

CHINA TELECOM CORP LTD
Form 20-F
June 16, 2006
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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, 2005

OR

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

For the transition period from _____ to _____

OR

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

Date of event requiring this shell company report

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:

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

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

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

None

(Title of Class)

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

None

(Title of Class)

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

As of December 31, 2005, 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 if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes No

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If this report is an annual or transition report, indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934. Yes No

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 whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act. (Check one):

Large Accelerated Filer Accelerated Filer Non-Accelerated Filer

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

Item 17 Item 18

If this is an annual report, indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes No

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CHINA TELECOM CORPORATION LIMITED

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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 herein, 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;

any potential restructuring of the PRC telecommunication industry;

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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 American depositary 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.

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, 2004 and 2005, and the selected income statement and cash flow data for each of the years ended December 31, 2003, 2004 and 2005, are derived from our audited consolidated financial statements included elsewhere in this annual report, and should be read in conjunction with our audited consolidated financial statements and operating and financial review and prospects included elsewhere in this annual report. The selected balance sheet data as of December 31, 2001, 2002 and 2003 and the selected income statement and cash flow data for each of the years ended December 31, 2001 and 2002 are derived from our audited consolidated financial statements, which are not included in this annual report. Our audited consolidated 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 36 to the audited consolidated 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, Our Acquisitions in 2003 and in 2004, and have been prepared as if our current structure had been in existence throughout the relevant periods.

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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.

	As of or for the year ended December 31,					2005 US\$
	2001 RMB	2002 RMB	2003 RMB	2004 RMB	2005 RMB	
Income Statement Data:						
IFRS⁽¹⁾						
Operating revenue	130,081	140,906	151,553	161,212	169,310	20,979
Operating expenses	(109,367)	(115,798)	(118,701)	(121,382)	(130,356)	(16,152)
Operating income	20,714	25,108	32,852	39,830	38,954	4,827
Income before income tax	6,839	6,435	14,407	33,263	34,114	4,228
Income tax	1,499	1,856	(469)	(5,187)	(6,160)	(764)
Net income attributable to equity holders of the Company	8,352	8,219	13,882	28,023	27,912	3,459
Basic earnings per share ⁽²⁾	0.12	0.12	0.18	0.36	0.34	0.04
Basic earnings per ADS ⁽²⁾	12.23	11.87	18.36	35.54	34.49	4.27
U.S. GAAP						
Net income	16,254	16,991	21,452	25,715	22,575	2,798
Basic earnings per share ⁽²⁾	0.24	0.25	0.28	0.33	0.28	0.03
Basic earnings per ADS ⁽²⁾	23.79	24.54	28.37	32.62	27.89	3.46
Balance Sheet Data:						
IFRS⁽¹⁾						
Cash and cash equivalents	15,274	22,743	12,721	13,465	15,121	1,873
Accounts receivable, net	11,074	11,605	12,951	13,921	16,142	2,001
Property, plant and equipment, net ⁽³⁾	312,326	311,241	309,896	320,179	328,281	40,678
Total assets ⁽³⁾	423,434	423,701	403,942	412,570	417,136	51,688
Short-term debt ⁽⁴⁾	44,897	53,196	56,243	65,976	76,005	9,418
Accounts payable	38,756	34,859	35,629	33,658	33,949	4,207
Long-term obligations	46,469	39,052	68,675	72,523	55,829	6,917
Deferred revenues (excluding current portion)	49,308	40,894	32,744	25,182	18,750	2,324
Total liabilities	252,974	235,490	251,879	251,951	234,175	29,017
Equity attributable to equity holders of the Company	169,472	187,025	150,794	159,206	181,517	22,492

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	As of or for the year ended December 31,					
	2001 RMB	2002 RMB	2003 RMB	2004 RMB	2005 RMB	2005 US\$
(in millions, except share numbers and per share and per ADS data)						
U.S. GAAP						
Property, plant and equipment, net	320,102	331,350	339,300	342,718	343,592	42,575
Total assets	431,210	443,810	433,346	435,109	432,447	53,586
Shareholders' equity	174,590	200,406	170,641	176,134	193,113	23,929
Cash Flow Data:						
IFRS⁽¹⁾						
Cash flows from operating activities	57,083	62,357	58,392	66,078	68,359	8,471
Net cash used in investing activities ⁽⁵⁾	(75,073)	(62,578)	(57,094)	(56,353)	(51,894)	(6,431)
Capital expenditures ⁽⁵⁾	(73,976)	(61,437)	(57,692)	(56,446)	(52,083)	(6,454)
Net cash from / (used in) financing activities	8,105	7,690	(11,320)	(8,981)	(14,809)	(1,835)

- (1) The International Accounting Standard Board has issued a number of new and revised IFRS interpretations that became effective for accounting periods beginning on or after January 1, 2005. See Note 3 to our audited consolidated financial statements for the effect of changes in accounting policies, financial statement presentation and disclosures.
- (2) The basic earnings per share have been calculated based on the net income attributable to equity holders of the Company of RMB8,352 million, RMB8,219 million, RMB13,882 million, RMB28,023 million and RMB27,912 million, respectively, for the years ended December 31, 2001, 2002, 2003, 2004 and 2005, and the weighted average number of shares in issue during the relevant year of 68,317,270,803, 69,241,674,942, 75,614,186,503, 78,839,968,917 and 80,932,368,321 shares, respectively. The weighted average number of shares for the years ended December 31, 2001 and 2002 reflects, as if the 68,317,270,803 shares issued and outstanding upon our formation on September 10, 2002 had been outstanding for years ended December 31, 2001 and 2002. The weighted average number of shares in issue for the year ended December 31, 2002 reflects the issuance of 7,296,915,700 shares in November 2002 in connection with the Company's global initial public offering. The weighted average number of shares in issue for the year ended December 31, 2004 reflects the issuance of 5,318,181,818 new H shares in May 2004. 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.
- (3) 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 8 to our audited consolidated financial statements.
- (4) Excludes current portion of long-term debt.
- (5) 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 25, 2005, a final dividend of RMB5,596 million (RMB0.069139 equivalent to HK\$0.065 per share) in respect of the year ended December 31, 2004 was declared and paid on June 23, 2005. Holders of our ADRs received a dividend of USD\$0.8352 per share in 2005 based on the exchange rate of HK\$7.782 = US\$1.00.
- Pursuant to the shareholders' approval at the annual general meeting held on May 23, 2006, a final dividend of RMB 0.077637 per share equivalent to HK\$0.075 per share totaling approximately RMB6,283 million in respect of the year ended December 31, 2005 was declared and is expected to be paid on or about June 15, 2006. The dividend has not been provided for in the consolidated financial statements for the year ended December 31, 2005.

Exchange Rate Information

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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 RMB8.0702 = US\$1.00 and HK\$7.753 = 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, 2005. 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.

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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 RMB8.0084 = US\$1.00 and HK\$7.7619 = US\$1.00, respectively, on June 8, 2006. 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	
December 2005	8.0808	8.0702	December 2005	7.7548	7.7516
January 2006	8.0702	8.0596	January 2006	7.7571	7.7506
February 2006	8.0616	8.0415	February 2006	7.7618	7.7564
March 2006	8.0505	8.0167	March 2006	7.7620	7.7570
April 2006	8.0248	8.0040	April 2006	7.7598	7.7529
May 2006	8.0300	8.0005	May 2006	7.7575	7.7510
June 2006 (through June 8, 2006)	8.0225	8.0057	June 2006 (through June 8, 2006)	7.7619	7.7578

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 2001, 2002, 2003, 2004 and 2005, calculated by averaging the noon buying rates on the last day of each month during each of the relevant years.

	Average Noon Buying Rate	
	RMB per US\$ 1.00	HK\$ per US\$1.00
2001	8.2772	7.7997
2002	8.2772	7.7996
2003	8.2771	7.7864
2004	8.2768	7.7899
2005	8.1826	7.7755

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 services 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

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Communications Group Corporation, or China Netcom Group;

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

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we face increasingly intense competition in our Internet and value-added 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, and telephone services offered over broadband Internet.

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 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. As a result, our competitors who enjoy this preferential treatment may be able to provide more competitive services 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, in particular, the third generation mobile telecommunications technology, or 3G, license. In 2004, China Telecom Group conducted testing for CDMA 2000 and W-CDMA technologies in Guangzhou in Guangdong province and Shanghai Municipality. In 2006, China Telecom Group conducted testing for TD-SCDMA technology in Baoding, Hebei province. China Telecom Group did not use any of our Company's resources to conduct such testing. We can provide no assurance as to whether any of such new technologies will be adopted by the PRC government in the future. In addition, we cannot assure you whether our Company could receive any benefit from such testing, or be granted any license to provide mobile telecommunications service based on such new technologies. 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. We cannot assure you that we can compete effectively in the mobile telecommunications services industry due to different regulatory requirements in such industry and our limited experience in mobile telecommunications operations. In addition, the cost of implementing new technologies, including, among others, 3G, may also be significant. In particular, in order for us to effectively respond to technological changes, we may be required to make substantial capital expenditures in the future.

Due to the increasingly competitive environment, our customers may choose to use other providers' services. Increased competition from other telecommunication services 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 70.89% of our outstanding share as of June 8, 2006. Accordingly, subject to our Articles of Association and applicable laws and

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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.

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 basic network operator into a modern integrated information services provider.

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Our business strategy will focus on transforming from a traditional basic 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 also exploit the development potential of rural telephony, value-added services, leased line and other services.

In addition, we have been actively participating in testing some new telecommunications technologies. In July 2005, the Ministry of Information Industry requested China Telecom Group to conduct testing for PC Phone VoIP in Shenzhen in Guangdong province and Shangrao in Jiangxi province. Our Company performed such testing on behalf of China Telecom Group.

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However, we cannot assure you that the implementation of our new business strategy will not be delayed, or that the strategy will ever be successfully implemented. In particular, if any new technologies are adopted in the PRC telecommunications industry, we cannot assure you that we will be granted license from national or local governments to provide services based on such new technologies. We also cannot assure you that we can develop the necessary 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.

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

use of international gateway facilities;

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

use of nationwide inter-provincial optic fibers; and

lease of properties.

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

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

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

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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 basic 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 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.

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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.

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;

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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, such as any consolidation among the services providers within the industry, might change the competition environment in the PRC telecommunications industry. The rapid development of new technologies, such as 3G technology, 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 and other changes in tariff regulations mandated by the Chinese government.

We are subject to extensive government regulations on tariffs, especially those relating to our basic telecommunications services. On October 1, 2005, the Ministry of Information Industry liberalized the tariff level by allowing telecommunication services providers to set tariffs for wireline local inter-district telephone services and all domestic and international, Hong Kong, Macau and Taiwan long distance services using public switched telephone networks provided the tariff levels are below certain tariff ceilings set by the government. 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 or regulated by the Chinese government. In the past, our revenues have been adversely affected by reductions in tariffs and other changes in tariff regulations mandated by the Chinese government. We cannot assure you that our businesses or results of operations will not be adversely affected by any government-mandated adjustments on tariff level 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.

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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.

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.

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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 ADSs, if the Chinese government restricts access to foreign currencies for current account transactions.

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

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

We receive substantially all of our revenues, and our financial statements are presented, in Renminbi. The value of the Renminbi fluctuates and is subject to changes in China's political and economic conditions. The value of the Renminbi against U.S. dollar and other foreign currencies fluctuates and is affected by, among other things, changes in the PRC's and international political and economic conditions. Since 1994, the conversion of Renminbi into foreign currencies, including Hong Kong and U.S. dollars, has been based on rates set by the People's Bank of China, which are set daily based on the previous business day's inter-bank foreign exchange market rates and current exchange rates on the world financial markets. From 1994 to July 20, 2005, the official exchange rate for the conversion of Renminbi to U.S. dollars was generally stable. On July 21, 2005, the PRC government introduced a managed floating exchange rate system to allow the value of the Renminbi to fluctuate within a regulated band based on market supply and demand and by reference to a basket of currencies. On the same day, the value of the Renminbi appreciated by approximately 2% against the U.S. dollar. The PRC government has since made and in the future may make further adjustments to the exchange rate system. Fluctuations in exchange rates may adversely affect the value, translated or converted into 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 Disclosures 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.

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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.

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.

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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

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. 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. 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. Immediately prior to our initial public offering, China Telecom Group transferred to Guangdong Rising Assets Management Co., Ltd., Jiangsu Guoxin Investment Group Co., Ltd. and Zhejiang Financial Development Company 8.37%, 1.43% and 3.19%, respectively, of our outstanding shares. Under the relevant share transfer agreements, each of Guangdong Rising Assets Management Co., Ltd., Jiangsu Guoxin Investment Group Co., Ltd. and Zhejiang Financial Development Company has agreed 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.

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.

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.

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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Our Acquisitions in 2003 and in 2004

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 (the First Acquisition).

The purchase price of the First 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 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 2005, we paid China Telecom Group approximately RMB1,753 million interest on the deferred consideration for our acquisition in 2003. We also repaid RMB10 billion of the deferred consideration to China Telecom Group in October 2005.

In connection with this acquisition and for the purpose of paying consideration to People's Government of Fujian province for acquiring the rural telecommunication assets in Fujian province, China Telecom Group agreed to transfer its 969,317,182 shares in our Company to Fujian State-Owned Assets Investment Holdings Co., Ltd, a state-owned enterprise owned by the provincial government of the Fujian province to hold such transferred shares.

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.

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 (the Second Acquisition).

The purchase price of the Second 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. On June 30, 2004, we repaid RMB4.31 billion of this payable amount using the net proceeds from issue of new H shares in May 2004. From June 30, 2004, we will pay interest to China Telecom Group at semi-annual intervals on the actual amount of deferred consideration remaining outstanding at an annual rate of 5.184% for the first five years after June 30, 2004, 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. This rate will be adjusted on June 30, 2009 based on the then current Renminbi lending rate of the Chinese commercial banks for loans of similar amount and tenure with the same discount. In 2005, we paid China Telecom Group approximately RMB785 million interest on the deferred consideration for such acquisition.

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

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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 as of June 8, 2006:

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Commercial Paper Issuance in 2005 and 2006 and Proposed Issuance of Commercial Paper in 2006

Pursuant to the resolution passed at the extraordinary general meeting held on October 18, 2005, we issued short-term commercial paper in an aggregate principal amount of RMB10 billion with an annual interest rate of 2.54%. The short-term commercial paper was issued in the PRC inter-bank debenture market at a discount to its par value. All the proceeds from this issue of short-term commercial paper were used to satisfy our funding needs of operation.

On April 10, 2006, we issued short-term commercial paper in an aggregate principal amount of RMB20 billion with an annual interest rate of 3.05%. The short-term commercial paper was issued through a centralized book-building and allocation process in the PRC inter-bank debenture market at par value. All the proceeds from this issue of short-term commercial paper would be used to satisfy our funding needs of operation.

At the annual general meeting held on May 23, 2006, our shareholders approved the proposal for our Company to issue short-term commercial paper. Pursuant to the resolutions passed at the annual general meeting, we will be able to issue short-term commercial paper with a maximum outstanding amount of RMB30 billion before the end of October 2006, and short-term commercial paper, in one or more tranches, with a maximum outstanding amount of RMB40 billion, from the end of October 2006 to the date before next annual general shareholders meeting of our Company in 2007.

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 Shanghai municipality, Guangdong province, Jiangsu province, Zhejiang province, Anhui province, Fujian province, Jiangxi province, Guangxi Zhuang autonomous region, Chongqing municipality, Sichuan province, 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 in China. 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.

In 2005, our business grew steadily and our customer base gradually expanded. Our total operating revenue increased from RMB161,212 million in 2004 to RMB169,310 million, or by approximately 5.0%, in 2005. Revenue from our local telephone services, interconnection, Internet and value-added services and leased line and other services increased while revenue from long distance telephone services and managed data services decreased. With the introduction of new technology and the launch of various new services by the telecommunications service providers, the market competition among telecommunications service providers has intensified. In order to respond

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to such intensified competition, we will continue to focus on transforming from a traditional basic network operator into a modern integrated information services provider and explore new growth areas to assure the sustainable growth of our Company.

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.

	As of or for the year ended December 31, 2003 2004 2005		
Local Telephone:			
Access lines in service (in millions)	161.0	186.7	210.1
Total pulses (in billions) ⁽¹⁾	455.1	466.8	474.7
Domestic Long Distance:			
Total outgoing call minutes carried (in billions) ⁽²⁾	67.3	82.0	93.8
International, Hong Kong, Macau and Taiwan Long Distance:			
Total outgoing call minutes carried (in billions) ⁽³⁾	1.67	1.65	1.71
Interconnection			
Volume of inbound local call minutes (in billions)	76.2	94.7	102.7
Dial-up Internet Access:			
Number of subscribers (in millions)	22.2	15.8	11.0
Dial-up on-line usage (minutes in billions)	54.9	30.0	19.0
Broadband Access:			
Number of subscribers (in millions)	7.2	13.8	21.0
Managed Data (bandwidth leased in thousands):			
DDN (x64Kbps)	471.2	493.3	460.9
Frame relay (x128Kbps)	88.3	156.3	162.1
ATM (x2Mbps)	19.0	23.8	29.3
Leased Digital Circuits:			
Total bandwidth (x2Mbps) (bandwidth leased in thousands)	163.1	169.5	197.4
Value-added Services			
Caller ID service subscribers (in millions)	82.5	109.0	131.5
Usage of telephone information services (minutes in billions)	1.7	2.4	3.5
Color Ring Tone subscribers (in millions) ⁽⁴⁾			18.2
SMS usage volume (messages in billions) ⁽⁴⁾			17.3

(1) Pulses are the billing units for calculating local telephone usage fees.

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

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

(4) The Color Ring Tone and Short Message Service over Personal Handyphone System, or SMS over PHS services were launched in 2004, and we started to collect operating data for these two new services from 2005.

The number of our local access lines in service increased by approximately 12.6% from 186.7 million in 2004 to 210.1 million in 2005. The total usage of our local telephone services increased by approximately 1.7% from 466.8 billion pulses in 2004 to 474.7 billion pulses in 2005.

Subscribers for our broadband access services grew from 13.8 million as of December 31, 2004 to 21.0 million as of December 31, 2005. We expect broadband business to become a key driver of our future growth. We experienced significant growth in value-added services in 2005. The subscriber number of our caller ID services increased by approximately 20.6% in 2005. The usage of telephone information services increased by approximately 46.3% from 2,419 million minutes in 2004 to 3,540 million minutes in 2005. The subscriber number of our Color Ring Tone services was 18.2 million in 2005. The usage volume of our short message services was 17.3 billion messages in 2005. We expect to further capitalize on the market potential of value-added services in the future.

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The following table sets forth a breakdown of our operating revenue for 2003, 2004 and 2005:

	For the Year Ended December 31		
	2003	2004	2005
	(RMB in millions)		
Wireline telephone services ⁽¹⁾			
Local			
Installation fees	2,643	2,865	2,970
Monthly fees	27,499	29,827	30,351
Local usage fees	45,815	47,646	47,624
Sub-total	75,957	80,338	80,945
Domestic long distance ⁽²⁾	25,460	26,231	25,993
International, Hong Kong, Macau and Taiwan long distance ⁽²⁾	3,943	3,788	3,407
Interconnections	8,365	10,719	12,838
Upfront connection fees	9,771	8,458	6,781
Sub-total	123,496	129,534	129,964
Internet access and Value-added service	14,737	20,229	27,838
Managed data	3,210	3,015	2,958
Leased line services and Others ⁽³⁾	10,110	8,434	8,550
Total operating revenue	151,553	161,212	169,310

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

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

(3) Other revenue includes primarily revenue from sale, repairs and maintenance of customer-end equipment and provision of consulting services.

Wireline Telephone Services

Our telephone services consist of local telephone, domestic long distance, international, Hong Kong, Macau and Taiwan long distance and interconnection.

Wireline telephone services are our main services, generating 76.8% of our total operating revenue in 2005, compared to 80.3% in 2004. Revenue generated by these services increased by approximately 0.3% from RMB129,534 million in 2004 to RMB129,964 million in 2005. We believe that our wireline telephone services will continue to provide a steady revenue source to our overall business.

Local Telephone Services

Our local telephone services provide the largest revenue source for our wireline telephone services. In 2005, revenue from local telephone services increased by approximately 0.8% from RMB80,338 million in 2004 to RMB80,945 million in 2005. In 2005, as the difference between tariffs for mobile services and for wireline telephone services continued to decrease, mobile substitution for wireline telephone subscribers and local voice usage intensified. To maintain the steady development of our local telephone services, we have adopted initiatives to segment our subscribers, offered service discounts plans, optimized our distribution channels and strengthened our agent channels and on-line channels. In addition, we focused our efforts to optimize the coverage of our wireless local access network to improve our service quality.

Our local telephone subscribers reached 210.1 million at the end of 2005, which represents an increase of 23.5 million, or approximately 12.6% from 2004. Wireless local access service and public telephone service subscribers grew relatively faster. As of the end of 2005, wireless local access service subscribers and public telephone service subscribers reached 57.1 million and 14.1 million, respectively, which represent increases of 14.9 million and 1.7 million, or approximately 35.3% and 13.7%, respectively, from 2004.

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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,		
	2003	2004	2005
	(in millions)		
Residential	108.1	113.1	118.0
Enterprise	17.7	19.0	20.9
Public telephones	9.6	12.4	14.1
Wireless local access	25.6	42.2	57.1
Total	161.0	186.7	210.1

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