

Chairman's Statement



Dear Shareholders,

2006 was an important year for the development of China's telecommunications industry. In 2006, although broadband businesses in China grew rapidly, more and more fixed-line telephone subscribers and voice traffic migrated to mobile service. The extent of mobile substitution that is currently happening in China is one of the largest among the major telecommunications markets in the world as there is no genuine full-service provider in China.

Facing such challenges and opportunities, in 2006, we continued to pursue our strategic goal of becoming a "broadband communications and multi-media services provider" relentlessly. Our high-growth businesses maintained its rapid growth and made an impressive contribution to revenue. At the same time, the Company's traditional fixed-line telephone business was facing severe challenges. We saw negative growth in local telephone subscribers for the first time in corporate history. In 2006, the consolidated net profit of the Company was RMB12,960 million (Excluding RMB2,406 million of upfront connection fees, the Company's consolidated net profit was RMB10,554 million). Basic earnings per share was RMB1.95.

Strategic Transformation

The telecommunications industry is undergoing a major reform. The rapid development of Internet technology and its wide applications has created a new industrial revolution, with concomitant effects on culture and society. While the reforms in the telecommunications industry pose challenges, they also bring about enormous opportunities for industry participants. In this context, in order to grow, we must innovate. Thus, the Company has set a long-term strategic goal of transforming itself from a traditional voice-centric telecommunications services provider to a broadband and multi-media services provider.

In 2006, we made major progress towards our strategic goal of becoming a broadband communications and multi-media services provider.

By the end of 2006, the total number of the Company's broadband subscribers reached 15.081 million, representing a year-on-year increase of 31.4%. In March 2006 the Company established China Netcom Group Broadband Online Limited Corporation a wholly-owned subsidiary, then launched "CNC MAX", the first all-video website in China. In July 2006, we were approved to provide IPTV services in five cities in addition to Harbin, Heilongjiang Province. In cooperation with local government, we launched IPTV-based integrated information services in rural areas of Henan Province, and this cooperative model was recognised by relevant governmental departments. In 2006, the Company's broadband strategy, which includes broadband access and content as well as IPTV services, was strengthened and enhanced to embrace multi-dimensional delivery. We have begun to see substantial growth in our broadband business, and are now moving into new parts of the broadband and Internet value chain.

In 2006, the Company leveraged on the opportunities brought about by the government initiatives of "informationisation". We inaugurated such services through our brand, "CNC Connected", to meet the demand by corporate and government customers for integrated information services which comprise telecommunications, IT and IT related applications services. With our extensive network, customer and brand resources, we are moving away from a monolithic network and voice communications services provider to become a provider of integrated information services.



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The Olympic Games and Strategic Cooperation

As the sole official partner of the 2008 Beijing Olympics for fixed-line telecommunications services, our strategies are

- To leverage on the historic opportunity of the Olympic Games to bring our service performance to a higher level, by establishing a bottleneck-free service system and meeting market demand for stable, safe and user-friendly services;
- To enhance penetration of our broadband services, accelerate broadband content and applications development, so as to honour our commitment to deliver a "Broadband Olympics";
- To enhance our management standard through the process of delivering high quality and multi-level communications solutions to the Olympic Games;
- To enhance our corporate identity and branding through Olympics-related marketing efforts.

We intensified our Olympic strategy in 2006. We believe through implementing our Olympic strategy, the Olympics Games will serve as a milestone in our corporate development, and play a pivotal role in our overall transformation into a multi-media telecommunications service provider.

We have long maintained an open mind towards strategic cooperations with the world's leading telecommunications operators. We believe that such cooperations will help to bring about innovations in technology, products and management knowhow, constituting elements conducive to enhancing our management standard and core competences. In 2006 we deepened our cooperative relationship with Telefónica in the areas of strategy, innovation, budgeting and operations. This exercise was instrumental in helping the Company strengthen its management, especially its capital expenditure (CAPEX) management.

Corporate Governance

The Company is putting in place international best-practices of corporate governance. We believe that these will strengthen our core competences.

In 2006, the Company carried out reformation of its board of directors from the perspective of the "hardware" and "software" of corporate governance. Firstly, changes were made with regard to the structure and responsibilities of the board of directors and board committees. We modified key board and committee procedures. In

particular, we put in place a system to evaluate performance of directors, board committees, and the board of directors. These changes in board structure, procedures and the introduction of a performance evaluation system are meant to improve the board's efficiency, encourage active participation on the part of directors, and ensure that board decisions will be to the benefit of all shareholders as well as to the Company's long-term development.

In 2006, the nominating and corporate governance committee conducted the first round of performance evaluations of the board of directors and board committees. The compensation committee conducted the first performance evaluation of board members based on their professional capabilities, ability to fulfill duties, and ability to maintain objective in decision making. Based on the results, the board will provide training and research sessions to directors; and to reform operational procedures of the board of directors in order to improve efficiency and professional standards of the board and board committees.

Value to Shareholders

After taking into account the Company's financial position in 2006, estimated cash flow in 2007 and business development strategies for the future, the Board of Directors has recommended payment of a final dividend of HK\$0.553 per share for the financial year ended December 31, 2006, up 18.7% from HK\$0.466 in 2005.

On August 22, 2006, we disposed our entire shareholding in Asia Netcom. On February 28, 2007, we disposed our Guangdong and Shanghai telecommunications assets and operations to our parent company China Network Communications Group Corporation ("China Netcom Group"). These two transactions have enabled us to concentrate on our northern service region, where we have extensive network resources and dominant market share. We believe that these transactions enabled the Company to reinforce our market dominant position in the traditional fixed-line telephone market, better grasp the growth opportunities in the northern service region, with a view to creating greater value for the shareholders.

Change of Directors and Management

On December 19, 2006, Mr. Mauricio Sartorius was appointed as a non-executive director of the Company and Ms. Hong Chen Jin was appointed as an alternate director to Mr. José María Álvarez-Pallete and Mr. Mauricio Sartorius. On December 20, 2006, Mr. Miao Jianhua resigned from his position as joint company secretary of the Company, but remained as an executive director of the Company. On the same date, Mr. Li Fushen, the Chief Financial Officer of the



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Company, was appointed as joint company secretary of the Company. On January 15, 2007, Ms. Li Liming resigned as non-executive director of the Company, and Mr. Li Fushen was appointed as an executive director of the Company.

On behalf of the Company, I wish to express our sincere gratitude for the contributions made by Mr. Miao Jianhua as joint company secretary and Ms. Li Liming as non-executive director. At the same time, I would also like to extend our warmest welcome to Mr. Mauricio Sartorius, Ms. Hong Chen Jin and Mr. Li Fushen for joining the board.

Prospects

Looking ahead, as information technology develops rapidly and the telecommunications industry rapidly shifts focus towards broadband, mobility, IP and convergence, our business philosophy is innovation and development. Through innovation in technologies, services and management, we will strive to establish our engines of sustainable development to get ourselves well-prepared to seize future growth opportunities and to support pursuit of our strategic goal of becoming a broadband communications and multi-media services provider.

In 2007, we will utilize bundled and convergence services to lessen the effects brought about by the decline in traditional fixed-line telephone businesses. We will take full advantage of the forthcoming Olympic Games to increase penetration of broadband and make new breakthroughs in high-growth businesses such as broadband access, broadband content and applications as well as ICT (Information and communications technology) services. We will promote innovation in such areas as tariff, services, branding, and organization to accommodate changes in the market. We will prepare ourselves for mobile services and accelerate network convergence, with a view to providing our customers with multi-dimensional services.

Lastly, I would like to extend my sincere appreciation to our shareholders for their trust and support. I am also grateful for the management and staff's contributions to the Company in 2006. We believe that, with the commitment of our management and staff, we will be able to provide our customers with high quality service, our employees with greater satisfaction, and our shareholders with increased value and returns.

ZHANG Chunjiang

Chairman

Hong Kong, April 2, 2007