

CHINA TELECOM CORP LTD
Form 20-F
May 24, 2005
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SECURITIES AND EXCHANGE COMMISSION

Washington, DC 20549

FORM 20-F

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

OR

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

For the fiscal year ended December 31, 2004

OR

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

For the transition period from _____ to _____

Commission file number 1-31517

(Exact Name of Registrant as Specified in Its Charter)

China Telecom Corporation Limited

(Translation of Registrant's Name into English)

People's Republic of China

(Jurisdiction of Incorporation or Organization)

31 Jinrong Street, Xicheng District

Beijing, China 100032

(Address of Principal Executive Offices)

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

<u>Title of Each Class</u>	<u>Name of Each Exchange On Which Registered</u>
American depositary shares	New York Stock Exchange, Inc.
H shares, par value RMB1.00 per share	New York Stock Exchange, Inc.*

* Not for trading, but only in connection with the listing on the New York Stock Exchange, Inc. of American depositary shares, each representing 100 H shares.

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

None

(Title of Class)

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

None

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(Title of Class)

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

As of December 31, 2004, 67,054,958,321 domestic shares and 13,877,410,000 H shares, par value RMB1.00 per share, were issued and outstanding. H shares are ordinary shares of the Company listed on The Stock Exchange of Hong Kong Limited.

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

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

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FORWARD-LOOKING STATEMENTS

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

our businesses and operating strategies;

our network expansion and capital expenditure plans;

our operations and business prospects;

the expected benefit of any acquisitions or other strategic transactions;

our financial condition and results of operations;

the future prospects of and our ability to integrate the acquired businesses;

the industry regulatory environment as well as the industry outlook generally; and

future developments in the telecommunications industry in China.

The words anticipate, believe, could, estimate, expect, intend, may, plan, seek, will, would and similar expressions, as they are used in this report, are intended to identify a number of these forward-looking statements.

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

any changes in the regulatory policies of the Ministry of Information Industry and other relevant government authorities relating to, among other matters:

- the granting and approval of licenses;

- tariff policies;
- interconnection and settlement arrangements;
- capital investment priorities;
- the provision of telephone services to rural areas in China; and
- numbering resources allocation;

the effects of competition on the demand for and price of our services;

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the development of new technologies and applications or services affecting our current and future businesses;

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

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

CERTAIN DEFINITIONS AND CONVENTIONS

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

On June 30, 2004, we acquired the entire equity interests in each of Hubei Telecom Company Limited, Hunan Telecom Company Limited, Hainan Telecom Company Limited, Guizhou Telecom Company Limited, Yunnan Telecom Company Limited, Shaanxi Telecom Company Limited, Gansu Telecom Company Limited, Qinghai Telecom Company Limited, Ningxia Telecom Company Limited and Xinjiang Telecom Company Limited from China Telecom Group. As we and these acquired companies were under the common control of China Telecom Group, our acquisition of the acquired companies has been treated as a combination of entities under common control, which was accounted for in a manner similar to a pooling-of-interests. As presented in this annual report, all data and information relating to our businesses and operations include the data and information relating to the businesses and operations of the acquired companies.

PART I

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

Not applicable.

Item 2. Offer Statistics and Expected Timetable.

Not applicable.

Item 3. Key Information.

A. Selected Financial Data

The following table presents our selected financial data. The selected balance sheet data as of December 31, 2003 and 2004, and the selected income statement data and cash flow data for each of the years ended December 31, 2002, 2003 and 2004, are derived from our audited financial statements included elsewhere in this annual report, and should be read in conjunction with our audited financial statements and operating and financial review and prospects included elsewhere in this annual report. The selected balance sheet data as of December 31, 2000, 2001 and 2002

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and the selected income statement and cash flow data for each of the years ended December 31, 2000 and 2001 are derived from our audited financial statements, which are not included in this annual report. Our audited financial statements are prepared and presented in accordance with International Financial Reporting Standards, or IFRS, which differ in certain significant respects from accounting principles generally accepted in the United States of America, or US GAAP. Information relating to the nature and effect of significant differences between IFRS and US GAAP, as they relate to us for the periods described therein, is presented in Note 33 to the audited financial statements included elsewhere in this annual report.

The selected financial data reflect the restructuring in 2001, the acquisitions in 2003 and 2004 described under Item 4. Information on the Company A. History and Development of the Company Our Restructuring and Initial Public Offering , The Acquisition in 2003 and Acquisition in 2004 , respectively, and have been prepared as if our current structure had been in existence throughout the relevant periods. The

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

On December 31, 2003, we acquired the entire equity interests in each of Anhui Telecom Company Limited, Fujian Telecom Company Limited, Jiangxi Telecom Company Limited, Guangxi Telecom Company Limited, Chongqing Telecom Company Limited and Sichuan Telecom Company Limited from China Telecom Group. On June 30, 2004, we acquired the entire equity interests in each of Hubei Telecom Company Limited, Hunan Telecom Company Limited, Hainan Telecom Company Limited, Guizhou Telecom Company Limited, Yunnan Telecom Company Limited, Shaanxi Telecom Company Limited, Gansu Telecom Company Limited, Qinghai Telecom Company Limited, Ningxia Telecom Company Limited and Xinjiang Telecom Company Limited from China Telecom Group. As we and these acquired companies were under the common control of China Telecom Group, our acquisitions of these acquired companies are accounted for in a manner similar to a pooling-of-interests. Accordingly, the assets and liabilities of the acquired companies have been accounted for at historical amounts and our financial statements for periods prior to the respective acquisitions have been restated to include the financial position and results of operations of the acquired companies on a combined basis. Unless otherwise indicated in this section, our financial data for periods prior to the acquisition in 2004 are presented based on those restated amounts.

In connection with our restructuring in 2001, China Telecom Group retained the ownership of certain assets that were historically associated with our operations and primarily consisted of investments in non-telecommunications industries, inter-provincial optic fibers, international gateway and international transmission equipment, telecommunications equipment for special communications services, and certain office equipment, properties and buildings, and the segregation and separate management of these assets by China Telecom Group took effect on December 31, 2001. In connection with our acquisitions in 2003 and 2004, China Telecom Group retained the ownership of certain assets that were historically associated with our operations and primarily consisted of investments in non-telecommunications industries and certain properties, and the segregation and separate management of these assets by China Telecom Group took effect on December 31, 2002 and December 31, 2003, respectively. With respect to the restructuring in 2001, except for the income statement data for the years ended December 31, 2002, 2003 and 2004, the income statement data for the other periods presented below include the results of the assets retained by China Telecom Group. The results of such assets are not reflected in our income statement for periods beginning after December 31, 2001. These assets are not reflected in our balance sheet as of and after December 31, 2001. With respect to the acquisition in 2003, except for the income statement data for the year ended December 31, 2003 and 2004, the income statement data for the other periods presented below include the results of the assets retained by China Telecom Group. The results of such assets are not reflected in our income statement for periods beginning after December 31, 2002. Except for the balance sheet data as of December 31, 2002, 2003 and 2004, the balance sheet data as of other dates presented below include data related to the assets retained by China Telecom Group in relation to the acquisition in 2003. These assets are not reflected in our balance sheet as of and after December 31, 2002. With respect to the acquisition in 2004, except for the income statement data for the year ended December 31, 2004, the income statement data for the other periods presented below include the results of the assets retained by China Telecom Group. The results of such

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assets are not reflected in our income statement for periods beginning after December 31, 2003. Except for the balance sheet data as of December 31, 2003 and 2004, the balance sheet data as of other dates presented below include data related to the assets retained by China Telecom Group in relation to the acquisition in 2004. These assets are not reflected in our balance sheet as of and after December 31, 2003.

	As of or for the year ended December 31,					
	2000 RMB	2001 RMB	2002 RMB	2003 RMB	2004 RMB	2004 US\$
(in millions, except share numbers and per share and per ADS data)						
Income Statement Data:						
IFRS						
Operating revenue	129,665	130,081	140,906	151,553	161,212	19,478
Operating expenses	(101,085)	(109,367)	(115,798)	(118,701)	(121,382)	(14,665)
Operating income	28,580	20,714	25,108	32,852	39,830	4,813
Income before income tax and minority interests ⁽²⁾	27,432	6,839	6,435	14,407	33,263	4,019
Income tax	(4,556)	1,499	1,856	(469)	(5,187)	(627)
Net income	22,801	8,352	8,219	13,882	28,023	3,386
Basic earnings per share ⁽¹⁾	0.33	0.12	0.12	0.18	0.36	0.04
Basic earnings per ADS ⁽¹⁾	33.38	12.23	11.87	18.36	35.54	4.29
U.S. GAAP						
Net income	22,801	16,254	16,991	21,452	25,715	3,107
Basic earnings per share ⁽¹⁾	0.33	0.24	0.25	0.28	0.33	0.04
Basic earnings per ADS ⁽¹⁾	33.38	23.79	24.54	28.37	32.62	3.94
Balance Sheet Data:						
IFRS						
Cash and cash equivalents	25,159	15,274	22,743	12,721	13,465	1,627
Accounts receivable, net	14,324	11,074	11,605	12,951	13,921	1,682
Property, plant and equipment, net ⁽²⁾	285,587	312,326	311,241	309,896	320,179	38,685
Total assets ⁽²⁾	420,199	423,434	423,701	403,942	412,570	49,848
Short-term debt ⁽³⁾	31,376	44,897	53,196	56,243	65,976	7,971
Accounts payable	37,283	38,756	34,859	35,629	33,658	4,067
Long-term obligations	45,924	46,469	39,052	68,675	72,523	8,762
Deferred revenues (excluding current portion)	55,990	49,308	40,894	32,744	25,182	3,043
Total liabilities	253,223	252,974	235,490	251,879	251,951	30,441
Shareholders' equity ⁽²⁾	165,985	169,472	187,025	150,794	159,206	19,236
U.S. GAAP						
Property, plant and equipment, net	285,587	320,102	331,350	339,300	342,718	41,409
Total assets	420,199	431,210	443,810	433,346	435,109	52,572
Shareholders' equity	165,985	174,590	200,406	170,641	176,134	21,281
Cash Flow Data:						
IFRS						
Cash flows from operating activities	59,341	57,083	62,357	58,392	66,078	7,984
Net cash used in investing activities ⁽⁴⁾	(71,030)	(75,073)	(62,578)	(57,094)	(56,353)	(6,809)
Capital expenditures ⁽⁴⁾	(68,901)	(73,976)	(61,437)	(57,692)	(56,446)	(6,820)
Net cash from / (used in) financing activities	7,634	8,105	7,690	(11,320)	(8,981)	(1,085)

- (1) The basic earnings per share have been calculated based on the net income of RMB22,801 million, RMB8,352 million, RMB8,219 million, RMB13,882 million and RMB28,023 million, respectively, for the years ended December 31, 2000, 2001, 2002, 2003 and 2004, and the weighted average number of shares in issue during the relevant year of 68,317,270,803, 68,317,270,803, 69,241,674,942, 75,614,186,503 and 78,839,968,917 shares, respectively, as if the 68,317,270,803 shares issued and outstanding upon our formation on September 10, 2002 had been outstanding for all periods presented. Basic earnings per ADS have been computed as if all of our issued and outstanding shares, including domestic shares and H shares, are represented by ADSs during each of the years presented. Each ADS represents 100 H shares.

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- (2) Includes the effect of the revaluation of property, plant and equipment as of December 31, 2001 in connection with our restructuring and as of December 31, 2002 and as of December 31, 2003 in connection with our acquisitions. It also includes the effect of the Company's revaluation of property, plant and equipment as of December 31, 2004 which was carried out in accordance with the Company's accounting policies under IFRS. See Note 7 to our audited financial statements.
- (3) Excludes current portion of long-term debt.
- (4) Capital expenditures are part of and not an addition to net cash used in investing activities.

Pursuant to the shareholders' approval at the annual general meeting held on May 3, 2004, a final dividend of RMB0.069083 equivalent to HK\$0.065 per share totaling RMB5,224 million in respect of the year ended December 31, 2003 was declared and was paid on May 20, 2004. Holders of our ADRs received a dividend of USD\$0.8333 per share in 2004 based on the exchange rate of HK\$7.80=US\$1.00.

Pursuant to a resolution passed at the directors' meeting on March 31, 2005, a final dividend of equivalent to HK\$0.065 per share totaling approximately RMB5,576 million for the year ended December 31, 2004 was proposed for shareholders' approval at the annual general meeting. The dividend has not been provided for in the consolidated financial statements for the year ended December 31, 2004.

Exchange Rate Information

Our financial statements are expressed in Renminbi. Solely for the convenience of the reader, this annual report contains translations of certain Renminbi and Hong Kong dollar amounts into U.S. dollars and vice versa at RMB8.2765 = US\$1.00 and HK\$7.7723 = US\$1.00, the noon buying rates in New York City for cable transfers as certified for customs purposes by the Federal Reserve Bank of New York on December 31, 2004. These translations should not be construed as representations that the Renminbi or Hong Kong dollar amounts could have been or could be converted into U.S. dollars at such rates or at all.

The noon buying rates in New York City for cable transfers as certified for customs purposes by the Federal Reserve Bank of New York were RMB8.2765 = US\$1.00 and HK\$7.7861 = US\$1.00, respectively, on May 23, 2005. The following table sets forth the high and low noon buying rates between Renminbi and U.S. dollars and between Hong Kong dollars and U.S. dollars for each month during the previous six months:

Noon Buying Rate

	RMB per US\$1.00			HK\$ per US\$1.00	
	High	Low		High	Low
November 2004	8.2765	8.2764	November 2004	7.7815	7.7718
December 2004	8.2767	8.2765	December 2004	7.7821	7.7698
January 2005	8.2765	8.2765	January 2005	7.7994	7.7775
February 2005	8.2765	8.2765	February 2005	7.7999	7.7984
March 2005	8.2765	8.2765	March 2005	7.7998	7.7987
April 2005	8.2765	8.2765	April 2005	7.7995	7.7946
May 2005 (as of May 23)	8.2765	8.2765	May 2005 (as of May 23)	7.7995	7.7861

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The following table sets forth the average noon buying rates between Renminbi and U.S. dollars and between Hong Kong dollars and U.S. dollars for each of 2000, 2001, 2002, 2003 and 2004, calculated by averaging the noon buying rates on the last day of each month during each of the relevant years.

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	<u>RMB per US\$1.00</u>	<u>HK\$ per US\$1.00</u>
2000	8.2784	7.7936
2001	8.2772	7.7997
2002	8.2772	7.7996
2003	8.2771	7.7864
2004	8.2768	7.7899

B. Capitalization and Indebtedness

Not applicable.

C. Reasons for the Offer and Use of Proceeds

Not applicable.

D. Risk Factors***Risks Relating to Our Businesses***

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

The telecommunications industry in China is rapidly evolving. Until the mid-1990s, we were the sole provider of wireline telecommunications services in our service regions and, as a result, we had a dominant market position in our service regions. We began to operate in a competitive market as the Chinese government started to implement a number of measures to restructure the telecommunications industry and encourage competition in the industry in the mid-1990s. We face increasing competition from other telecommunications service providers in China. We expect our competitors to expand further their network coverage and increase their sales and marketing efforts in our service regions. See Item 4. Information on the Company B. Business Overview Competition. In particular:

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

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

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

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

Moreover, as a result of China's accession to the World Trade Organization, or the WTO, and the adoption of the Regulations on the Administration of Foreign-Invested Telecommunications Enterprises in January 2002, which implement China's commitments to the WTO, the Chinese government has agreed to gradually liberalize the various segments and regions of the telecommunications market in China to foreign operators. See Item 4. Information on the Company B. Business Overview Regulatory and Related Matters Licensing. Both the percentage of ownership of Sino-foreign joint ventures offering telecommunications services in China and the regions where those

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joint ventures are permitted to offer telecommunications services might be increased over the next several years. These and other potential new entrants into the Chinese telecommunications market may further increase the competitive pressure we face.

Our ability to compete effectively may be constrained by a number of factors. For example, under the Chinese government's policy of promoting competition in the telecommunications industry, certain competitors of ours, such as China Unicom and China Railcom, continue to enjoy certain preferential treatment from the Chinese government in tariff setting. They may set their respective tariffs for long distance services using public switched telephone networks and leased line services at levels below the tariffs of our company with the annual approval of the regulatory authorities. This preferential treatment is not available to us. As a result, our competitors who enjoy this preferential treatment may be able to provide their services at prices that are more competitive than ours.

In addition, we are not yet permitted to provide mobile communications services. We, through China Telecom Group, are, however, actively seeking the issuance of a license for mobile communications services in the PRC. We can provide no assurances, however, as to whether or when we may be able to receive any benefit of any license for mobile communications in China. Moreover, if we receive the necessary license and commence providing mobile communications services, we will compete with other telecommunications providers not only in our traditional wireline services, but also in mobile telecommunications services.

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

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

China Telecom Group, a wholly state-owned enterprise, currently owns approximately 72.09% of our outstanding shares. Accordingly, subject to our articles of association and applicable laws and regulations, China Telecom Group, as our controlling shareholder, will continue to be able to exercise significant influence over our management and policies by:

controlling the election of our directors and, in turn, indirectly controlling the selection of our senior management;

determining the timing and amount of our dividend payments;

approving our annual budgets;

deciding on increases or decreases in our share capital;

determining issuance of new securities;

approving mergers and acquisitions; and

amending our articles of association.

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

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

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

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

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

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

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

We face uncertainties associated with the process to implement our strategy to transform from a traditional wireline network operator into a modern integrated information services provider.

Our business strategy will focus on transforming from a traditional wireline network operator into a modern integrated information services provider. As part of the strategy, we plan to continue pursuing the operation of mobile business proactively and seek to work with IT service providers to offer differentiated total solutions to enterprise customers. We will exploit the development potential of rural telephony, value-added services, leased line and other services.

However, we cannot assure you that the implementation of this new business strategy will not be delayed, or that the strategy will ever be successfully implemented. We cannot assure you that we will be able to obtain the necessary consents, licenses and approvals from national and local governments to conduct new services. We cannot assure you that we can develop sufficient technology to support our new businesses. Even if our initiatives of transformation can be implemented, we cannot assure you that these initiatives will allow us to increase revenues from our existing service offerings or from new communications services. The success of new service development depends on many factors, including, but not limited to, receipt of necessary government approval, proper identification of customer needs, successful development of technology, the ability to manage cost and expenses, timely completion and introduction of new services, differentiation from offerings of competitors and market acceptance. The uncertainties associated with these factors could materially adversely affect our future business and operation.

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

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

use of international gateway facilities;

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

use of nationwide inter-provincial optic fibers; and

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lease of properties.

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

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

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

We may be unable to obtain sufficient financing to fund our capital requirements, which could limit our growth potential and future prospects.

We believe that cash from operations, together with any necessary borrowings, will provide sufficient financial resources to meet our projected capital and other expenditure requirements. We may require additional funds to the extent we have underestimated our capital requirements or overestimated our future cash from operations. In addition, a significant feature of our business strategy is to explore opportunities to transform from a traditional network operator into a modern integrated information services provider, which may require additional capital resources. The cost of implementing new technologies, upgrading our networks or expanding capacity may also be significant. In particular, in order for us to effectively respond to technological changes and more intensive competition, we may be required to make substantial capital expenditures in the future.

Financing may not be available to us on acceptable terms or at all. In addition, any future issuance of equity securities, including securities convertible or exchangeable into or that represent the right to receive equity securities, may require approval from the relevant government authorities. Our ability to obtain additional financing will depend on a number of factors, including:

our future financial condition, results of operations and cash flows;

general market conditions for financing activities by telecommunications companies; and

economic, political and other conditions in the markets where we operate.

We cannot assure you that we can obtain sufficient financing at commercially reasonable terms or at all. If adequate capital is not available, our growth potential and future prospects could be adversely affected.

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

The telecommunications market is characterized by rapid advancements in technology, evolving industry standards and changes in customer needs. We cannot assure you that we will be successful in responding to these

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

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

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

Our network may be vulnerable to unauthorized access, computer viruses and other disruptive problems. We cannot assure you that the security measures we have implemented will not be circumvented or otherwise fail to protect the integrity of our network. Unauthorized access could jeopardize the security of confidential information stored in our customers' computer systems. Eliminating computer viruses and other security problems may also require interruptions, delays or suspension of our services, cause us to incur costs and divert management attention.

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

Our Personal Handyphone System business may lose its competitiveness due to price fluctuation of mobile services and difficulties on further development of its technologies.

We currently provide Personal Handyphone System, or PHS, services in our service regions. PHS is a telecommunications technology that allows us to offer to our customers wireless local access services with mobility within an area with the same area code. Our ability to realize acceptable returns from our investment in PHS technology will depend on continued customer adoption of this technology. However, this market may not continue to develop. If China Mobile or China Unicom reduces the tariffs for mobile telecommunications services, our existing and potential PHS customers may choose to use these services instead of our PHS services to take advantage of the less geographically restricted service scope and other features of mobile technology, or we may have to reduce our PHS tariff. Our PHS is also facing difficulties in improving its technology. If we cannot improve technologies to support PHS' future development and customers' needs, our PHS business will be adversely affected.

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

We are pursuing a number of new growth opportunities in the broader telecommunications industry, including advanced data and broadband information and application services. These opportunities relate to new services for which there are no established markets in China. Our ability

to deploy and deliver these new services depends, in many instances, on the development of new applications, which may not be developed successfully or may not perform as we expect.

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

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Risks Relating to the Telecommunications Industry in China

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

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

industry policies and regulations;

licensing;

tariffs;

competition;

telecommunications resource allocation;

service standards;

technical standards;

interconnection and settlement arrangements;

enforcement of industry regulations; and

universal service obligations.

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

Possible future industry restructurings may adversely affect our businesses.

The PRC telecommunications industry has undergone restructuring from time to time in the past and may be subject to further restructuring. Possible future restructuring might change the competition environment in the PRC telecommunications industry. The fast development of new technologies might also cause the PRC government to make other adjustments of the existing structure of the industry. Such further industry restructuring may affect the operations of all telecommunications operators in China, including us. Accordingly, we cannot predict the implications and effect of any further restructuring on our operations.

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

Tariffs are the prices we charge our customers for our telecommunications services. We are subject to extensive government regulations on tariffs, especially those relating to our basic telecommunications services. Currently, the relevant provincial communications administrations and provincial price bureaus determine the monthly fee and usage fee tariffs for our wireline local telephone services, based on a guidance tariff range set by the Ministry of Information Industry in consultation with the National Development and Reform Commission. The Ministry of Information Industry and the National Development and Reform Commission jointly set tariffs for all domestic and international, Hong Kong, Macau and Taiwan long distance services using public switched telephone networks,

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leased lines and managed data services. See Item 4. Information on the Company B. Business Overview Regulatory and Related Matters Tariff Setting. We derive a substantial portion of our revenues from services that are subject to tariffs determined by the Chinese government. In the past, our revenues have been adversely affected by reductions in tariffs mandated by the Chinese government. In September 2002, the Ministry of Information Industry indicated in writing that it does not intend to initiate any adjustment to tariffs for wireline local telephone services during the next three to five years. We believe therefore that the risk of adjustment of such tariffs in such period has been substantially reduced. However, we cannot predict with accuracy or assure you on the timing, likelihood or likely magnitude of tariff adjustments generally or the extent or potential impact on our businesses of future tariff adjustments. We cannot assure you that our businesses or results of operations will not be adversely affected by any government-mandated tariff adjustments in the future.

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

The regulations and policies governing the telecommunications industry in China experienced continuous changes in the past several years. Possible future changes to regulations and policies of the Chinese government governing the telecommunications industry could adversely affect our businesses and operations. For example, to provide a uniform regulatory framework for the orderly development of the telecommunications industry, the Chinese government is currently preparing a draft telecommunications law. If and when the telecommunications law is adopted by the National Peoples Congress or its Standing Committee, it is expected to provide a new regulatory framework for telecommunications regulation in China. We cannot be certain how this law will affect our businesses and operations and whether it will contain provisions more stringent than the current telecommunications regulations.

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

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

Under the Telecommunications Regulations promulgated by the State Council, telecommunications service providers in China are required to fulfill universal service obligations in accordance with relevant regulations to be promulgated by the Chinese government, and the Ministry of Information Industry has the authority to delineate the scope of universal service obligations. The Ministry of Information Industry may also select universal service providers through a tendering process. The Ministry of Information Industry, together with government finance and pricing authorities, is also responsible for formulating administrative rules relating to the establishment of a universal service fund and compensation schemes for universal services.

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

Risks Relating to the People's Republic of China

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

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

Substantially all of our businesses, assets and operations are located in China. The economy of China differs from the economies of most developed countries in many respects, including without limitation:

government involvement;

level of development;

growth rate;

control of foreign exchange; and

allocation of resources.

While China's economy has experienced significant growth in the past twenty years, growth has been uneven, both geographically and among various sectors of the economy. The Chinese government has implemented various measures to encourage economic growth and guide the allocation of resources. Some of these measures benefit the overall economy of China, but may also have a negative effect on us. For example, our operating results and financial condition may be adversely affected by government control over capital investments or changes in tax regulations applicable to us.

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

Government control of currency conversion may adversely affect our financial condition.

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

payment of interest and principal on foreign currency-denominated debt;

payment for equipment and materials purchased offshore; and

payment of dividends declared, if any, in respect of our H shares.

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

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

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

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

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

We were incorporated under the laws of the PRC and are governed by our articles of association. The Chinese legal system is based on written statutes. Prior court decisions may be cited for reference but have limited precedential value. Since 1979, the Chinese government has promulgated laws and regulations dealing with economic matters such as foreign investment, corporate organization and governance, commerce, taxation and trade. However, because these laws and regulations are relatively new, and because of the limited volumes of published cases and their non-binding nature, interpretation and enforcement of these laws and regulations involve uncertainties.

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

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

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

rights and protections. In addition, our minority shareholders may not be able to enjoy protections to the same extent afforded to them by companies incorporated under the laws of the United States.

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

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

We are a company incorporated under the laws of the PRC, and substantially all of our assets and our subsidiaries are located in China. In addition, most of our directors and officers reside within China, and substantially all of the assets of our directors and officers are located within China. As a result, it may not be possible to effect service of process within the United States or elsewhere outside China upon most of our directors or officers, including with respect to matters arising under applicable laws and regulations. Moreover, our Chinese counsel has advised us that China does not have treaties providing for the reciprocal recognition and enforcement of judgments of courts with the United States, the United Kingdom, Japan or most other Western countries. Our Hong Kong counsel has also advised us that Hong Kong has no arrangement for the reciprocal enforcement of judgments with the United States. As a result, recognition and enforcement in China of judgments of a court in the United States and any of the other jurisdictions mentioned above in relation to any matter not subject to a binding arbitration provision may be difficult or impossible.

Holders of H shares may be subject to PRC taxation.

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

Item 4. Information on the Company.

A. History and Development of the Company

Restructuring of the Telecommunications Industry

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

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As part of the Chinese government's restructuring of the telecommunications industry, the Ministry of Information Industry was formed in March 1998 to assume, among other matters, the regulatory responsibilities of the former Ministry of Posts and Telecommunications.

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

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Restructuring of China Telecom Group

In November 2001, the telecommunications assets of our parent company, China Telecom Group, in ten northern provinces, autonomous regions and centrally administered municipalities in China were split off from China Telecom Group in May 2002 and were merged with China Netcom Corporation and Jitong Communications Co. Ltd. to form China Netcom Group. China Telecom Group retains the telecommunications assets in the remaining 21 provinces, autonomous regions and centrally administered municipalities and continues to own the brand name of China Telecom. Under the restructuring plan, both China Telecom Group and China Netcom Group are permitted to operate nationwide wireline telecommunications networks and provide nationwide services.

In connection with the implementation of the restructuring plan, China Telecom Group and China Netcom Group entered into a number of framework agreements providing for the division of network resources, trademarks, network access codes and other assets and nationwide enterprise customers of China Telecom Group prior to the restructuring, and circuit leasing, network maintenance and other business arrangements. Under these framework agreements, we obtained, indirectly through China Telecom Group, access to local networks owned by China Netcom Group in the ten northern provinces, autonomous regions and centrally administered municipalities. China Telecom Group and China Netcom Group also entered into a couple of implementation agreements in 2002, 2003 and 2004 to implement those framework agreements, the provisions of which are consistent with those framework agreements.

Our Restructuring and Initial Public Offering

We were incorporated under the laws of China on September 10, 2002 as a joint stock company with limited liability under the name of China Telecom Corporation Limited. Our controlling shareholder, China Telecom Group, a wholly state-owned enterprise, directly owns approximately 72.09% of our issued capital as of May 23, 2005. As part of the restructuring, China Telecom Group's telecommunications operations in Shanghai Municipality, Guangdong Province, Jiangsu Province and Zhejiang Province, together with the related assets and liabilities, were transferred to us. These assets, liabilities and operations have been segregated and separately managed by us since December 31, 2001. As part of the restructuring, China Telecom Group retained certain assets historically associated with the businesses in Shanghai Municipality, Guangdong Province, Jiangsu Province and Zhejiang Province. These assets had a carrying amount of RMB11,285 million as of December 31, 2001 and primarily consisted of investments in non-telecommunications industries, the inter-provincial transmission optic fibers and properties. In consideration of the net assets related to the telecommunications operations transferred to us, which had a carrying amount of RMB97,485 million as of December 31, 2001, we issued 68,317,270,803 of our shares to China Telecom Group.

The telecommunications operations that were transferred to us included:

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

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

leased line services.

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

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

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

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

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

China Telecom Group has undertaken to give us a preferential right to acquire its interest in companies or other entities that provide telecommunications services. See Item 7. Major Shareholders and Related Party Transactions B. Related Party Transactions Arrangements Relating to Our Restructuring and Initial Public Offering Letter of Undertakings.

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

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

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

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

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

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

Our Acquisition in 2003

On December 31, 2003, we acquired from China Telecom Group the entire equity interests in each of Anhui Telecom Company Limited, Fujian Telecom Company Limited, Jiangxi Telecom Company Limited, Guangxi Telecom Company Limited, Chongqing Telecom Company Limited and Sichuan Telecom Company Limited and certain network management and research and development facilities. These acquired companies are the leading providers of wireline telecommunications services, including wireline telephone, managed data, Internet and leased line services in Anhui Province, Fujian Province, Jiangxi Province, Guangxi Zhuang Autonomous Region, Chongqing Municipality and Sichuan Province, respectively. The assets, liabilities and operations of these acquired companies had been segregated and separately managed by us since December 31, 2002. As part of the reorganization in preparation of the acquisition, China Telecom Group has undertaken to indemnify these companies for any loss or damages suffered by them as a result of, or related to, the reorganization and/or in connection with events preceding the reorganization.

The purchase price of the acquisition amounted to RMB46 billion. Of the purchase price, we paid an initial consideration of RMB11 billion in cash upon the completion of the acquisition. The deferred consideration of the remaining RMB35 billion is payable on December 31, 2013. We may prepay all or, from time to time, a part of the deferred consideration at any time within a ten-year period without penalty. We will pay interest to China Telecom

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Group at semi-annual intervals on the actual amount of the deferred consideration remaining outstanding at an annual rate of 5.184% for the first five years after December 31, 2003. This rate will be adjusted on the fifth anniversary of the completion of the acquisition on December 31, 2003 based on the then current Renminbi lending rate of the Chinese commercial banks for loans with tenure of more than five years. In 2004, we paid China Telecom Group approximately RMB1,814 million interest on the deferred consideration for our acquisition in 2003.

In connection with this acquisition and as part of the reform plan of rural telecommunications services, China Telecom Group agreed to transfer to Fujian Electronic Information (Group) Co., Ltd., a state-owned enterprise owned by the provincial governments of the Fujian Province, 977,004,913 of our domestic shares. Since China Telecom Group sold 462,749,683 shares in our global offering in 2004, the shares it agreed to transfer to Fujian Electronic Information (Group) Co., Ltd. has decreased to 969,317,182 shares accordingly, which represents approximately 1.45% of our total issued domestic shares as of May 23, 2005. Such transfer is subject to a number of conditions precedent and will not be made prior to September 10, 2005.

On December 31, 2003, our Company, together with our wholly-owned subsidiary, Shanghai Telecom Company Limited, acquired from China Telecom Group the entire equity interest in China Telecom Group Yellow Pages Information Company Ltd., or China Telecom Yellow Page. The aggregate consideration of the transaction was RMB25 million, which falls below the de minimis provision under the Listing Rules, and therefore the transaction is exempt from the reporting, announcement and independent shareholders' approval requirements.

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Set out below is our corporate structure immediately after the acquisition in 2003 but prior to the acquisition in 2004:

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- (1) The percentages may not add up to 100% due to rounding discrepancies.
 - (2) Denotes the companies acquired pursuant to the acquisition.
 - (3) Includes 977,004,913 of our domestic shares that China Telecom Group agreed to transfer to Fujian Electronic Information (Group) Co., Ltd., a state-owned enterprise owned by the provincial governments of the Fujian Province as part of the reform plan of rural telecommunications services. Due to the sale of certain shares by China Telecom Group in our global offering in 2004, the number of shares to be transferred has decreased to 969,317,182 shares after our global offering in 2004, which represents approximately 1.45% of our total issued domestic shares as of May 23, 2005. Such transfer is subject to a number of conditions precedent and will not be made prior to September 10, 2005.
 - (4) On December 31, 2003, our Company, together with our wholly-owned subsidiary, Shanghai Telecom Company Limited, acquired from China Telecom Group the entire equity interest in China Telecom Group Yellow Pages Information Company Ltd., which is not shown in the chart above. The aggregate consideration of the transaction was approximately RMB25 million, which falls below the de minimis provision under the Listing Rules, and therefore the transaction is exempt from the reporting, announcement and independent shareholders approval requirements.

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Our Acquisition in 2004

On June 30, 2004, we acquired from China Telecom Group its entire equity interests in each of Hubei Telecom Company Limited, Hunan Telecom Company Limited, Hainan Telecom Company Limited, Guizhou Telecom Company Limited, Yunnan Telecom Company Limited, Shaanxi Telecom Company Limited, Gansu Telecom Company Limited, Qinghai Telecom Company Limited, Ningxia Telecom Company Limited and Xinjiang Telecom Company Limited. These acquired companies are providers of wireline telecommunications services, including wireline telephone, Internet and managed data and leased line services in Hubei province, Hunan province, Hainan province, Guizhou province, Yunnan province, Shaanxi province, Gansu province, Qinghai province, Ningxia Hui Autonomous Region and Xinjiang Uygur Autonomous Region, respectively.

The purchase price of the acquisition amounted to RMB27.8 billion. Of the purchase price, we paid an initial consideration of RMB8.34 billion in cash upon the completion of the acquisition. The deferred consideration of the remaining RMB19.46 billion is payable on June 30, 2014. We may prepay all or, from time to time, a part of the deferred consideration at any time within a ten-year period without penalty. From June 30, 2004, we will pay interest to China Telecom Group at half-yearly intervals on the actual amount of deferred consideration remaining outstanding. Interest will accrue daily and, for the first five years after June 30, 2004, will be payable at the rate of 5.184% per year, being 10% discount to the RMB lending rate of 5.76% per year of commercial banks in the PRC in respect of loans with tenure of more than five years as published by the People's Bank of China and prevailing at 12:00 noon (Beijing time) on April 8, 2004, being the business day immediately preceding the day of the execution of the acquisition agreement. Thereafter, the interest rate will be adjusted on June 30, 2009 to the then RMB lending rate of a commercial bank loan of similar amount and tenure with the same discount. On June 30, 2004, we repaid RMB4,310 million of this payable amount using the net proceeds from issue of new H shares in May 2004. In 2004, we paid China Telecom Group approximately RMB393 million interest on the deferred consideration.

In preparation for this acquisition, Hubei Telecom Company Limited, Hunan Telecom Company Limited, Hainan Telecom Company Limited, Guizhou Telecom Company Limited, Yunnan Telecom Company Limited, Shaanxi Telecom Company Limited, Gansu Telecom Company Limited, Qinghai Telecom Company Limited, Ningxia Telecom Company Limited and Xinjiang Telecom Company Limited were all incorporated in March 2004, each as a wholly-owned subsidiary of China Telecom Group. China Telecom Group's telecommunications operations in Hubei province, Hunan province, Hainan province, Guizhou province, Yunnan province, Shaanxi province, Gansu province, Qinghai province, Ningxia Hui Autonomous Region and Xinjiang Uygur Autonomous Region, together with related assets and liabilities were transferred to the respective acquired companies. The assets, liabilities and operations of these companies have been segregated and separately managed since December 31, 2003. As part of the reorganization in preparation of the acquisition, China Telecom Group has undertaken to indemnify these companies for any loss or damages suffered by them as a result of, or related to, the reorganization and/or in connection with events preceding the reorganization.

Our Global Offering in 2004

In May 2004, we issued 5,318,181,818 new H shares with a par value of RMB1.00 each, representing 4,466,693,018 H shares and 8,514,888 ADSs, each representing 100 H shares, at prices of HK\$2.30 per H share and US\$29.49 per ADS, respectively, by way of a global offering to Hong Kong and overseas investors. We raised net proceeds of RMB12,702 million from this issuance of new H shares. On June 30, 2004, we used RMB12,650 million of the net proceeds from this issuance to make a cash payment for the acquisition of 2004, i.e., RMB8,340 million as the initial consideration and RMB4,310 million as part of the deferred consideration. As part of the global offering, 531,818,182 existing domestic shares of RMB1.00 each owned by China Telecom Group and our other domestic shareholders were converted into H shares and sold to Hong Kong and overseas investors.

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Set out below is our corporate structure immediately after the acquisition in 2004 and as of May 23, 2005:

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- (1) The percentages may not add up to 100% due to rounding discrepancies.
- (2) Includes 969,317,182 of our domestic shares (representing approximately 1.45% of our total issued domestic shares as of May 23, 2005) that China Telecom Group has agreed to transfer to Fujian Electronic Information (Group) Co., Ltd., a state-owned enterprise owned by the provincial governments of the Fujian Province as part of the reform plan of rural telecommunications services. Such transfer is subject to a number of conditions precedent and will not be made prior to September 10, 2005.
- (3) Denotes the companies acquired pursuant to the acquisition in 2004.
- (4) On December 31, 2003, our company, together with our wholly-owned subsidiary, Shanghai Telecom Company Limited, acquired from China Telecom Group the entire equity interest in China Telecom Group Yellow Pages Information Company Ltd., which is not shown in the chart above. The aggregate consideration of the transaction was approximately RMB25 million, which falls below the de minimis provision under the Listing Rules, and therefore the transaction is exempt from the reporting, announcement and independent shareholders approval requirements.

General Information

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

B. Business Overview

We are the leading provider of wireline telecommunications services in our service regions in China. Our service regions consist of Anhui Province, Chongqing Municipality, Fujian Province, Gansu Province, Guangdong Province, Guangxi Zhuang Autonomous Region, Guizhou Province, Hainan Province, Hubei Province, Hunan Province, Jiangsu Province, Jiangxi Province, Ningxia Hui Autonomous Region, Qinghai Province, Shaanxi Province, Shanghai Municipality, Sichuan Province, Xinjiang Uygur Autonomous Region, Yunnan Province, Zhejiang Province. Our scope of business includes:

- (1) operating a variety of domestic wireline telecommunications networks and facilities (including wireless local loops);
- (2) providing voice, data, image, multimedia telecommunications and information services based on the wireline networks;
- (3) providing international services and conducting accounts settlement with overseas operators in accordance with state regulations; and
- (4) providing telecommunications and information-related system integration, technological development, technical services, information consulting, and conducting design, manufacture, sales and installation of telecommunications equipment.

Our businesses grew steadily in 2004. Our local telephone subscribers continue to grow at a steady pace. Broadband subscribers maintained strong growth and became a growth driver with increasing importance in our revenue structure. Domestic long distance services recorded both usage and revenue growth and value-added services portfolio was further expanded.

Our operating revenue depends largely on customer base, usage volume and the level and structure of our tariffs. The following table shows our selected operating data as of the dates and for the periods indicated.

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	As of or for the year ended December 31,		
	2002	2003	2004
Local Telephone:			
Access lines in service (in millions)	133.1	161.0	186.7
Total pulses (in billions)	459.3	455.1	466.8
Domestic Long Distance:			
Total outgoing call minutes carried (in billions)	59.5	67.3	82.0
International, Hong Kong, Macau and Taiwan Long Distance:			
Total outgoing call minutes carried (in billions)	1.55	1.67	1.65
Interconnection			
Volume of inbound local call minutes (in billions)	53.5	76.2	94.7
Dial-up Internet Access:			
Number of subscribers (in millions)	24.0	22.2	15.8
Dial-up on-line usage (minutes in billions)	81.6	54.9	30.0
Broadband Access:			
Number of subscribers (in millions)	2.4	7.2	13.8
Managed Data (bandwidth leased in thousands):			
DDN (x64Kbps)	378.2	471.2	493.3
Frame relay (x128Kbps)	48.1	88.3	156.3
ATM (x2Mbps)	16.6	19.0	23.8
Leased Digital Circuits:			
Total bandwidth (x2Mbps) (bandwidth leased in thousands)	164.5	163.1	169.5
Value-added Services			
Caller ID service subscribers (in millions)	51.5	82.5	109.0
Usage of telephone information services (minutes in billions)	0.9	1.7	2.4

The number of our local access lines in service increased by approximately 15.9% from 2003 to 2004. The usage of our local voice services increased by approximately 11.6% from 384.5 billion pulses to 429.2 billion pulses from 2003 to 2004. Subscribers for our broadband access services grew significantly from 7.2 million as of December 31, 2003 to 13.8 million as of December 31, 2004. We expect broadband business to become a key driver of our future growth. We experienced significant growth in value-added services in 2004. The subscriber number of our caller ID services increased by approximately 32.1% from 2003 to 2004. The usage of telephone information services increased by approximately 38.8% from 2003 to 2004. We expect to further capitalize on the market potential of value-added services in the future.

The following table sets forth a breakdown of our operating revenue for 2002, 2003 and 2004:

	For the Year Ended December 31		
	2002	2003	2004
(RMB in millions)			
Wireline telephone services⁽¹⁾			
Local			
Installation fees	2,305	2,643	2,865
Monthly fees	25,338	27,499	29,827
Local usage fees	44,440	45,815	47,646
Sub-total	72,083	75,957	80,338
Domestic long distance ⁽²⁾	25,726	25,460	26,231

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International, Hong Kong, Macau and Taiwan long distance ⁽²⁾	3,878	3,943	3,788
Interconnections	7,524	8,365	10,719
Upfront connection fees	10,564	9,771	8,458
Sub-total	119,775	123,496	129,534
Internet	5,998	10,007	14,109
Managed data	3,147	3,210	3,015
Leased line services	5,520	5,103	4,154
Others ⁽³⁾	6,466	9,737	10,400
Total operating revenue	140,906	151,553	161,212

(1) Includes revenue from our registered subscribers, public telephones and prepaid calling cards services.

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

(3) Includes primarily revenue from the provision of value-added telecommunications services, sale and repairs and maintenance of customer-end equipment, and lease of telecommunications network facilities.

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We believe there is still potential for further growth in China's telecommunications market, due to the growth of China's economy, the broader adoption of information technology and advanced communications services in China. However, with increasingly intensified competition and the further expansion and price fluctuation of mobile services, mobile substitution has become more apparent and adversely affected the growth potential of our wireline telephone service. Therefore, in 2005, our business strategy will focus on transforming from a traditional wireline network operator into a modern integrated information services provider. As part of the strategy, we plan to continue to pursue the operation of mobile business proactively and seek to work with IT service providers to offer differentiated total solutions to enterprise customers. We will fully exploit the development potential of rural telephony, value-added services, leased line and other services.

Wireline Telephone Services

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

Wireline telephone services are our main services, generating 80.3% of our total operating revenue in 2004, compared to 81.5% in 2003. Revenue generated by these services slightly increased from RMB123,496 million in 2003 to RMB129,534 million in 2004.

Local Telephone Services

Our local telephone services provide the largest revenue source for our wireline telephone services. Revenue derived from our local telephone services in 2004 accounted for 49.8% of our total operating revenue, compared to 50.2% in 2003.

We have expanded our local telephone subscribers and the total number of our subscribers reached 186.7 million at the end of 2004, an increase of 25.7 million, or approximately 15.9% from 2003. Wireless local access service and public telephone service subscribers grew relatively faster. As of the end of 2004, wireless local access service subscribers and public telephone service subscribers reached 42.2 million and 12.4 million, increasing 16.6 million and 2.8 million, or approximately 64.9% and 29.0%, respectively, from 2003. In the local telephone services market, urban residential subscribers growth has slowed down and the subscribers and usage diversion exacerbated, while wireless local access service demand was comparatively stable and the rural telecommunications market exhibited a strong growth potential.

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

	As of December 31,		
	2002	2003	2004
	(in millions)		
Residential	98.8	108.1	113.1
Enterprise	16.3	17.7	19.0
Public telephones	7.2	9.6	12.4
Wireless local access	10.8	25.6	42.2
Total	133.1	161.0	186.7

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

	Year Ended December 31,		
	2002	2003	2004
Total usage (pulses in billions) ⁽¹⁾	459.3	455.1	466.8

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

Local voice usage reached 429,150 million pulses in 2004, an increase of approximately 11.6% from 2003. As some customers of our dial-up Internet services began to use our broadband Internet services, dial-up Internet usage, including dial-up usage of customers of other Internet service providers, decreased from 70,621 million pulses in 2003 to 37,665 million pulses in 2004, representing a 46.7% decrease. Tariffs for dial-up Internet access were much lower than the usage fees for voice services.

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

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

Before Tariff Adjustments

After Tariff Adjustments

	(RMB)			
Monthly fee: ⁽¹⁾				
Residential customers	7.6	25.0	10.0	25.0
Enterprise customers	12.0	37.0	15.0	35.0
Usage fee:				
Intra-district	0.16	0.22 per pulse (three minute intervals)	0.18	0.22 for the first two pulses (first three minutes or less) and 0.09 0.11 for each additional pulse (one minute intervals)
Inter-district	0.20	0.50 per pulse (one minute intervals)	0.20	0.50 per pulse (one minute intervals)

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	Before Tariff Adjustments	After Tariff Adjustments
	(RMB)	
Communications fee:		
Internet dial-up	0.08 0.11 per pulse (three minute intervals)	0.02 per pulse (one minute intervals)

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

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

Domestic Long Distance Services

Revenue from our domestic long distance services reached RMB26,231 million, an increase of approximately 3.0% from 2003. Total domestic long distance usage was 81,960 million minutes, representing an annual growth rate of approximately 21.8%. Total revenue from our domestic long distance services represented approximately 16.3% of our total operating revenue in 2004, compared to approximately 16.8% in 2003. Our domestic long distance services had a market share of 45.8% as measured by total minutes carried through our networks as calculated based on statistical data from the Ministry of Information Industry, which was down 3.6 percentage points from 2003. In order to improve our revenue in the increasingly competitive market environment for our long distance services market, we adopted a more effective pricing strategy and accelerated the development of public telephone supermarkets. Meanwhile, we further streamlined phone cards distribution channels to divert long distance usage volume from mobile services. Our efforts were rewarded with increases in both domestic long distance usage and revenue.

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

	Year Ended December 31,		
	2002	2003	2004
Total minutes of usage (in millions): ⁽¹⁾			
Public switched telephone networks	30,367	31,491	39,831
VoIP	29,125	35,821	42,129
Total	59,492	67,312	81,960

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

We have commenced providing VoIP services since 1999. The usage of our VoIP domestic long distance services as a percentage of the total usage of domestic long distance services decreased from approximately 53.2% in 2003 to approximately 51.4 % in 2004, mainly because of the migration of the customers to mobile telecommunications. However, the average VoIP call duration is generally longer than that of long distance calls using public switched telephone networks. We provide VoIP services primarily to price sensitive customers, such as small businesses, certain residential customers and non-resident persons. We offer our VoIP services selectively to small businesses or other non-resident persons

in response to market demand and offer flexible VoIP service packages in response to competition.

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

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

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

- (1) A discount rate of up to 40% applies to calls made during off-peak hours, which are from 12:00 am to 7:00 am every day.
- (2) A discount rate of 50% applies to calls made during off-peak hours, which are from 9:00 pm to 12:00 am for weekdays and from 7:00 am to 12:00 am on public holidays and weekends; a discount rate of 70% applies to calls made during 12:00 am to 7:00 am everyday.
- (3) Does not include separate usage fees for local services when a VoIP call is placed. The local usage fee of a VoIP call is the same as the local usage fee of an intra-district local voice call.

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

International, Hong Kong, Macau and Taiwan Long Distance Services

Revenue from our international, Hong Kong, Macau and Taiwan long distance services amounted to RMB3,788 million in 2004, down approximately 3.9% from 2003. Usage in 2004 was 1,654 million minutes, approximately the same level as 2003. Our market share in this sector was 56.3% as measured by total minutes carried through our networks as calculated based on statistical data from the Ministry of Information Industry, 4.9 percentage points down from 2003. Nevertheless, we maintained our leading position in this market. Our international, Hong Kong, Macau and Taiwan long distance telephone services contributed approximately 2.3% to our total operating revenue in 2004, compared to approximately 2.6% in 2003. We also provide VoIP international, Hong Kong, Macau and Taiwan long distance services, similar to our VoIP domestic long distance services in our service regions.

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

	Year Ended December 31,		
	2002	2003	2004
Outgoing call minutes (in millions) ⁽¹⁾ :			
Public switched telephone networks	793	1,015	632

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VoIP	753	655	1,022
Total	1,546	1,670	1,654

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

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

	Before Tariff Adjustments		After Tariff Adjustments	
	(RMB)			
Public switched telephone networks services:				
To Hong Kong, Macau and Taiwan	2.55	5.00 per minute ⁽¹⁾	0.20	per 6 seconds
To all international destinations	5.30	15.00 per minute ⁽²⁾	0.80	per 6 seconds ⁽³⁾
VoIP services: ⁽⁴⁾				
To Hong Kong, Macau and Taiwan	1.50	2.50 per minute	1.50	per minute
To all international destinations	2.40	4.80 per minute	2.40 - 4.60	per minute

- (1) A discount rate of 40% applies to calls made during off-peak hours.
- (2) Rates of RMB5.30-12.00 per minute apply to calls made to Asian countries and regions and a rate of RMB15.00 per minute applied to calls to all other international destinations. A discount rate of 40% applied to calls made during off-peak hours.
- (3) A discount rate of up to 40% applies to calls made during off-peak hours.
- (4) Does not include separate usage fees for local services when a VoIP call is placed. The local usage fee of a VoIP call is the same as the local usage fee of an intra-district local voice call.

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

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

Value-added Voice and Information Services

In addition to basic local and long distance voice services, we offer a variety of value-added voice and information services. Significant usage growth of our value-added services in 2004 contributed to our overall revenue growth.

Value-added voice services. Our value-added voice services include caller ID, call forwarding, conference call and toll-free services. Subscribers of our caller ID services reached 109 million, with a penetration rate of 58.4%, by the end of 2004, an increase by 7 percentage points from 2003. Based on our extensive network resources, customer base and distribution channels, we cooperate with other service providers and continue to develop new value-added voice services. In recent years, we gradually introduced new services such as call-center out-sourcing, video conferencing, direct dial VoIP services with a pre-set access number of 17901, wireline chat room called Telephone QQ, wireline short messaging services and PHS short messaging services. We also launched a service called Color Ring Tone in 2004. We intend to develop this service to meet the existing and potential PHS subscribers' demands. We also expect the revenue generated by this service to grow in line with our existing and potential PHS subscribers' increasing usage of this service. Through our intensive marketing efforts, our customers became familiar with these services and increased their usage. We believe that these value-added voice services allow us to enhance customer satisfaction and increase our revenue. As subscribers in our service regions become more accustomed to these value-added voice services, we believe there is significant growth potential in these areas.

Telephone information services. We have significantly expanded the scope of our automated and operator-assisted telephone information and applications services in recent years. Our general information services allow users to access information at our standard telephone usage rates plus information usage fees. We also provide other specialized telephone information and application services, such as telephone banking, telephone advertising, telephone lottery and telephone stock trading services. Total usage of our telephone information services was 2,419 million minutes in 2004, an increase of approximately 38.8% from 2003. We intend to further expand the scope and usage of these services and develop flexible revenue sharing arrangements with content and application service providers.

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

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

Interconnection

Interconnection services accounted for approximately 6.6% of our total operating revenue in 2004. Under relevant regulations, we are exempt from any interconnection payment for outbound local traffic to mobile operators. See Regulatory and Related Matters Interconnection for tariff details. As a result of our continuously expanding customer base and the growing Chinese telecommunications industry, the volume of inbound local calls through our networks reached 94,747 million minutes in 2004, an increase of 24.3% from 2003. The volume of inbound long distance calls also recorded an increase.

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

China Telecom Group entered into interconnection agreements with other telecommunications service providers in Shanghai Municipality, Guangdong Province, Jiangsu Province and Zhejiang Province, prior to our incorporation in 2002, with other telecommunications service providers in Anhui Province, Fujian Province, Jiangxi Province, Guangxi Zhuang Autonomous Region, Chongqing Municipality and Sichuan Province, prior to our acquisition in 2003 and with other telecommunications service providers in Hubei province, Hunan province, Hainan province, Guizhou province, Yunnan province, Shaanxi province, Gansu province, Qinghai province, Ningxia Hui Autonomous Region and Xinjiang Uygur Autonomous Region prior to our acquisition in 2004. These agreements provide for interconnection settlement with respect to local calls and domestic and international, Hong Kong, Macau and Taiwan long distance calls involving our networks. In connection with our initial public offering in 2002 and the acquisitions in 2003 and 2004, China Telecom Group has assigned to us, and we have assumed, its rights and obligations under these agreements in relation to our service regions. We also entered into an interconnection agreement with China Telecom Group. The economic terms and the settlement procedures under that agreement are in accordance with the standards set forth in the interconnection rules and regulations, which are described in more details under Regulatory and Related Matters Interconnection included elsewhere under this item. See also Item 7. Major Shareholders and Related Party Transactions B. Related Party Transactions Apportionment of International Settlement; Ongoing Related Party Transactions between Us and China Telecom Group Interconnection Agreement.

Internet and Managed Data Services

We intend to strategically expand our Internet services. Revenue from Internet services was RMB14,109 million in 2004, an increase of approximately 41.0% from 2003 and represented approximately 8.8% of our total operating revenue. Broadband business became a key strategic driver for our sustainable development. In 2004, our broadband subscribers grew by 6.6 million or 91.4% from the end of 2003 to 13.8 million in 2004, further consolidated our leading position in the broadband access service market in our service regions.

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

	As of or for the Year Ended December 31,		
	2002	2003	2004
Dial-up Internet access services:			
Dial-up subscribers (in thousands)	24,020	22,163	15,824
Dial-up on-line usage (minutes in millions)	81,648	54,886	30,046
Broadband access services (in thousands):			
DSL subscribers	1,718	5,229	10,000
FTTx + LAN subscribers	674	1,975	3,716
Others	19	28	122

Dial-up Internet Access Services

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

Our dial-up Internet access subscribers decreased by approximately 28.6%, from approximately 22.2 million as of December 31, 2003 to approximately 15.8 million as of December 31, 2004. Total usage of our dial-up Internet access services by our subscribers decreased from 54,886 million minutes in 2003 to 30,046 million minutes in 2004, or approximately 45.3%. We believe the decline was mainly due to migration of customers from our dial-up Internet services to our broadband Internet services.

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

Broadband Internet Access

We began offering broadband Internet access services in 2000. In 2004, our broadband subscribers maintained its strong growth and became a revenue growth driver with increasing importance in our revenue structure. Our broadband subscribers grew by 6.6 million or 91.4% from the end of 2003 to 13.8 million in 2004.

DSL services. In 2004, we continued to leverage on our dominant position in local access networks, extensive distribution network and high quality customer services in promoting our DSL services. We promote DSL services as the primary broadband Internet access means for our residential customers and small- and medium-sized enterprise customers. DSL services can be offered over existing copper wires and are suitable for high-speed Internet access. We had approximately 5 million DSL subscribers as of December 31, 2003 and approximately 10 million

DSL subscribers as of December 31, 2004.

Fiber-Ethernet access services. We offer broadband access services through fiber optic cables that directly link Ethernet technology-based LANs in office buildings or high-end residential complexes to the Internet. Fiber-Ethernet access uses optic fiber technology and Ethernet protocol to connect residential users and business users to a telecommunications network and greatly expands capacity of the access network. As of December 31, 2003 and 2004, we had approximately 1.9 million customers and 3.7 million customers, respectively, using fiber-Ethernet access services.

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

Based on our large subscriber base, network resources, application platforms and reliable supporting systems, as well as our customer management and billing system, we cooperated with other service providers and launched ChinaVnet in 2003 to promote our broadband Internet access services. ChinaVnet offers billing platforms and channels for Internet content and application providers and provides subscribers with convenient access to the comprehensive content and application services provided by those service providers. We believe that the introduction of ChinaVnet will stimulate growth in the subscriber base and revenue from our broadband Internet services.

In 2003, we introduced a service known as *Broadband New Vision*, which is a multimedia service that allows the transmission of video, voice and data over our Broadband access networks. In addition, we provide to our key customers tailored total solutions based on our broadband and data networks. For example, we cooperated with the customs departments in our service regions and launched a service called *e-Customs*. The *e-Customs* service provides our Internet users with customs clearance services and certain other import and export related services over the Internet. Since 2004, we have commenced conducting research on the technology and business models in the IPTV business. We may form alliance with content providers to supply IPTV programs. In addition, we expect to cooperate with television manufacturers to upgrade our telephone terminals in order to realize the integration of television, broadband and voice service.

Tariffs. Internet services are classified as *market-based* for purpose of tariff determination by relevant regulatory authorities. See *Regulatory and Related Matters* *Tariff Setting*. We determine tariffs for dial-up and broadband services according to market conditions. Tariffs for these services vary to a large extent based on types of services and geographical locations.

Managed Data Services

Our managed data services include Digital Data Network, or DDN, frame relay, or FR, and Asynchronous Transfer Mode, or ATM, services. In 2004, we continued to focus on government, financial and large enterprise customers. Our marketing efforts focused on providing global one-stop shopping, tailored services and comprehensive solution packages to these customers. Our customers can enjoy a full range of consulting, trouble-shooting, billing and collection, and technical support services by contacting any designated account manager in our company.

DDN services. The bandwidth volume of our DDN services grew by approximately 4.7% in 2004. Our DDN services provide high-quality and reliable transmission at speeds ranging from 64Kbps to 2Mbps and continue to meet the increasing demand for low- to medium-speed transmission capacity from enterprise customers. DDN systems are composed of optic fibers, digital transmission paths and digital cross multiplexing nodes. DDN systems are capable of providing high-quality private circuits and other services at various data rates to satisfy users multimedia communications needs.

Frame relay/ATM services. The bandwidth volume of our frame relay and ATM services grew by approximately 77.0% and 25.3%, respectively, in 2004. We offer advanced high-speed data communications services based on frame relay and ATM technologies. These services enable flexible and cost-effective usage of bandwidth resources. Frame relay is a type of connection-oriented packet switching technology that employs statistical multiplexing over a shared network. Frame relay offers both access to a network and transmission of data across a network and is used by customers with significant amounts of data traffic. ATM is a high bandwidth and multiplexing technology. ATM is developed for high data rates with a high quality of service, and can offer integrated voice, data and video services at various data rates.

We offer these services as part of our total telecommunications solutions to large enterprise customers, including government agencies, large corporations and institutions. Many of these customers choose frame relay and

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ATM services to form VPNs and link their local area networks at different locations. We also collaborate with a number of international telecommunications service providers to build global communications networks for multinational corporations.

Tariffs. We determine most of the tariffs for our data services within a price range set by the Chinese government. We generally charge an upfront fee for installation and testing for our data services and a fixed monthly fee. We offer various incentive programs and discounts for our customers who wish to upgrade to higher bandwidth services. These incentive programs and discounts have stimulated demand for our managed data services in recent years.

The following table sets forth the monthly fees for DDN services at the bandwidth of 64Kbps and 2Mbps for the periods indicated:

	Monthly Fee		
	2002	2003	2004
	(RMB)		
64Kbps			
Intra-district	1,500	1,500	1,500
Inter-district	2,000	2,000	2,000
Intra-provincial	3,500	3,500	3,500
Inter-provincial	3,500	3,500	3,500
2Mbps			
Intra-district	6,000	6,000	6,000
Inter-district	8,000	8,000	8,000
Intra-provincial	12,000	12,000	12,000
Inter-provincial	12,000	12,000	12,000

The following tables set forth the monthly fees in 2004 for frame relay and ATM services, which include monthly fees for port access and permanent virtual circuits, or PVCs:

Bandwidth	Monthly Fee for Port Access			
	2Mbps	10Mbps	100Mbps	155Mbps
	(RMB)			
Monthly fees	1,000	5,000	9,000	10,000

PVC monthly fees (RMB):⁽¹⁾

Bandwidth	PVC Monthly Fees		
	Intra-District	Inter-District	Domestic Long Distance
	(RMB)		

256Kbps	800	1,150	2,200
2Mbps	1,500	2,200	4,000
10Mbps	5,000	11,500	15,500
155Mbps	14,500	39,000	130,000

(1) One-way tariff for PVC circuits of ATM services.

System Integration and Other Value-added Services

We offer system integration and solution services to our customers. Our system integration services encompass initial consulting, network planning, network implementation, application development and maintenance. Our current development focuses on system integration and information management such as network management and data mining and analysis services.

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In 2004, we also launched Short Message Services over PHS, or SMS over PHS service. Usage of SMS over PHS grew rapidly after achieving interconnection with other wireline and mobile services operators, presenting a market potential for further growth.

Leased Line Services

We also provide domestic and international leased line services in our service regions. We offer these services as part of our total telecommunications solutions and market these services to large enterprise customers and other operators through our large enterprise customer service teams. In addition to leased lines, we also lease other network elements to business and government customers and other telecommunications service providers. We mainly lease digital circuits, digital trunk lines and optic fibers. The revenue from our leased line services is mainly derived from the lease of domestic and international digital circuits. Revenue from our leased line services was RMB4,154 million in 2004, a decrease of approximately 18.6% from 2003, mainly due to the decrease in prices. As of the end of 2004, we leased out a total of 169.5 thousand digital circuits (in 2Mbps equivalent), an increase of approximately 3.9% from 2003.

The following table sets forth the total amounts of bandwidth of our leased line service as of the end of the year indicated:

	2002	2003	2004
	_____	_____	_____
Leased Digital Circuits			
Total bandwidth (x2Mbps) (thousand)	164.5	163.1	169.5

Tariffs. We charge monthly fees for leased lines based on tariff rates set by the Chinese government, which vary based on bandwidth and whether the leased line is local or long distance. Leased line tariffs have generally decreased in recent years. The tariff adjustments in 2001 substantially reduced tariffs for leased line services.

The following table sets forth the tariffs for 2Mbps and 155Mbps digital circuits for the periods indicated:

	Monthly Fee		
	2002	2003	2004
	_____	_____	_____
	(RMB)		
2Mbps			
Intra-district	2,000	2,000	2,000
Inter-district	4,000	4,000	4,000
Intra-provincial ⁽¹⁾	6,000	6,000	6,000
Inter-provincial ⁽¹⁾	6,000	6,000	6,000
155Mbps			
Intra-district	44,000	44,000	44,000
Inter-district	88,000	88,000	88,000
Intra-provincial ⁽¹⁾	132,000	132,000	132,000
Inter-provincial ⁽¹⁾	132,000	132,000	132,000

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

Marketing, Distribution and Customer Services

Marketing Initiatives

We market all of our telecommunications services under the "China Telecom" brand name, which is one of the best known brand names in China. We offer a full range of differentiated services to our customers to address their telecommunications needs. Based on customer segmentation, we have implemented various promotion measures, in particular packaging our services and providing a variety of tariff plans, to mitigate our loss of local voice service usage. Moreover, in order to meet customers' increasingly diversified demands for telecommunications services, we have further optimized our products and services development and marketing mechanisms, and established a "total solution" service system for major customers. We believe these measures have facilitated our business.

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transformation from a provider of telecommunications network services to an integrated telecommunications solutions provider. As a result, we also believe that we have increased our responsiveness to the market and our service quality. In addition, in 2004, we established our China Telecom brand strategy to enhance customer awareness of our available services.

Sales, Distribution and Customer Services

Dedicated customer manager system for large enterprise customers. We have implemented a large enterprise customer manager system. Under this system, our dedicated customer managers directly market our services to large enterprise customers. These customer managers form dedicated management teams based on the industry background or geographical locations of the customers. We conduct periodic performance reviews and evaluations of the performance of the customer managers based on several factors, including revenue growth, market share, customer satisfaction and customer retention. As of December 31, 2004, we had 9,298 managers for major customers, 10,405 managers for corporate customers nationwide.

Community manager system. We offer integrated sales and maintenance services to small- and medium-sized enterprise customers through our community manager system and divide their community coverage responsibilities by geographical area. Our community managers are responsible for customer development and customer care. We link their compensation mainly to the voice traffic in their coverage areas. In addition, our community managers are also responsible for gathering market and demand information. As of December 31, 2004, we had 38,304 managers for community customers nationwide.

Contract system in rural areas. Under this system, we select certain local residents to be responsible for service promotion, customer development, equipment maintenance and fee collection. This system enables us to lower operational costs effectively while at the same time satisfying the needs of our rural customers.

Customer service hotlines. We provide customer services through our customer service hotlines with the uniform access number of 10000. Our customer service hotlines offer uniform electronic-based services to our residential and enterprise customers. Our customer service hotlines handle service inquiries and service applications, collect bill payments and handle customers' complaints.

Billing services. We bill our residential customers on a monthly basis and provide a range of payment choices for the convenience of our customers, including direct-debit service, which automatically deducts the monthly payment from the subscriber's designated bank or postal account. We also provide specially tailored billing and collection services to our large enterprise customers to help them more effectively plan and monitor their telecommunications needs.

Marketing and sales agencies and other wholesale channels. We market our services through our own retail outlets as well as agents and distributors. Our cooperation with third party agencies and distributors helps us reach a broader customer base and reduce our operating expenses. We provide a range of wireline telecommunications services, including, among others, local and long distance telephone and data services, to government agencies and regulatory authorities at all levels as well as to many state-owned enterprises in our service regions. A number of these government entities and state-owned enterprises are among our largest customers, and the amount of revenue received from entities controlled by the PRC government during 2004 was material to us. We provide these services in the normal course of business.

Precision Management

To ensure our successful business transformation, we will implement precision management at all levels of the Company. We will adopt quantitative standards to reduce data deviations in all aspects of management on an integrated basis covering marketing activities, network operations, allocation of financial resources and management of human resources.

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Network System

We were able to realize significant economies of scale as a result of the extensive coverage and scale of our network. It employs a variety of advanced technologies and suitable architecture and can be efficiently migrated to the next generation of network technology. Our network system is managed and operated by our experienced network management and maintenance teams and offers flexible functionality and reliable operation. It supports a comprehensive range of end-to-end wireline telecommunications services and enables customized products to be delivered for a variety of telecommunications needs. Our networks and services are supported by our strong research and development capabilities. We have formulated viable plans in light of future advances in technology to migrate our network system smoothly to the next generation of network technology in order to protect our existing investments.

Network Architecture

Our network system consists of transport networks, service networks, an application layer and support networks.

Transport networks: Transport networks provide the transport functions of voice and data signals for all of our services.

Service networks: Service networks include our wireline telephone network, data networks, Internet network and other service networks such as intelligent networks, and support our basic and value-added telecommunications services.

Application layer: The application layer provides the platform for a variety of applications and services such as e-commerce, video-on-demand, and on-line games.

Support networks: Support networks include signaling networks, digital synchronous networks and network management systems and support the reliable and effective operation of our networks at all levels.

Network Capacity and Technology

Local access networks. We own extensive local access networks in our service regions. As of December 31, 2004, our local access networks covered all cities, counties and most rural villages in our service regions. As part of our strategic focus on the broadband and PHS network in order to optimize our network and improve utilization, we continue to expand our broadband local access networks utilizing our existing copper line resources and optimizing our PHS network. As of December 31, 2004, the total capacity of our DSL access ports reached 16.9 million lines. At the same time, we are selectively connecting additional large office buildings and business centers with fiber optic access. We also developed wireless LANs in certain business areas in major cities, including hotels, airports, cafes and office buildings to provide business travelers with broadband access services.

Transport network. Our transport system is based on an advanced, high-speed, large-capacity, secure and reliable fiber optic network throughout our service regions. Our fiber optic transport network is also supplemented by satellite transmissions and digital microwave links. Our fiber optic network had a total cable length of 1.1 million kilometers in our service regions as of December 31, 2004.

Wireline telephone networks. Our wireline telephone network has been substantially built in the last decade utilizing digital technology. As of December 31, 2004, the total capacity of local switches reached approximately 251.8 million lines and the capacity of long distance switches reached approximately 5.0 million lines. In addition, China Telecom Group has built international gateways in Shanghai and Guangzhou and we utilize these international gateways for our international, Hong Kong, Macau and Taiwan long distance telephone services.

In developing our wireline telephone networks, we have adopted technologies that enable high capacity and fewer exchanges to reduce our construction and operating costs. We have installed advanced intelligent networks

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over our telephone networks. Intelligent networks combine advanced computer technologies with traditional switching techniques to provide flexible value-added services such as prepaid services, virtual private network services and toll free call services. As of December 31, 2004, the utilization rate of local and long distance switches were approximately 76.5% and 74.3%, respectively.

Internet and managed data networks. We have developed a large-capacity, high-quality, reliable and extensive Internet and managed data network system in our service regions. Our Internet and managed data networks allow us to provide services both at the network layer, such as Internet access, managed data and virtual private network services, and at the application layer, such as Internet data center, e-commerce and video-on-demand services.

Our data network system includes a DDN network, a frame relay network and an ATM network. These networks cover all cities and counties in our service regions. Our ATM network allows multi-service access and flexible bandwidth management and provides high-quality, integrated end-to-end services.

Our Internet network is part of ChinaNET. ChinaNET deploys mainstream Gigabyte routers as the main network technology. Most of its backbone routes allow high-speed transmission with the use of several 2.5Gbps circuits.

Support networks. The operation of our wireline telephone, Internet and managed data networks depends on various support networks, including a signaling network based on a signaling technology known as Signaling System 7 protocol, a digital synchronous network and network management systems for various networks and services, such as Internet data center, e-commerce and video-on-demand services.

Equipment procurement. We purchase most of our network equipment from leading international and domestic suppliers. We also purchase from local suppliers a variety of network equipment, such as transport equipment and local switches. We make most of our purchases through competitive tenders primarily based on product and service quality, system compatibility and price.

Our five largest suppliers of telecommunications equipment accounted for approximately 36.6% of our total capital expenditures for 2004. Our largest supplier of telecommunications equipment accounted for approximately 12.9% of our total capital expenditures for 2004.

Information Technology Systems

As a consistent corporate focus, we continue to improve our operational and management efficiency through the establishment and improvement of our information technology systems. Our information technology systems (CTG-MBOSS) include the business support systems, operation support systems and management information. Adoption of the enterprise application integration technology has allowed for smooth interconnection among all major systems of our company, enabling full information sharing within our company.

Our business support systems (BSS) include our business management system, billing and customer service systems and provide comprehensive and integrated support for various aspects of our business, such as customer relationship management, new service request responses, billing and network error reporting and correction.

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We have developed our operation support systems (OSS) and continue to enhance their functionality. These systems include an integrated network management system and a network resources system, and enable us to enhance network management capabilities, promptly correct network errors and improve resource utilization and network reliability. See Support Networks.

Our management support systems (MSS) include financial information, procurement and human resources management systems. These systems gather and process various operational and financial data for management, marketing and customer service purposes. Operating and financial data gathered by these

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systems allow us to analyze network usage patterns, monitor service quality and customer satisfaction, understand market demand and trends, determine network expansion needs and investment plans and formulate marketing strategies. We are in the process of further improving our management information systems and incorporating them into our enterprise resource planning system.

We believe that the development of our information technology systems will further enhance our market responsiveness and quality of customer services, and will significantly improve our operating efficiency, the management of our business and our competitiveness.

Competition

We compete with other telecommunications service providers in our wireline telephone, Internet, managed data and leased line services. All of our principal competitors are wholly or majority owned by the Chinese government. The government encourages orderly and fair competition in the telecommunications industry in China. Currently, providers of basic telecommunications services must apply for a license from the Ministry of Information Industry. Only a limited number of providers have obtained licenses to provide basic telecommunications services in China. In China, there are currently two licensed mobile telecommunications service providers, China Mobile and China Unicom, and four wireline service providers, China Netcom Group, China Unicom, China Railcom and us. We face direct and indirect competition from our competitors in all of our businesses within our service regions. During the implementation of our strategy to become an integrated information service provider, we will not only face competition in our traditional wireline service, but also in new services, including mobile telecommunications service. We also expect the level of competition to increase as further deregulation occurs within China's telecommunications industry. See Risk Factors Risk Relating to Our Business We face increasing competition, which may adversely affect our business growth and results of operations. and Regulatory and Related Matters Licensing included elsewhere under this item.

Competition in Wireline Telephone Services

Local telephone services. Mobile service substitution for our wireline telephone services has been the principal competition to our local telephone services. Currently, China Mobile and China Unicom are the only licensed providers of mobile communications services in China. Compared with these mobile service providers, our wireline telephone services continue to offer better voice quality, higher communication consistency, reliability and lower cost, and our wireless local access services also offer mobility within limited local areas. Mobile service providers, however, have the advantages of unrestricted mobility and roaming capability.

Until the mid-1990s, we were the sole licensed wireline local telephone services provider in our service regions. Our local telephone services currently compete with the wireline services offered by China Netcom Group and China Railcom, which have been licensed to provide local telephone services in our service regions. We compete with these operators primarily on the basis of brand name, network coverage, service quality and service offerings. In addition, we have a large customer base, which allows us to compete through economies of scale and to cross-sell our services to our existing customers.

Long distance telephone services. We compete with China Unicom, China Railcom and China Netcom Group with respect to long distance telephone services using public switched telephone networks in our service regions. China Unicom and China Railcom are allowed to set their tariffs, subject to annual regulatory approval, for long distance services using public switched telephone networks and are therefore able to offer more competitive prices to customers. In addition, mobile telecommunications services have diverted some of the traffic from our long distance telephone services. We compete with these service providers on the basis of customer base, brand name, network resources, quality of service and marketing and distribution strength. Access to our long distance services does not require the dialing of any pre-set access number or personal identification number.

China Mobile, China Netcom Group, China Unicom, China Railcom and China Satellite provide VoIP services that compete with our public switched telephone network and VoIP long distance services in our service regions. We compete with these VoIP service providers on the basis of customer base, reliability, quality and coverage of

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networks and general service quality. The tariff adjustments in 2001 deregulated the tariffs of VoIP services. This has allowed us to combine price flexibility with bundled services to meet different customer needs and to attract new customers.

Competition in Internet Service

We compete with other service providers of Internet access services on the basis of customer base, brand name, coverage of access networks and cooperation with the providers of Internet content and applications.

Competition in Managed Data Services

We compete with China Netcom Group, China Railcom, China Mobile and China Unicom for managed data services. We compete on the basis of end-to-end connectivity, network coverage, service quality and scale efficiency.

Competition in Leased Line Services

We compete with China Netcom Group, China Unicom and China Railcom in leased line services. We compete with them on the basis of the coverage and quality of networks, ability to provide end-to-end connectivity, quality of network management and customer services.

Competitive Implications of China's Accession to WTO

Since China's accession to the WTO, foreign operators have been permitted to gradually increase their investments in the telecommunications industry in China. Like domestic service providers, foreign operators are subject to the licensing requirements of the Ministry of Information Industry. In addition, investments by foreign operators may not exceed limits set forth in relevant laws and regulations with respect to the amount of investment and percentage of total investment that foreign operators are permitted to make in telecommunications enterprises in China. For example, the foreign ownership percentage in basic telecommunications services will be subject to a maximum limit of 49%. See Regulatory and Related Matters – Licensing included elsewhere under this item.

Foreign operators may have competitive advantages over us in terms of financial and management resources, network management and technical expertise. On the other hand, because foreign operators currently are prohibited from establishing wholly owned subsidiaries in the telecommunications industry in China, we believe that we are well positioned to establish strategic alliances with strong global operators in this respect. See Item 3. Key Information – D. Risk Factors – Risks Relating to Our Business – We face increasing competition, which may adversely affect our business growth and results of operations.

Trademarks

We conduct our businesses under the China Telecom brand name and logo. Currently, China Telecom Group owns certain trademarks in China, some of which have been registered with the Trademark Office of the PRC State General Administration for Industry and Commerce, or the Trademark Office, and some of which are in the process of being registered with the Trademark Office. China Telecom Group has executed a trademark license agreement with us. Under this agreement, China Telecom Group agreed to grant to us and our subsidiaries the right to use these trademarks upon the completion of the registration on a royalty-free basis until December 31, 2006, which is automatically renewable for three more years at our option. See Item 7. Major Shareholders and Related Party Transactions B. Related Party Transactions Ongoing Related Party Transactions between Us and China Telecom Group Trademark License Agreement.

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Regulatory and Related Matters

Overview

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

The Ministry of Information Industry, which is responsible for, among other things:

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

granting telecommunications service licenses;

supervising the operations and quality of service of telecommunications service providers;

allocating and administering telecommunications resources such as spectrum and numbers;

together with other relevant regulatory authorities, formulating tariff standards for telecommunications services;

formulating interconnection and settlement arrangements between telecommunications networks; and

maintaining fair and orderly market competition among service providers.

Provincial communications administrations under the Ministry of Information Industry, which oversee the implementation of the Ministry's regulations and exercise regulatory authorities delegated by the Ministry within their respective provinces, autonomous regions and centrally administered municipalities.

The National Development and Reform Commission, which, together with the Ministry of Information Industry, sets government fixed tariffs and government guidance tariffs for certain telecommunications services. The actual tariffs charged by providers of telecommunications services are determined by provincial communications administrations, together with the price bureaus of the provinces, autonomous regions or centrally administered municipalities where those providers operate. See [Tariff Setting](#) below. It also approves investment and finance projects exceeding certain capital expenditure amounts as well as foreign investment projects exceeding certain investment amounts.

In order to provide a uniform regulatory framework to encourage the orderly development of the telecommunications industry, the Chinese government is in the process of drafting a telecommunications law. We expect that, if and when the telecommunications law is adopted by the National People's Congress or its Standing Committee, the highest state legislative body in China, it will become the basic telecommunications statute and provide a regulatory framework for the telecommunications industry in China.

Telecommunications Regulations

China's State Council promulgated the Telecommunications Regulations, which became effective as of September 25, 2000. The Telecommunications Regulations are substantially consistent with, and are primarily intended to, streamline and clarify the then existing rules and policies for the telecommunications industry. They provide the primary regulatory framework for China's telecommunications industry in the interim period prior to the adoption of the telecommunications law.

The Telecommunications Regulations are intended to develop a transparent and fair regulatory environment to encourage fair and orderly competition and development in the telecommunications industry. The

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Telecommunications Regulations address all key aspects of telecommunications operations, including, among others, entry into the telecommunications industry, network interconnection, telecommunications resource allocation, tariffs and service standards.

Licensing

The Telecommunications Regulations adopt the existing regulatory distinction between basic and value-added telecommunications services, which are subject to different licensing requirements. Basic telecommunications services include, among others, wireline local and domestic long distance telephone services, international telecommunications services, IP telephone services, mobile communications services (such as 900/1800MHz GSM, 800MHz CDMA and 3G mobile communications services), satellite communications services, paging services, data communications services (such as Internet data transmission services, international data communications services), network access services and the domestic and international telecommunications facility services. Value-added telecommunications services include, among others, value-added services provided over wireline telephone networks (e.g., telephone information, call center, voice mail and video conferencing services), value-added services provided over mobile networks, value-added services provided over Internet networks (e.g., Internet data center and Internet access and content services) and value-added services provided over other data networks (e.g., computer information, e-mail and electronic data interchange services).

Providers of any basic telecommunications services as well as providers of value-added services in two or more provinces, autonomous regions and centrally administered municipalities in China must apply for licenses from the Ministry of Information Industry. In accordance with the approval of the Ministry of Information Industry, we derive our exclusive rights to operate our businesses from our status as a subsidiary controlled by China Telecom Group, which holds the licenses required for operating our telecommunications businesses.

China's State Council has promulgated the Administrative Regulations on Telecommunications Companies with Foreign Investment, which became effective on January 1, 2002. According to those regulations, enterprises with foreign investment may operate basic and value-added telecommunications businesses subject to the approval of the Ministry of Information Industry and the Ministry of Commerce, formerly the Ministry of Foreign Trade and Economic Cooperation. Certain limitations have been placed on the total registered capital of, and maximum foreign shareholdings in, such enterprises.

The table below summarizes the foreign ownership and geographic restrictions for telecommunications joint ventures in China:

**Foreign Ownership Percentage and Geographic Restrictions
for Foreign-Invested Telecommunications Enterprises**

Sector	As of December 31,						
	2001	2002	2003	2004	2005	2006	2007
Wireline				25% (3 cities) ⁽¹⁾		35% (17 cities) ⁽²⁾	49% (nationwide)
Mobile							

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	25%	35%	49%	49%
	(3 cities) ⁽¹⁾	(17 cities) ⁽²⁾	(17 cities) ⁽²⁾	(nationwide)
Value-added	30%	49%	50%	
	(3 cities) ⁽¹⁾	(17 cities) ⁽²⁾	(nationwide)	
Paging	30%	49%	50%	
	(3 cities) ⁽¹⁾	(17 cities) ⁽²⁾	(nationwide)	

(1) The initial three cities are Beijing, Shanghai and Guangzhou.

(2) The 17 cities are Beijing, Chengdu, Chongqing, Dalian, Fuzhou, Guangzhou, Hangzhou, Nanjing, Ningbo, Qingdao, Shanghai, Shenyang, Shenzhen, Xiamen, Xi'an, Taiyuan and Wuhan.

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The Ministry of Information Industry has promulgated the Measures on Administration of Telecommunication Business Licenses, which became effective on January 1, 2002. Those regulations apply to the application for, and examination and approval of, telecommunications business licenses in China.

The Chinese government has not publicly announced its decisions on issues such as whether it will grant any 3G licenses, and if so, the timing of the grant of the 3G licenses, the number of 3G licenses to be granted, any technical requirements, or any selection of preferred technologies.

Tariff Setting

The levels and categorization of most of our current tariffs are subject to regulation by various government authorities, including the Ministry of Information Industry, the National Development and Reform Commission, and, at the local level, the relevant provincial communications administrations and price bureaus. Under the Telecommunications Regulations, telecommunications tariffs are categorized into government fixed tariffs, government guidance tariffs and market based tariffs.

Currently, the monthly fee and usage fee for wireline local telephone services are determined by the relevant provincial communications administrations and provincial price bureaus, based on a guidance tariff range set by the Ministry of Information Industry in consultation with the National Development and Reform Commission. Tariffs for all domestic and international long distance services using public switched telephone networks, leased lines and other basic telecommunications services are fixed jointly by the Ministry of Information Industry and the National Development and Reform Commission. Tariffs for telecommunications services in respect of which effective competition has already developed, as determined by the Ministry of Information Industry according to the market conditions, may be set by the service providers. We derive a substantial portion (in excess of 70%) of our revenue from services that are subject to government guidance tariffs and government fixed tariffs. Currently, the Ministry of Information Industry allows tariffs for VoIP, Internet access services and certain value-added services provided over wireline telephone networks, such as telephone information, caller identification, voice mail and video conferencing services, to be set by service providers.

There is uncertainty with respect to how the Ministry of Information Industry would make a determination regarding effective competition as it has not publicly disclosed the criteria it uses for determining whether a certain type of service should be subject to market based tariffs. Under the Telecommunications Regulations, cost should be the primary basis for tariff setting, but the tariff level should also take into account social and economic development, the development of the telecommunications industry and consumers' ability to afford the services. The Ministry of Information Industry has not provided a timetable for tariff deregulation or indicated that service providers will eventually be permitted to freely set all tariffs.

Over the past few years, the Chinese government has adjusted the tariffs for telecommunications services, including the elimination of connection fees in July 2001. See [B. Business Overview Wireline Telephone Services](#) included elsewhere under this item. In general, we expect these adjustments to stimulate the overall usage of our telecommunications services. We also expect that increased flexibility in setting certain tariffs will allow us to better respond to changes in market demand and competitive conditions. For a discussion on the impact of these adjustments on our financial condition and results of operations, see [Item 5. Operating and Financial Review and Prospects](#).

The Chinese government retains the ultimate authority to adopt changes to tariffs. However, the Telecommunications Regulations require the government to hold public hearings before setting or changing fixed or guidance tariff rates, which should be attended by, among others, telecommunications operators and consumers. See [Item 3. Key Information D. Risk Factors Risks Relating to the Telecommunications Industry in China](#). Our revenues may be adversely affected by reductions in tariffs mandated by the Chinese government.

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Under the Telecommunications Regulations and the Administrative Rules on Interconnection between the Public Telecommunications Networks promulgated by the Ministry of Information Industry in May 2001, major telecommunications operators in China cannot refuse requests for interconnection and must enter into interconnection agreements upon request by other service providers. Interconnection agreements must be filed with the Ministry of Information Industry. Interconnection agreements may not be terminated unilaterally without prior approval by the Ministry of Information Industry.

The Telecommunications Regulations further provide that the technical standards and settlement methods for network interconnections be formulated by the Ministry of Information Industry. In accordance with these regulations, China Telecom Group has entered into various interconnection agreements with other telecommunications service providers, including China Mobile, China Unicom, China Netcom Group and China Railcom.

In October 2003, the Ministry of Information Industry promulgated a new regulation on interconnection between public telecommunications networks. In addition to formalizing certain existing interconnection rules, the new regulation provides for the interconnection settlement arrangements among mobile operators and provide further detailed implementation mechanisms in relation to revenue sharing and settlement arrangements. This new regulation has no significant impact on wireline operators such as us.

The following table sets forth selected interconnection revenue sharing and settlement arrangements for local calls before and after the regulatory adjustment in 2001⁽¹⁾:

Network from Which	Network at Which	Old Settlement Arrangement	New Settlement Arrangement
Calls Originated	Calls Terminated		
Mobile operator	Wireline local operator	(1) Mobile operator collects the cellular usage charge from its subscribers (2) Mobile operator pays RMB0.05 per minute to wireline operator	(1) Mobile operator collects the cellular usage charge from its subscribers (2) Mobile operator pays RMB0.06 per minute to wireline operator
Wireline local operator	Mobile operator	No revenue sharing or settlement	No revenue sharing or settlement
Wireline local operator A	Wireline local operator B	(1) Operator A collects the usage charge from its subscribers (2) In the case of intra-district calls, operator A and operator B equally share the revenue. In the case of inter-district calls, the operator whose inter-district transmission facility is used in transmitting the call gets 90% of the usage charge and the other operator gets 10%.	

(1) Except for settlement arrangement between mobile operators which became effective in 2003.

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

Network from Which	Network at Which	Current Main Settlement
Calls Originated	Calls Terminated	Arrangement
Wireline local or mobile operator A	Wireline local or mobile operator B, through the long distance network of operator C	RMB0.06 per minute for operator A, RMB0.06 per minute for operator B, the rest of the long distance tariff for operator C

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

Network from Which	Network at Which	Current Main Settlement
Calls Originated	Calls Terminated	Arrangement
Domestic wireline local or mobile operator A	International long distance operator B, through the domestic long distance network of operator C to international gateway	RMB0.06 per minute for operator A, not more than RMB0.54 per minute for operator C, the rest of the international long distance tariff for operator B, where operator A and operator B, or operator B and operator C can be the same operator
International long distance operator A	Domestic wireline local or mobile operator B, through domestic long distance network of operator C and international gateway of operator D	RMB0.06 per minute for operator B, not more than RMB0.54 per minute for operator C, the rest of the international long distance tariff for operator D, where operator B and operator C, or operator C and operator D can be the same operator

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

Network from Which Calls	Network at Which Calls	Current Main Settlement
Originated	Terminated	Arrangement
Wireline or mobile network A	Wireline local or mobile operator B through the VoIP network of operator C	<ol style="list-style-type: none"> (1) Operator C collects the VoIP long distance charges from its subscribers (2) Operator C pays RMB0.06 per minute to operator B on the terminating end (3) No settlement between operator C and operator A on the originating end

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Effective November 1, 2002, the Ministry of Information Industry has unified the minimum level of the termination rate for international calls, including for this purpose calls from Hong Kong, Macau and Taiwan, terminating in mainland China. Such termination rate is required to be no less than US\$0.17 per minute, but can be higher based upon negotiations between the carriers.

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Technical Standards

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

Capital Investment

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

The Investment Reform Decision grants large enterprises more power of decision-making on investment. Where a large enterprise which has established modern corporate governance invests in any of the projects in the restricted sectors specified in the 2004 catalogue, it may apply for approval on individual project basis, or make medium and long-term development and construction plan, which, if approved by the State Council or the competent governmental authority, no specific approval is required for the projects contemplated in the plan. In this case, the enterprise is only required to go through the registration process and report to the relevant governmental authority, on a timely basis, the construction process of the project.

Telecommunications Resources

The Ministry of Information Industry is responsible for the administration and allocation of telecommunications resources in China, including radio frequencies and telecommunications network numbers. The use of these resources by telecommunications service providers is subject to the approval of the Ministry of Information Industry or the relevant provincial communications administrations and a usage fee payable to the Chinese government.

On December 31, 2004, the Ministry of Information Industry, the Ministry of Finance and the National Development and Reform Commission promulgated the Interim Measure on Collection of Usage Fees of Telecommunications Network Numbers, or the Interim Measures, effective January 1, 2005. The Interim Measures provide for the standards and collection of usage fees of telecommunications network numbers. In accordance with the Interim Measures, telecommunications services providers, including us, shall pay the usage fees of telecommunications network numbers.

Quality of Service

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Under the Telecommunications Regulations, the Ministry of Information Industry and the relevant provincial communications administration have the responsibility of supervising and monitoring the quality of services provided by telecommunications service providers in China. Under the Telecommunications Regulations, customers of telecommunications service providers have the right to submit their complaints to the Ministry of Information Industry and the relevant provincial communications administration or other relevant government authorities.

Under the Consumer Protection Law of China, the Consumers Associations can participate in the inspection and examination of goods and services by relevant governmental authorities; and the customers can lodge their complaints with the Consumers Associations, which can investigate the goods or services involved in the complaints, and mediate the complaints.

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Universal Services

Under the Telecommunications Regulations, telecommunications service providers in China are required to fulfill universal service obligations in accordance with relevant regulations to be promulgated by the Chinese government, and the Ministry of Information Industry has been given authority by the Chinese government to delineate the scope of its universal service obligations. The Ministry of Information Industry may also select universal service providers through a tendering process. The Ministry of Information Industry, together with government finance and pricing authorities, is also responsible for formulating administrative rules relating to the establishment of a universal service fund and compensation schemes for universal services.

Under the Telecommunications Regulations, all Chinese telecommunications operators shall provide universal services, but the formal timetable for the establishment of the systems to implement universal services has not been set up. Currently, China's government requires telecommunications operators to provide telephone services in a number of remote villages in China as transitional measures prior to the formalization of a universal service obligation framework. In order to fulfill such obligations under those transitional measures, China Telecom Group will assume the responsibility for investing in and constructing the necessary network facilities in remote villages of some provinces. We operate and maintain such network facilities, while China Telecom Group will compensate us for the related expenses. Once the universal service regulatory framework is finalized, we will perform our duties thereunder accordingly.

State-Owned Assets Supervision

Under the Company Law of the People's Republic of China, Interim Measures for the Supervision and Administration of State-Owned Assets of the Enterprises, and other administrative regulations, the State-owned Assets Supervision and Administration Commission of the State Council, or the SASAC, among others, supervises the preservation of the value of state-owned assets, guides the reform and restructuring of state-owned enterprises, and evaluates the performances of management executives of state-owned enterprises through legal procedures. Our controlling shareholder, China Telecom Group, is a wholly state-owned enterprise and subject to the SASAC's supervision.

C. Organization Structure

See A. History and Development of the Company Our Restructuring and Initial Public Offering included elsewhere under this item.

D. Property, Plants and Equipments

Properties

Executive Offices

Our principal executive offices are located in Beijing and we obtained the right to occupy and use these offices pursuant to an agreement we entered into with China Telecom Group in September 2002 and its supplemental agreements on October 26, 2003 and April 13, 2004, respectively. See Item 7. Major Shareholders and Related Party Transactions B. Related Party Transactions Ongoing Related Party Transactions between Us and China Telecom Group Centralized Services Agreement.

Properties

We conduct our businesses on land and premises either owned by ourselves or leased from China Telecom Group and/or its affiliates and third parties. As to our owned properties, although a majority of the land and building titles to these properties have been registered in our name after they were acquired by us as part of our restructuring, certain land and building titles to these properties are still registered in the name of China Telecom Group. China Telecom Group has agreed to indemnify us against any loss or damage incurred by us caused by or arising from any

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challenge of, or interference with, our right to use these properties. As to our leased properties, China Telecom Group has undertaken to us that it will indemnify us against any loss or damage caused by or arising from any challenge to, or interference with, such right. See Item 7. Major Shareholders and Related Party Transactions B. Related Party Transactions Ongoing Related Party Transactions between Our Subsidiaries and Subsidiaries of China Telecom Group Property Leasing Agreements.

Item 5. Operating and Financial Review and Prospects.

You should read the following discussion and analysis in conjunction with our audited financial statements and our selected financial data, in each case, together with the accompanying notes included elsewhere in this annual report. Our audited financial statements have been prepared in accordance with IFRS. IFRS differs in a number of significant respects from US GAAP. Note 33 to our audited financial statements, included elsewhere in this annual report, contains information relating to the nature and effect of significant differences between IFRS and US GAAP as they relate to us and provides a reconciliation to US GAAP of our net income and shareholders' equity. Since China Telecom Group controlled the telecommunications operations and the related assets transferred to us prior to our restructuring and continues to control us after our restructuring, the financial data of the telecommunications operations transferred to us presented in this section and in our audited financial statements included elsewhere in this annual report for periods prior to our incorporation have been combined in a manner similar to a pooling-of-interests. The assets and liabilities of the entities being combined are carried forward at their recorded historical amounts, and the book value of the assets and liabilities and the revenue and expenses of each of these entities for the periods prior to our incorporation are added together to prepare our financial statements. On December 31, 2003, we acquired the entire equity interests in each of Anhui Telecom Company Limited, Fujian Telecom Company Limited, Jiangxi Telecom Company Limited, Guangxi Telecom Company Limited, Chongqing Telecom Company Limited and Sichuan Telecom Company Limited from China Telecom Group. On June 30, 2004, we acquired the entire equity interests in Hubei Telecom Company Limited, Hunan Telecom Company Limited, Hainan Telecom Company Limited, Guizhou Telecom Company Limited, Yunnan Telecom Company Limited, Shaanxi Telecom Company Limited, Gansu Telecom Company Limited, Qinghai Telecom Company Limited, Ningxia Telecom Company Limited and Xinjiang Telecom Company Limited from China Telecom Group. As we and these acquired companies were under the common control of China Telecom Group, our acquisitions of these companies have been accounted for in a manner similar to a pooling-of-interests. Accordingly, the assets and liabilities of the acquired companies have been accounted for at historical amounts and our financial statements for periods prior to the respective acquisitions have been restated to include the financial position and results of operations of the acquired companies on a combined basis. Unless otherwise indicated in this section, our financial data for periods prior to the acquisitions are presented based on those restated amounts. With respect to the acquisition in 2003, the income statement data for the year ended December 31, 2002 include the results of the assets retained by China Telecom Group in relation to the acquisition in 2003. The results of such assets are not reflected in our income statement for periods beginning after December 31, 2002. These assets are not reflected in our balance sheet as of and after December 31, 2002. With respect to the acquisition in 2004, the income statement data for the years ended December 31, 2002 and 2003 include the results of the assets retained by China Telecom Group in relation to our acquisition in 2004. The results of such assets are not reflected in our income statement for periods beginning after December 31, 2003. The balance sheet data as of December 31, 2002 include data related to the assets retained by China Telecom Group in relation to the acquisition in 2004. These assets are not reflected in our balance sheet as of and after December 31, 2003.

Overview

We are the leading provider of wireline telecommunications services in our service regions in China. Our service regions consist of Anhui Province, Chongqing Municipality, Fujian Province, Gansu Province, Guangdong Province, Guangxi Zhuang Autonomous Region, Guizhou Province, Hainan Province, Hubei Province, Hunan Province, Jiangsu Province, Jiangxi Province, Ningxia Hui Autonomous Region, Qinghai Province, Shaanxi Province, Shanghai Municipality, Sichuan Province, Xinjiang Uygur Autonomous Region, Yunnan Province and Zhejiang Province.

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Our operating revenue increased while our operating expenses grew at a rate below our revenue growth rate. The table below sets forth a breakdown of our operating revenue in terms of amount and as a percentage of our total operating revenue for the periods indicated:

	Year Ended December 31,					
	2002		2003		2004	
	Amount	Percentage of Operating Revenue	Amount	Percentage of Operating Revenue	Amount	Percentage of Operating Revenue
(RMB in millions, except percentage data)						
Operating Revenue:						
Wireline telephone services:⁽¹⁾						
Local:						
Installation fees	2,305	1.6%	2,643	1.8%	2,865	1.8%
Monthly fees	25,338	18.0%	27,499	18.2%	29,827	18.5%
Local usage fees	44,440	31.5%	45,815	30.2%	47,646	29.5%
Sub-total	72,083	51.1%	75,957	50.2%	80,338	49.8%
Domestic long distance ⁽²⁾	25,726	18.3%	25,460	16.8%	26,231	16.3%
International, Hong Kong, Macau and Taiwan long distance ⁽²⁾	3,878	2.8%	3,943	2.6%	3,788	2.3%
Interconnection ⁽³⁾	7,524	5.3%	8,365	5.5%	10,719	6.6%
Upfront connection fees	10,564	7.5%	9,771	6.4%	8,458	5.3%
Sub-total	119,775	85.0%	123,496	81.5%	129,534	80.3%
Internet and managed data services:						
Internet ⁽⁴⁾	5,998	4.3%	10,007	6.6%	14,109	8.8%
Managed data ⁽⁵⁾	3,147	2.2%	3,210	2.1%	3,015	1.9%
Sub-total	9,145	6.5%	13,217			