vi) Operating lease charges represent the rental paid or payable to the Guangdong PTA/PTBs, the Zhejiang PTA/PTBs and Telpo for operating leases in respect of land and buildings and others.
- (vii) With effect from 20 October 1997, the Group entered into certain new services agreements with Guangdong PTA and Zhejiang PTA in respect of commission services with authorised dealers, debt collection services and billing services.  
  
Sales commission represents the amounts paid or payable to the Guangdong PTA/PTBs and the Zhejiang PTA/PTBs for their marketing of the cellular services in Guangdong and Zhejiang, respectively.  
  
Debt collection service fees represent the amounts paid or payable to the Guangdong PTA/PTBs for their provision of debt collection services to Guangdong Mobile.  
  
Billing service fees represent the amounts paid or payable to the Zhejiang PTA/PTBs for their provision of the billing services to Zhejiang Mobile.
- (viii) Interest paid/payable represents the interest incurred on loans borrowed from Zhejiang PTA and Telpo.
- (ix) Capital contributions represent cash received from the Guangdong PTA.
- (x) Distributions represent cash payments by Guangdong Mobile to acquire assets transferred to the Guangdong PTA for businesses unrelated to Guangdong Mobile, and the cash effects of the effective settlement of an intercompany account balance arising in the ordinary course of business related to Zhejiang Mobile's TACS operations.

**Notes to the Accounts** (cont'd)

(Expressed in Renminbi)

**23 Commitments**

## (a) Capital commitments

Capital commitments outstanding at 31 December 1997 not provided for in the accounts were as follows:

	<b>The Group 1997 RMB'000</b>	<b>The Company 1997 RMB'000</b>
Commitments in respect of land and buildings		
— authorised and contracted for	<b>298,226</b>	—
— authorised but not contracted for	<b>865,987</b>	—
	<b><u>1,164,213</u></b>	<b><u>—</u></b>
Commitments in respect of telecommunications equipment		
— authorised and contracted for	<b>6,788,040</b>	<b>2,893,128</b>
— authorised but not contracted for	<b>9,919,129</b>	—
	<b><u>16,707,169</u></b>	<b><u>2,893,128</u></b>
Total commitments		
— authorised and contracted for	<b>7,086,266</b>	<b>2,893,128</b>
— authorised but not contracted for	<b>10,785,116</b>	—
	<b><u>17,871,382</u></b>	<b><u>2,893,128</u></b>

**Notes to the Accounts** (cont'd)

(Expressed in Renminbi)

**23 Commitments** (cont'd)

## (b) Operating lease commitments

At 31 December 1997, the Group and the Company had commitments under operating leases to make payments in the next year as follows:

	<b>Land and buildings</b> RMB'000	<b>The Group 1997</b> <b>Leased lines</b> RMB'000	<b>Others</b> RMB'000	<b>Total</b> RMB'000	<b>The Company 1997</b> <b>Land and buildings</b> RMB'000
Leases expiring:					
Within one year	5,392	—	—	5,392	—
After one year but within five years	30,172	830,318	—	860,490	4,730
After five years	<u>107,282</u>	<u>1,592,195</u>	<u>17,116</u>	<u>1,716,593</u>	<u>—</u>
	<u>142,846</u>	<u>2,422,513</u>	<u>17,116</u>	<u>2,582,475</u>	<u>4,730</u>

**24 Post balance sheet events**

Subsequent to the balance sheet date, the Company commenced discussions with the MPT in relation to the acquisition of the cellular telephone operations in Jiangsu province of the PRC and to date no contractual terms have been agreed.

**25 Ultimate holding company**

The directors consider the ultimate holding company at 31 December 1997 to be Telpo Communications (Group) Limited, incorporated in Hong Kong.



## Supplementary Information for ADS Holders

The Group's accounts are prepared in accordance with the generally accepted accounting principles applicable in Hong Kong ("HK GAAP"), which differ in certain significant respects from those applicable in the United States ("US GAAP"). The significant differences relate principally to the following items and the adjustments considered necessary to restate net profit and shareholders' equity in accordance with the US GAAP are shown in the tables set out below.

### (a) Capitalisation of interest

Under HK GAAP, the Group capitalises interest costs to the extent that the related borrowings are directly attributable to the acquisition or construction of an asset which necessarily takes a substantial period of time to get ready for its intended use.

Under US GAAP, interest costs capitalised are determined based on specific borrowings related to the acquisition or construction of an asset, if an entity's financing plans associate a specific new borrowing with a qualifying asset. If average accumulated expenditures for the asset exceed the amounts of specific new borrowings associated with an asset, additional interest costs capitalised are based on the weighted average interest rate applicable to other borrowings of the entity.

### (b) Revaluation of fixed assets

For certain periods prior to 31 May 1997, the fixed assets of the subsidiaries were revalued in compliance with PRC rules and regulations, resulting in an increase in shareholders' equity.

Additionally, in connection with the Group restructuring, the fixed assets of the subsidiaries were revalued as of 31 May 1997. Such fixed assets revaluation results in an increase in shareholders' equity with respect to the increase in carrying amount of certain fixed assets above their historical cost bases.

Under US GAAP, fixed assets are stated at their historical cost, less accumulated depreciation. However, as a result of the tax deductibility of the revaluation reserve, a deferred tax asset related to the reversal of the revaluation reserve is created under US GAAP with a corresponding increase in shareholders' equity.

### (c) Employee housing scheme

The subsidiaries of the Group provides staff quarters under its employee housing schemes at below market prices. Under HK GAAP, employee housing scheme costs borne by the corresponding PTA and not charged to the subsidiaries are not recognised by the subsidiaries.

Under US GAAP, employee housing scheme costs borne by the corresponding PTA and not charged to the subsidiaries are reflected as an expense in the profit and loss account and a corresponding capital contribution. Additionally, under US GAAP, the costs to be borne by the subsidiaries are accrued over the term of the programme.

**Supplementary Information for ADS Holders (cont'd)**

**(d) Deferred taxation**

Under HK GAAP, the Group provides for deferred tax liabilities only to the extent that there is a reasonable probability that such deferred tax liabilities will become payable in the foreseeable future. Deferred tax assets are not recognised unless their realisation is assured beyond reasonable doubt.

Under US GAAP, provisions are made for all deferred taxes as they arise, except a valuation allowance is provided against deferred tax assets when realisation of such amounts does not meet the criterion of "more likely than not".

Effect on proforma combined net profit of significant differences between HK GAAP and US GAAP is as follows:

	<b>1997</b>	<b>1997</b>	1996	1995
	<b>US\$'000</b>	<b>RMB'000</b>	RMB'000	RMB'000
<b>Net profit under HK GAAP</b>	<b>598,490</b>	<b>4,955,381</b>	4,509,158	4,668,646
Adjustments:				
Capitalised interest	<b>7,088</b>	<b>58,688</b>	133,938	43,411
Revaluation of fixed assets	<b>49,710</b>	<b>411,587</b>	31,711	31,647
Employee housing scheme	<b>(2,347)</b>	<b>(19,433)</b>	(36,374)	(36,510)
Deferred taxation	<b>5,189</b>	<b>42,963</b>	(163,839)	(105,106)
Deferred tax effects of US GAAP adjustments	<u><b>(18,743)</b></u>	<u><b>(155,191)</b></u>	<u>(54,664)</u>	<u>(20,022)</u>
<b>Approximate net profit under US GAAP</b>	<u><b>639,387</b></u>	<u><b>5,293,995</b></u>	<u>4,419,930</u>	<u>4,582,066</u>
Approximate net profit per proforma share in accordance with US GAAP	<u><b>0.07</b></u>	<u><b>0.56</b></u>	<u>0.49</u>	
Approximate net profit per proforma ADS in accordance with US GAAP*	<u><b>1.34</b></u>	<u><b>11.11</b></u>	<u>9.81</u>	

\* Based on a ratio of 20 ordinary shares to one ADS.

**Supplementary Information for ADS Holders (cont'd)**

Effect on shareholders' equity of significant differences between HK GAAP and US GAAP is as follows:

	1997 US\$'000	1997 RMB'000	Proforma combined 1996 RMB'000
<b>Shareholders' equity under HK GAAP</b>	<b>6,588,283</b>	<b>54,549,669</b>	12,471,099
Adjustments:			
Capitalised interest	28,508	236,037	177,349
Revaluation of fixed assets			
— Cost	(453,092)	(3,751,508)	(222,438)
— Accumulated depreciation	57,362	474,945	63,358
Deferred tax adjustments on revaluations	130,590	1,081,260	52,491
Employee housing scheme	(14,694)	(121,665)	(102,232)
Deemed capital contribution for employee housing scheme	11,675	96,665	83,604
Recognition of deferred taxes	27,547	228,082	(361,549)
Deferred tax effects of US GAAP adjustments	<u>(9,408)</u>	<u>(77,893)</u>	<u>(58,526)</u>
<b>Approximate shareholders' equity under US GAAP</b>	<b><u>6,366,771</u></b>	<b><u>52,715,592</u></b>	<b><u>12,103,156</u></b>

Solely for the convenience of the reader, the 31 December 1997 accounts have been translated into United States dollars at the rate of US\$ 1.00 = RMB8.2798 quoted by the People's Bank of China on 31 December 1997. No representation is made that the Renminbi amounts could have been, or could be, converted into United States dollars at that rate or at any other certain rate on 31 December 1997, or any other certain date.

## Financial Summary

(Expressed in Renminbi)

### Results

	<b>Proforma combined 1997 RMB'000</b>	Proforma combined 1996 RMB'000	Proforma combined 1995 RMB'000	Proforma combined 1994 RMB'000
<b>Turnover</b>				
Usage fees	<b>8,718,056</b>	5,527,875	3,243,101	1,655,259
Monthly fees	<b>2,692,166</b>	1,658,188	939,478	598,574
Connection fees	<b>3,173,529</b>	2,673,425	2,981,214	2,014,612
Others	<b>904,028</b>	507,753	434,332	321,903
	<b><u>15,487,779</u></b>	<u>10,367,241</u>	<u>7,598,125</u>	<u>4,590,348</u>
<b>Operating expenses</b>				
Leased lines	<b>3,134,260</b>	2,213,563	1,243,662	657,493
Interconnection	<b>1,214,229</b>	196,361	26,267	9,749
Depreciation	<b>2,680,538</b>	1,424,306	788,956	355,233
Personnel	<b>755,523</b>	416,459	213,942	137,483
Selling, general and administrative and others	<b>2,289,042</b>	1,154,115	583,358	454,795
	<b><u>10,073,592</u></b>	<u>5,404,804</u>	<u>2,856,185</u>	<u>1,614,753</u>
<b>Operating profit</b>	<b>5,414,187</b>	4,962,437	4,741,940	2,975,595
<b>Other income</b>	<b>84,954</b>	48,976	176,114	41,751
<b>Non-operating income</b>	<b>629,519</b>	96,490	125,259	67,510
<b>Interest expense</b>	<b><u>(175,335)</u></b>	<u>(167,144)</u>	<u>(88,966)</u>	<u>(63,740)</u>
<b>Profit before tax and minority interests</b>	<b>5,953,325</b>	4,940,759	4,954,347	3,021,116
<b>Income tax</b>	<b><u>(991,019)</u></b>	<u>(427,543)</u>	<u>(285,701)</u>	<u>(201,506)</u>
<b>Profit before minority interests</b>	<b>4,962,306</b>	4,513,216	4,668,646	2,819,610
<b>Minority interests</b>	<b><u>(6,925)</u></b>	<u>(4,058)</u>	<u>—</u>	<u>—</u>
<b>Net profit</b>	<b><u>4,955,381</u></b>	<u>4,509,158</u>	<u>4,668,646</u>	<u>2,819,610</u>

## Financial Summary (cont'd)

(Expressed in Renminbi)

### Assets and liabilities

	1997 RMB'000	Proforma combined 1996 RMB'000	Proforma combined 1995 RMB'000
Fixed assets	18,634,237	11,536,029	7,345,751
Construction in progress	3,557,665	1,001,499	820,899
Interest in associated companies	30,430	—	—
Amounts due from related parties	72,546	570,097	790,450
Deferred tax assets	24,140	22,131	108
Net current assets	<u>36,468,123</u>	<u>1,493,752</u>	<u>2,087,450</u>
<b>Total assets less current liabilities</b>	<b>58,787,141</b>	14,623,508	11,044,658
Long term bank and other loans	<b>(2,870,326)</b>	(1,946,444)	(2,003,970)
Deferred revenue	<b>(1,352,863)</b>	<u>(198,607)</u>	<u>—</u>
	<b><u>54,563,952</u></b>	<b><u>12,478,457</u></b>	<b><u>9,040,688</u></b>

Note: The above tables summarise the Group's proforma combined results for each of the four years ended 31 December 1994, 1995, 1996 and 1997 and the audited statements of the Group's assets and liabilities as at 31 December 1997, together with the proforma combined statements of the Group's assets and liabilities as at 31 December 1995 and 1996. The proforma combined statements of the Group's results and assets and liabilities have been prepared as if the current corporate structure of the Group had been in existence since 1 January 1994 or since the respective dates of incorporation where these are shorter periods.

## Milestones

1 November 1949	Ministry of Posts and Telecommunications established under the People's Central Government of the People's Republic of China.
February 1987	First cellular mobile telephone system in China introduced. Guangdong Posts and Telecommunications Administration signed the contract for the first phase of the Pearl Delta Mobile Telecommunications Project, the total investment being US\$8.9 million.
18 November 1987	Guangzhou Exchange, China's first cellular telecommunications exchange, opened with a subscriber base of 150. It had 3 base stations and 40 channels.
September 1988	Guangdong Mobile Communication Corporation was established.
October 1989	Pearl Delta Mobile network introduced automated roaming service.
December 1992	Automatic cellular roaming service inaugurated between Guangdong province, Hong Kong and Macau.
1 December 1993	Telco Communications Development Limited, later renamed Telco Communications (Group) Limited, a company wholly owned by the Ministry of Posts and Telecommunications, was established in Hong Kong.
9 February 1994	State Council approved the Ministry of Posts and Telecommunications' Three Directions proposal to change the status of the Directorate General of Telecommunications to an independently audited enterprise managing telecommunications networks and services throughout China.
27 April 1995	Directorate General of Telecommunications was registered as a legal enterprise and was renamed Directorate General of Telecommunications of China Posts and Telecommunications — China Telecom for short.
June 1995	National analogue mobile telecommunications networks A and B were interconnected to provide automatic roaming.
1 January 1996	GSM network started pilot operation, providing automatic roaming service covering 15 provinces and cities in China including Guangdong province and Zhejiang province.
10 January 1996	Interconnection of national analogue mobile networks A and B started pilot operation.
February 1996	Zhejiang GSM Mobile Communication Company Limited was established. The name was later changed to Zhejiang Mobile Communication Company Limited.

## Milestones (cont'd)

18 July 1996	China Telecom launched international GSM roaming service and roaming services to Hong Kong and Macau. Automatic roaming service was established with Hongkong Telecom CSL.
21 March 1997	China Telecom (Hong Kong) Limited was established in Hong Kong. It was later renamed China Telecom (Hong Kong) Group Limited.
6 June 1997	China Telecom (Hong Kong) Group Limited acquired a 5.5 per cent interest in Hongkong Telecom.
17 July 1997	Cellular subscriber base in China exceeded 10 million subscribers and was ranked the third largest cellular subscriber base in the world.
3 September 1997	China Telecom (Hong Kong) Limited was incorporated in Hong Kong.
16 September 1997	Securities Committee of the State Council gave its approval for China Telecom (Hong Kong) Limited to issue shares and seek listings in Hong Kong and overseas.
29 September 1997	Pricing limits for initial public offering announced for the first time.
8 October 1997	Pricing limits for initial public offering announced for the second time.
13 October 1997	IPO prospectus issued.
16 October 1997	Pricing confirmed. Application for shares under initial public offering in Hong Kong closed.
22-23 October 1997	Shares of China Telecom (Hong Kong) Limited listed on the New York Stock Exchange and The Stock Exchange of Hong Kong Limited.

## Glossary

This glossary contains certain definitions and other terms as they relate to the Company and the Group and as they are used in the annual report. These definitions may not correspond to standard industry definitions.

analogue	Communications by transmission of continuously varying representations of the input signal, as compared with binary coding of words in digital transmission.
base station; base transceiver station	Transmitter and receiver which serves as a bridge between all mobile users in a cell and connects mobile calls to the mobile switching centre.
cellular system	A telephone system based on a grid of cells deployed at a specified frequency.
channel	Communication path for transmitting voice or non-voice signals.
churn	Subscriber disconnections for a given period, determined by dividing the sum of voluntary and involuntary deactivations during the period by the average number of subscribers for the same period.
DCS 1800	Digital Cellular System for 1800 MHz, a European digital cellular standard based on GSM technology that operates in the 1800 MHz frequency band (also referred to as PCN).
digital	A method of storing, processing and transmitting information through the use of distinct electronic or optical pulses that represent the binary digits 0 and 1. Digital transmission and switching technologies employ a sequence of discrete, distinct pulses to represent information, as opposed to the continuously variable analogue signal.
GSM	Global System for Mobile Communications, pan-European mobile telephone system operating in the 900 MHz frequency band based on digital transmission and cellular network architecture with roaming. GSM is the standard accepted in most of Europe, the Middle East, Africa, Australia and Asia (with the exception of, among others, Japan and South Korea).
interconnect	Any variety of hardware arrangements that permit the connection of telecommunications equipment to a communications common carrier network such as a public switched telephone network.
MHz	Megahertz, a unit of measure of frequency; 1 MHz is equal to one million cycles per second.
mobile switching centre	A central switching point to which each call is connected, which controls the routing of calls. A mobile switching centre allows cellular telephone users to move freely from cell to cell while continuing their calls.