

The directors are pleased to present their annual report together with the audited financial statements for the year ended 31 December 2004.

Principal activities

The Group is a dominant provider of fixed-line telephone services, broadband, other Internet-related services, and business and data communications services in six northern municipalities and provinces, namely Beijing Municipality, Tianjin Municipality, Hebei Province, Henan Province, Shandong Province and Liaoning Province in the PRC. The Group also provides telecommunications services to selected business and residential customers in two southern municipality and province, namely Shanghai Municipality and Guangdong Province in the PRC. The Group operates an extensive network and offers international data services in the Asia Pacific region. The principal activity of the Company is investment holding.

The turnover of the Group during the financial year consisted primarily of income generated from the provision of fixed-line telecommunications and related services.

Major customers and suppliers

The Group's aggregate sales attributable to its five largest customers did not exceed 30 per cent. of the Group's total sales in 2004.

The Group's aggregate purchases from its five largest suppliers did not exceed 30 per cent. of the Group's total purchases in 2004.

Subsidiaries

Particulars of the Company's subsidiaries as at 31 December 2004 are set out in note 22 to the financial statements.

Financial statements

The results of the Group for the year ended 31 December 2004 and the Company's and the Group's financial positions as at that date are set out in the financial statements in pages 88 to 156.



Dividends

The Company has always held in the highest regard the interests of and returns achieved for its shareholders. Having taken into account such factors as our results of operations, cash flows, financial condition, future prospects, and statutory and regulatory restrictions on the payment of dividend by the Company, the Board recommends payment of a final dividend of HK\$0.037 per share and a total dividend of HK\$245 million for the financial year ended 31 December 2004. The Company underwent corporate reorganisation as part of its preparation for listing. As of 30 June 2004, the Company has no distributable reserves. Since the corporate reorganisation was completed on 30 June 2004, the net profits excluding upfront connection fee for the second half of 2004 after completion of corporate reorganisation amounted to HK\$2.61 billion. The Company was only listed on The Stock Exchange of Hong Kong Limited ("Hong Kong Stock Exchange") on 17 November 2004. The dividend payout ratio for 2004, based on the HK\$2.61 billion net profits and calculated on a pro rata basis for the period from the date of listing to 31 December 2004, is 37.5%. If the relevant resolution relating to declaration of dividend is passed, the dividends will be distributed on 10 June 2005 to shareholders whose names are registered on the Company's shareholders' register on 20 May 2005.

Charitable donations

Donations made by the Group during the year amounted to RMB24 million (2003: RMB36 million).

Fixed assets

Changes of the fixed assets of the Group and the Company during the year are set out in note 18 to the financial statements.

Bank and other loans

Particulars of bank and other loans of the Group as at 31 December 2004 are set out in note 27 to the financial statements.

Share capital and share option scheme

Details of the Company's share capital and share option scheme are set out in note 32 and note 33, respectively, to the financial statements. Information on the share option scheme can also be found in the paragraphs "Share option scheme" and "Supplementary information for American Depositary Shares Holders" below.

Conversion of convertible shares

Particulars of the exercise during the year of any conversion or subscription rights of convertible securities issued by the Group are set out in note 32 to the financial statements.

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

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

Reserves

Changes to the reserves of the Group during the year are set out in the consolidated statement of changes in equity and the changes to the reserves of the Company during the year are set out in note 34 to the financial statements.

Financial summary

A summary of the audited results and of the audited assets and liabilities of the Group for the last four financial years is set out on pages 177 to 180.

Connected Transactions

On 8 October 2004, China Netcom (Group) Company Limited ("**CNC China**"), a wholly-owned subsidiary of the Company, entered into certain transactions with China Network Communications Group Corporation ("**China Netcom Group**"). As at the date of this report, China Netcom Group beneficially holds 70.49% of the issued share capital of the Company and is the ultimate controlling shareholder of the Company. China Netcom Group is therefore a connected person of the Company.

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



These transactions between CNC China and China Netcom Group and between Asia Netcom and EANL (the “**Continuing Connected Transactions**”) constitute continuing connected transactions of the Company under the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Ltd (the “**Listing Rules**”). Details of the Continuing Connected Transactions are set out below and in note 39 to the financial statements. For the financial year ended 31 December 2004, the Continuing Connected Transactions have not exceeded their respective upper limits set by the Hong Kong Stock Exchange.

Continuing connected transactions relating to CNC China

Interconnection Settlement Agreement

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

For domestic long distance voice services between China Netcom Group and CNC China (except services between subsidiaries of China Netcom Group in four provinces and autonomous region and the branch companies of CNC China in six provinces and municipalities), the telephone operator in the location of the calling party makes a settlement payment to the telephone operator in the location of the called party at the rate of RMB0.06 per minute or RMB0.09 per minute (depending on whether the call terminates within or outside the network of either party).

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

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

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

Property Leasing Agreement

Pursuant to the Property Leasing Agreement:

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

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

Property Sub-leasing Agreement

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

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



Master Services Sharing Agreement

Pursuant to the Master Services Sharing Agreement:

- (i) CNC China agreed to provide customer relationship management services, network management services and supporting services such as billing and settlement to China Netcom Group, and to share with China Netcom Group the services provided by the administrative and managerial staff at the headquarters of CNC China in respect of the central management of both CNC China and China Netcom Group; and
- (ii) China Netcom Group agreed to provide to CNC China supporting services, including telephone card production, development and related services and IC card inter-provincial and inter-network clearing services, and certain other shared services, and to provide certain office space in Beijing to CNC China for use as its principal executive office.

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

Engineering and Information Technology Services Agreement

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

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

Materials Procurement Agreement

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

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

- (a) the government-fixed price;
- (b) where item (a) does not apply, the government guidance price;
- (c) where items (a) and (b) do not apply, the market price; or
- (d) where none of the above is applicable, the price to be agreed between the relevant parties and determined on a cost-plus basis.

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

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

Ancillary Telecommunications Services Agreement

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

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



Support Services Agreement

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

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

Telecommunications Facilities Leasing Agreement

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

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

Continuing connected transactions relating to Asia Netcom

Capacity Purchase Agreement

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

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

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

Capacity Lease Agreement

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

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



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

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

Management Services Agreement

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

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

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

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

in the ordinary and usual course of its business;

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

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

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

- (A) have received the approval of the Company's board of directors;
- (B) were in accordance with the pricing policy as stated in note 39 to the financial statements;
- (C) have been entered into in accordance with the relevant agreements governing the Continuing Connected Transactions; and
- (D) have not exceeded their respective upper limits set by the Hong Kong Stock Exchange for the financial year ended 31 December 2004.



Directors

The current directors are:

Executive Directors

Zhang Chunjiang	(appointed on 15 June 2004)
Tian Suning	
Zhang Xiaotie	(appointed on 4 October 2004)
Miao Jianhua	(appointed on 4 October 2004)

Non-executive Directors

Jiang Weiping	(appointed on 4 October 2004)
Li Liming	(appointed on 4 October 2004)
Keith Rupert Murdoch	(resigned on 30 June 2004 and re-appointed on 4 October 2004)
Yan Yixun	

Independent Non-executive Directors

John Lawson Thornton	(appointed on 4 October 2004)
Victor Cha Mou Zing	(appointed on 4 October 2004)
Qian Yingyi	(appointed on 4 October 2004)
Hou Ziqiang	(appointed on 4 October 2004)
Timpson Chung Shui Ming	(appointed on 22 October 2004)

Note: During the year ended 31 December 2004, Leng Rongquan (appointed on 4 October 2004 and resigned on 5 November 2004), Mark Schwartz (resigned on 15 June 2004), Zhang Haitao (resigned on 1 September 2004), Jiang Mianheng (resigned on 1 September 2004), Cai Qinghua (resigned on 1 September 2004), Yang Xiong (resigned on 1 September 2004), Li Tao (appointed on 22 June 2004 and resigned on 4 October 2004) were also directors of the Company.

In accordance with Article 99 of the Company's Articles of Association, Mr. Zhang Chunjiang, Dr. Tian Suning, Mr. Yan Yixun and Ms. Li Liming will retire by rotation at the forthcoming annual general meeting of the Company and, being eligible, offer themselves for re-election. In accordance with Article 103 of the Company's Articles of Association, Mr. Timpson Chung Shui Ming will also retire at the forthcoming annual general meeting and, being eligible, offer himself for re-election.

The biographical details of the directors proposed for re-election at the forthcoming annual general meeting (“**Directors for Re-election**”) are set out on pages 17 to 20. Except as disclosed in such biographical details, the Directors for Re-election have not held any other directorships in any listed public companies in the last three years. Further, except as noted in the biographical details, none of the Directors for Re-election is connected with any directors, senior management or substantial or controlling shareholders of the Company and, except for the share options granted to the Directors for Re-election (other than Mr. Timpson Chung Shui Ming) as set out in the paragraph “Share option scheme” below, none of them has any interests in the shares of the Company within the meaning of Part XV of the Securities and Futures Ordinance (“**SFO**”).

The service contracts of Mr. Zhang Chunjiang and Dr. Tian Suning do not provide for a specified length of services. Mr. Yan Yixun and Mr. Timpson Chung Shui Ming have not entered into any service contract with the Company. Each of the Directors for Re-election will be subject to retirement by rotation and re-election at annual general meetings of the Company every three years. Each of such directors is entitled to an annual director’s fee of HK\$250,000 as proposed by the board of directors and approved by the shareholders of the Company. Director’s fees are payable on a time pro-rata basis for any non full year’s service. In addition, Mr. Zhang Chunjiang and Dr. Tian Suning will receive annual base salary of HK\$500,000 and HK\$3,000,000, respectively, plus a performance-based bonus and any discretionary award of share options as may be determined by the board of directors. In addition, Mr. Zhang Chunjiang is entitled to an additional annual fee of HK\$50,000 as a member of the Strategic Planning Committee; Dr. Tian Suning is entitled to an additional annual fee of HK\$50,000 as a member of the Corporate Governance Committee; Mr. Timpson Chung Shui Ming is entitled to an additional annual fee of HK\$50,000 as a member of the Audit Committee and Ms. Li Liming is entitled to an additional annual fee of HK\$50,000 as a member of the Strategic Planning Committee.

None of the Directors for Re-election has an unexpired service contract which is not determinable by the Company or any of its subsidiaries within one year without payment of compensation, other than under normal statutory obligations.

Save as disclosed herein, there are no other matters relating to the re-election of the Directors for Re-election that need to be brought to the attention of the shareholders of the Company.

Independent non-executive directors’ confirmation of independence

The Company has received independence confirmation from each of the independent non-executive directors, namely Mr. John Lawson Thornton, Mr. Victor Cha Mou Zing, Dr. Qian Yingyi, Mr. Hou Ziqiang and Mr. Timpson Chung Shui Ming, and considers them to be independent.



Directors' interests in contracts

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

Directors' interest in competing businesses

China Netcom Group is engaged in fixed-line telecommunications business and other related businesses in the PRC and Asia-Pacific which are similar to that of the Company. The executive directors of the Company also hold executive positions with China Netcom Group. On 6 September 2004, China Netcom Group, the Company and CNC China entered into a non-competition agreement, under which China Netcom Group undertakes not to compete with the Company without the Company's prior written consent.

Apart from the above, none of the directors of the Company is or was interested in any business, apart from the Company's business, that competes or competed or is or was likely to compete, either directly or indirectly, with the Company's business at any time from the date of the prospectus issued in connection with the listing of the Company's shares on the Stock Exchange up to and including the date of this report.

Directors' and chief executive's interest and short positions in shares, underlying shares and debentures

Certain directors of the Company personally hold options to subscribe for ordinary shares of the Company. Details of such options are disclosed under the paragraph "Share option scheme" below. These share options were granted pursuant to the terms of the share option scheme adopted by the Company.

Apart from those disclosed herein, as at 31 December 2004, none of the directors nor the chief executive of the Company had any interests or short positions in any of the shares, underlying shares or debentures of the Company or any of its associated corporations (within the meaning of the SFO) that is required to be recorded and kept in the register in accordance with section 352 of the SFO, any interests required to be notified to the Company and the Stock Exchange pursuant to the Model Code for Securities Transactions by Directors of Listed Issuers ("**Model Code**").

Number of employees and emolument policy

As of 31 December 2004, the Company has 92,788 employees. The following table shows the number of employees in various departments as percentages of the Company's total employees:

	<i>Number of employees</i>	<i>As a percentage of total employees</i>
Management, finance and administration	14,664	15.8
Sales and Marketing	46,057	49.7
Operational and Maintenance	28,158	30.3
Others ⁽¹⁾	3,899	4.2
Total	92,788	100.0

(1) Including research and development personnel.

In addition, as of 31 December 2004, the Company employs approximately 40,668 temporary employees.

The emolument policy of the Company is based on the key principles of maintaining competitiveness in the market for talent, retaining talent and rewarding high performance. In line with these key principles, employees are remunerated with a combination of a basic salary, a performance-based bonus and a long-term incentive scheme in the form of a share option scheme for eligible employees, details of which can be found in the paragraph "Share option scheme" below.

The Company has established a Compensation Committee, which is responsible for making recommendations to the Board on the Company's emolument policy and structure in relation to all directors, the chief executive officer and other executive officers. The Compensation Committee determines the remuneration packages of executive directors and senior management, and make recommendations to the Board on the remuneration of non-executive directors. In making such determination, the Compensation Committee considers factors such as salaries payable by comparable companies, the time commitment and responsibilities involved in the relevant position, employment conditions elsewhere in the group of companies to which the Company belongs and the desirability of performance-based remuneration with reference to corporate goals and objectives resolved by the Board from time to time. No director is involved in deciding his or her own remuneration.



Employee retirement benefits

Particulars of the employee retirement benefits of the Group are set out in note 3 (r) (i) and note 11 to the financial statements.

Share option scheme

The following is a summary of the principal terms of the share option scheme approved and adopted by a resolution of the shareholders of the Company passed on 30 September 2004 (the “**Share Option Scheme**”).

(a) Purpose of the Share Option Scheme

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

(b) Participants of the Share Option Scheme

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

- (i) the directors (including executive and non-executive directors);
- (ii) members of the middle-to-senior management; and
- (iii) such class of “specialised professionals” as may be designated by the Compensation Committee.

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

(c) Maximum number of shares

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

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

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

- (d) As at the date of this report, the total number of securities available for issue under the Share Option Scheme is 158,640,000, representing 2.41 per cent. of the issued share capital of the Company as at the date of this report.

- (e) Maximum entitlement of each participant

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

- (f) Minimum period for which an option must be held before it can be exercised

There is a minimum period of 18 months from the later of the date of grant or the date of the listing of the shares on the Stock Exchange (the “**Effective Date**”) before an option can be exercised.

- (g) Period within which the shares must be taken up under an option

Any option shall lapse if not exercised within 6 years from the Effective Date.

- (h) The basis of determining the exercise price for shares

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

- (i) Consideration

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



(j) The remaining life of the Share Option Scheme

The Share Option Scheme will remain in force for a period of 10 years commencing on the date on which the Share Option Scheme is adopted.

As at 31 December 2004, the directors, chief executive and employees of the Company had the following personal interests in options to subscribe for shares of the Company granted under the Share Option Scheme.

	No. of shares involved in the options granted during the year ^(a)	No. of shares involved in the options lapsed during the year	No. of shares involved in the options outstanding at year end
<i>Directors</i>			
Zhang Chunjiang	920,000	—	920,000
Leng Rongquan ^(b)	920,000	920,000	—
Tian Suning (also the chief executive officer)	920,000	—	920,000
Zhang Xiaotie	800,000	—	800,000
Miao Jianhua	700,000	—	700,000
Jiang Weiping	700,000	—	700,000
Li Liming	700,000	—	700,000
Yan Yixun	590,000	—	590,000
Keith Rupert Murdoch	590,000	—	590,000
<i>Employees</i>	151,800,000	—	151,800,000
Total			157,720,000^(c)

Notes:

- (a) All the options granted during the year were granted on 22 October 2004. The shares of the Company were listed on the Stock Exchange on 17 November 2004 and therefore immediately before the date of grant of the options, the shares of the Company were not yet traded.
- (b) Mr. Leng Rongquan resigned as vice-chairman and non-executive director of the Company on 5 November 2004. In accordance with the terms of the Share Option Scheme, the options of Mr. Leng Rongquan lapsed on the same date.
- (c) The total number of shares involved in the options outstanding at the end of the year represents 2.39 per cent. of the issued share capital of the Company as at the date of this report.

Grantees of the share options granted on 22 October 2004 are entitled to exercise the options at a price of HK\$8.40 per share in the following periods:

- (i) in respect of 40 per cent. of the options granted, from 17 May 2006 to 16 November 2010;
- (ii) in respect of a further 30 per cent. of the options granted, from 17 May 2007 to 16 November 2010; and
- (iii) in respect of the remaining 30 per cent. of the options granted, from 17 May 2008 to 16 November 2010.

No share option has been exercised or cancelled during the year ended 31 December 2004.

The options granted are not recognised in the financial statements until they are exercised.

Regarding disclosure of the valuation of options, please refer to the paragraph “Supplementary information for American Depositary Shares Holders” in pages 157 to 169 of this annual report.

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



Substantial shareholders' and other persons' interests and short positions in shares and underlying shares

The Company has been notified of the following interests in the Company's issued shares at 31 December 2004 amounting to 5 per cent. or more of the ordinary shares in issue:

Name of substantial shareholder	Number of ordinary shares interested		Percentage of total issued share capital (%)
	directly	indirectly	
China Network Communications Group Corporation	—	5,390,648,000 ⁽¹⁾⁽²⁾⁽³⁾	81.76
China Netcom Group Corporation (BVI) Limited	4,647,449,014 ⁽¹⁾	743,198,986 ⁽¹⁾⁽²⁾⁽³⁾	81.76
CNC Cayman, Limited	1 ⁽¹⁾	445,500,000 ⁽⁴⁾	6.75
CNC Fund, L.P.	445,500,000 ⁽⁴⁾	—	6.75
Best Bluechip Investments Limited	—	445,500,000 ⁽⁴⁾	6.75
Shanghai Alliance Investment Limited	—	482,610,587 ⁽²⁾⁽⁵⁾	7.32
Sino-Alliance International Ltd	—	445,500,000 ⁽⁵⁾	6.75
GS Advisors III, LLC	—	445,500,000 ⁽⁶⁾	6.75
GS Capital Partners III, LP	—	445,500,000 ⁽⁶⁾	6.75
GS China BroadNet GP Holdings, LLC	—	445,500,000 ⁽⁶⁾	6.75
GS China BroadNet GP, LLC	—	445,500,000 ⁽⁶⁾	6.75
GS China BroadNet Investment Holdings, LLC	—	445,500,000 ⁽⁶⁾	6.75
The Goldman Sachs Group, Inc.	—	449,945,400 ⁽⁶⁾	6.82

Notes:

- (1) China Network Communications Group Corporation ("**China Netcom Group**") beneficially owns 4,647,449,014 shares held by its wholly-owned subsidiary, China Netcom Group Corporation (BVI) Limited ("**CNC BVI**") and 1 share held by CNC Cayman, Limited ("**CNC Cayman**"), a wholly-owned subsidiary of CNC BVI. The percentage of total issued share capital beneficially held by China Netcom Group is 70.49%.
- (2) China Netcom Group is deemed under the SFO to be interested in 297,698,985 shares held by CNC BVI as trustee on behalf of certain shareholders, including 37,110,587 shares held on behalf of Shanghai Alliance Investment Limited ("**Shanghai Alliance**").

- (3) China Netcom Group is also deemed under the SFO to be interested in 445,500,000 shares held by CNC Fund, L.P. (“**CNC Fund**”) through CNC Cayman as one of the general partners of the limited partnership (see further note (4) below).
- (4) 445,500,000 shares of the Company are held by CNC Fund, a limited liability partnership. For the purpose of Part XV of the SFO, CNC Cayman, Best Bluechip Investments Limited and GS China BroadNet GP, LLC, as the general partners of CNC Fund, are each deemed to be interested in the same 445,500,000 shares.
- (5) Best Bluechip Investments Limited is a wholly-owned subsidiary of Sino-Alliance International Ltd, which is in turn a wholly-owned subsidiary of Shanghai Alliance. Accordingly, each of Sino-Alliance International Ltd and Shanghai Alliance are deemed to be interested in the same 445,500,000 shares under the SFO.
- (6) GS China BroadNet GP, LLC is a wholly-owned subsidiary of GS China BroadNet GP Holdings, LLC, which is in turn a wholly-owned subsidiary of GS China BroadNet Investment Holdings, LLC, which is in turn 63.08% owned by GS Capital Partners III, LP, which is in turn deemed for the purpose of Part XV of the SFO to be controlled by GS Advisors III, LLC, which is in turn a wholly-owned subsidiary of The Goldman Sachs Group, Inc. Accordingly, GS China BroadNet GP Holdings, LLC, GS China BroadNet Investment Holdings, LLC, GS Capital Partners III, LP, GS Advisors III, LLC and The Goldman Sachs Group, Inc. are each deemed to be interested in the same 445,500,000 shares under the SFO. In addition, The Goldman Sachs Group, Inc. is also interested in 4,445,400 shares through its subsidiaries.

Apart from the foregoing, as at 31 December 2004, no person or corporation had any interest in 5 per cent. or more of or any short position in the issued share capital of the Company as recorded in the registers required to be kept under section 336 of the SFO.

Public Float

As at the date of this report, the Company has maintained the prescribed public float of less than 23 per cent. of the issued share capital of the Company pursuant to the Listing Rules and as agreed with the Stock Exchange, based on the information that is publicly available to the Company and within the knowledge of the directors of the Company.

Compliance with the Code of Best Practice

Throughout the period commencing from the date of the listing of the Company's shares on the Stock Exchange on 17 November 2004 through to 31 December 2004, the Company has complied with the Code of Best Practice as set out in Appendix 14 to the Listing Rules which was in force prior to 1 January 2005, except that the non-executive directors were not appointed for a specific term but are subject to retirement by rotation and re-election at the Company's annual general meeting in accordance with the Company's Articles of Association.



Compliance with the Model Code

The Company has adopted the Model Code. All directors who have acted as such at any time during the period commencing from the date of the listing of the Company's shares on the Stock Exchange on 17 November 2004 through to 31 December 2004 have confirmed, following enquiry by the Company, that they have complied with the required standard set out in the Model Code throughout such period.

Auditors

A resolution for the reappointment of PricewaterhouseCoopers as auditors of the Company shall be proposed at the forthcoming annual general meeting.

By order of the board

Zhang Chunjiang

Executive Chairman

Hong Kong