CHINA UNICOM LTD
Form 20-F
June 28, 2005

# SECURITIES AND EXCHANGE COMMISSION

**Washington, D.C. 20549**

# FORM 20-F

| | |
|---|---|
| **o** | **REGISTRATION STATEMENT PURSUANT TO SECTION 12(b) OR 12(g) OF THE SECURITIES EXCHANGE ACT OF 1934** |
| **OR** | |
| **ý** | **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**<br>**For the fiscal year ended December 31, 2004** |
| **OR** | |
| **o** | **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**<br>**For the transition period from to** |

**Commission file** number 1-15028

# CHINA UNICOM LIMITED

(Exact Name of Registrant as Specified in Its Charter)

| | |
|---|---|
| **N/A** | **Hong Kong** |
| (Translation of Registrant s Name Into English) | (Jurisdiction of Incorporation or Organization) |

**75th Floor, The Center**
**99 Queen s Road Central**
**Hong Kong**
(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 On Which Registered** |
|---|---|
| Ordinary shares, par value HK$0.10 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, or ADSs, each representing 10 ordinary 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.

12,607,241,000 Ordinary Shares as of December 31, 2004.

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 ý No o

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

Item 17 o Item 18 ý

**TABLE OF CONTENTS**

Note Regarding Forward-looking Statements

Certain Definitions

PART I

PART III

**NOTE REGARDING FORWARD-LOOKING STATEMENTS**

This annual report for the year ended December 31, 2004 contains forward-looking statements that are, by their nature, subject to significant risks and uncertainties. Such forward-looking statements include, without limitation, our strategy and future plan, our capital expenditure plan, our future business condition and financial results, our abilities to expand network capacity and increase network efficiency, our ability to develop new technology applications and offer new services, our ability to realize the advantages of code division multiple access, or CDMA, technology and successfully execute our CDMA-related strategy, our ability to leverage our position as an integrated telecommunications operator and expand into new businesses and new markets, future growth of market demand for our services, the future prospects of and our ability to integrate the acquired business, and future regulatory and other developments in the Chinese telecommunications industry.

Such forward-looking statements reflect our current views with respect to future events. Actual results may differ materially from information contained in the forward-looking statements as a result of a number of factors, including, without limitation, any changes in the regulatory policies of the Ministry of Information Industry, or MII, the State-owned Assets Supervision and Administration Commission, or SASAC, and other relevant government authorities in China, the effects of competition on the demand and price of our telecommunications services, any changes in telecommunications and related technology and applications based on such technology, and changes in political, economic, legal and social conditions in China including the Chinese government s policies with respect to economic growth, consolidations of and other structural changes in the telecommunications industry, foreign exchange, foreign investment and entry by foreign companies into China s telecommunications market. In addition, our future network expansion and other capital expenditure and development plans are dependent on numerous factors, including the availability of adequate financing on acceptable terms, the adequacy of currently available spectrum or availability of additional spectrum and the adequate and timely supply of equipment when required. Please also see the D. Risk Factors section under Item 3.

**CERTAIN DEFINITIONS**

As used in this annual report, references to us , we , our, the Company and Unicom are to China Unicom Limited. Unless the context otherwi requires, these references include all of our subsidiaries. In respect of any time prior to our incorporation, references to us , we , our and Unicom are to the telecommunications businesses in which our predecessors were engaged and which were subsequently assumed by us. All references to Unicom Group are to China United Telecommunications Corporation, our indirect controlling shareholder. Unless the context otherwise requires, these references include all of Unicom Group s subsidiaries, including us and our subsidiaries. Please also see A. History and Development of the Company under Item 4 for our current shareholding structure.

**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 consolidated income statement data for the years ended December 31, 2000, 2001, 2002, 2003 and 2004 and our selected consolidated balance sheet data as of December 31, 2000, 2001, 2002, 2003 and 2004. The selected consolidated balance sheet data as of December 31, 2003 and 2004 and income statement and cash flow data for the years ended December 31, 2002, 2003 and 2004 have been derived from our audited consolidated financial statements included in this annual report. The selected consolidated balance sheet data as of December 31, 2000, 2001 and 2002 and income statement and cash flow data for the years ended December 31, 2000 and 2001 have been derived from our audited consolidated financial statements that are not included in this annual report. The financial statements for periods prior to our restructuring and initial public offering in 2000 reflect historical results of operations and financial positions of the businesses that were transferred to us from Unicom Group in 2000 in preparation of our initial public offering.

Our financial statements are prepared in accordance with generally accepted accounting principles in Hong Kong, or HK GAAP. Under HK GAAP, prior to 2003, deferred taxation was accounted for at the current taxation rate in respect of timing differences between net income as computed for taxation purposes and net income as stated in the income statement. A deferred tax asset was not recognized unless the related benefits are expected to crystallize in the foreseeable future. Upon the adoption of SSAP 12 in 2003, deferred taxation is provided in full, using the liability method, on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the financial statements. Taxation rates enacted or substantively enacted at the balance sheet date are used to determine deferred taxation. Deferred tax assets are recognized to the extent that it is probable that future taxable income will be available against which the temporary differences can be utilized. Under HK GAAP, the adoption of SSAP 12 in 2003 represents a change in accounting policy which has been applied retrospectively so that the comparative data presented have been restated to conform to the changed policy. A detailed description is set forth in Note 3 to the financial statements.

In addition, financial statements prepared in accordance with HK GAAP vary in certain material respects from generally accepted accounting principles in the United States, or US GAAP. In accordance with HK GAAP, we adopted the purchase method to account for our acquisitions from Unicom Group of certain cellular businesses and assets held by Unicom New Century Telecommunications Corporation Limited, or Unicom New Century, Unicom New World Telecommunications Corporation Limited, or Unicom New World, and China Unicom International Limited, or Unicom International. The acquisitions of Unicom New Century, Unicom New World and Unicom International became effective on December 31, 2002, December 31, 2003 and in September 2004, respectively, as described in A. History and Development of the Company under Item 4. Accordingly, our consolidated income statement and, except as otherwise noted, all other HK GAAP financial information for the year 2004 presented in this annual report include the operating results of Unicom New Century and Unicom New World for the year ended December 31, 2004 and the operating results of Unicom International from the effective date of the acquisition to December 31, 2004, but our consolidated income statement and all other HK GAAP financial information for the year 2003 presented in this annual report do not include the operating results of Unicom New World for the year ended December 31, 2003. Under the purchase method, our consolidated balance sheet as of December 31, 2003 includes the financial position of Unicom New Century and Unicom New World and our consolidated balance sheet as of December 31, 2004 also includes the financial position of Unicom International. In contrast, under US GAAP, these acquisitions would be accounted for as transfers of entities under common control. The financial statements prepared under US GAAP would retroactively be restated for all periods presented on a combined basis as if the acquisitions had been in effect since inception, whereby related assets and liabilities of the acquired businesses would be accounted for at historical cost and the results of operations of the acquired businesses would be included in the consolidated financial statements for the earliest period presented.

Under HK GAAP, the sale of Guoxin Paging Corporation Ltd., or Guoxin Paging, on December 31, 2003 by us to Unicom Group has been accounted for as a sale of discontinued operation. The difference between the sale proceeds and the carrying amount of net assets of Guoxin Paging as of December 31, 2003 was recorded as the loss on sale of discontinued operation in our consolidated income statement for the year ended December 31, 2003. The operating results of Guoxin Paging from January 1, 2003 to the effective date of the sale of Guoxin Paging were included in our consolidated income statement for the year ended December 31, 2003. Under US GAAP, the sale of Guoxin Paging to Unicom Group is considered a transfer of business between entities under common control and accounted for at historical cost of the net assets transferred, after reduction, if appropriate, for an indicated impairment of value. In addition, under US GAAP, the results of operations of a component or segment of an entity that has been disposed of should be reported in discontinued operations as a separate component of income, separated from continuing operations, in the period in which the disposal occurred and in prior periods. Accordingly, all the operating results of Guoxin Paging have been grouped into and reported in the income statement as Discontinued operation - Loss from discontinued operation under US GAAP.

See Note 40 to the consolidated financial statements included in this annual report for a summary of the principal differences between HK GAAP and US GAAP that have a significant effect on our financial statements.

| | As of or for the year ended December 31 | | | | | |
|---|---|---|---|---|---|---|
| | 2000 | 2001 | 2002 | 2003 | 2004 | 2004 |
| | RMB | RMB | RMB | RMB | RMB | US$(1) |
| | (in millions, except number of shares and per share data) | | | | | |
| **Income Statement Data:** | | | | | | |
| Hong Kong GAAP (As restated)[2] | | | | | | |
| Operating revenue (Turnover): | | | | | | |
| Cellular Business | 12,188 | 20,505 | 30,613 | 56,927 | 70,799 | 8,554 |
| -GSM Business | 12,188 | 20,505 | 27,388 | 40,304 | 46,579 | 5,628 |
| -CDMA Business | | | 3,225 | 16,623 | 24,220 | 2,926 |
| Paging Business | 8,483 | 4,342 | 2,161 | 1,403 | | |
| Long Distance Business | 556 | 1,489 | 2,766 | 2,273 | 1,848 | 223 |
| Data and Internet Business | 540 | 1,820 | 2,793 | 3,437 | 3,663 | 443 |
| Total service revenue | 21,767 | 28,156 | 38,333 | 64,040 | 76,310 | 9,220 |
| Sales of telecommunications products | 1,925 | 1,237 | 2,244 | 3,596 | 3,022 | 365 |
| Total operating revenue | 23,692 | 29,393 | 40,577 | 67,636 | 79,332 | 9,585 |
| Operating expenses | (18,470) | (24,129) | (33,253) | (59,122) | (71,376) | (8,624) |
| Operating income | 5,222 | 5,264 | 7,324 | 8,514 | 7,956 | 961 |
| Loss on sale of discontinued operation (Guoxin Paging) | | | | 663 | | |
| Income before taxation | 4,482 | 5,463 | 6,303 | 6,096 | 6,467 | 781 |
| Net income | 3,324 | 4,602 | 4,598 | 4,217 | 4,387 | 530 |
| -Basic net income per share[3] | 0.297 | 0.367 | 0.366 | 0.336 | 0.349 | 0.042 |
| -Number of shares outstanding for basic net income per share (in thousands)[3] | 11,208,224 | 12,552,996 | 12,552,996 | 12,553,010 | 12,561,242 | 12,561,242 |
| -Diluted net income per share[3] | 0.297 | 0.367 | 0.366 | 0.336 | 0.348 | 0.042 |
| -Number of shares outstanding for diluted net income per share (in thousands)[3] | 11,208,224 | 12,552,996 | 12,552,996 | 12,568,683 | 12,607,241 | 12,607,241 |
| -Basic net income per ADS[4] | 2.966 | 3.666 | 3.663 | 3.359 | 3.492 | 0.422 |
| -Number of ADS outstanding for basic net income per share (in thousands)[3] | 1,120,822 | 1,255,300 | 1,255,300 | 1,255,301 | 1,256,124 | 1,256,124 |
| -Diluted net income per ADS[4] | 2.966 | 3.666 | 3.663 | 3.355 | 3.480 | 0.420 |
| -Number of ADS outstanding for diluted net income per share (in thousands)[3] | 1,121,968 | 1,255,300 | 1,255,300 | 1,256,869 | 1,260,724 | 1,260,724 |

| | As of or for the year ended December 31 | | | | | |
|---|---|---|---|---|---|---|
| | 2000 | 2001 | 2002 | 2003 | 2004 | 2004 |
| | RMB | RMB | RMB | RMB | RMB | US$(1) |
| | (in millions, except number of shares and per share data) | | | | | |
| US GAAP (As restated)(2)&(5) | | | | | | |
| Operating revenue | | 32,501 | 50,421 | 71,980 | 79,388 | 9,592 |
| Operating income from continuing operations | | 7,921 | 9,759 | 10,710 | 8,185 | 989 |
| Net income before discontinued operation, and cumulative effect of change in accounting policy | | 5,866 | 5,500 | 6,078 | 4,713 | 569 |
| Loss from discontinued operation, net of tax | | 710 | 422 | 1,342 | | |
| Cumulative effect of change in accounting policy (transitional adjustment of goodwill impairment upon the adoption of SFAS 142) | | | 42 | | | |
| Net income | | 5,155 | 5,036 | 4,736 | 4,713 | 569 |
| -Basic net income per share before discontinued operation and cumulative effect of change in accounting policy(3) | | 0.467 | 0.438 | 0.484 | 0.375 | 0.045 |
| -Basic net income per ADS before discontinued operation and cumulative effect of change in accounting policy(4) | | 4.673 | 4.382 | 4.842 | 3.752 | 0.453 |
| -Basic net income per share after discontinued operation and cumulative effect of change in accounting policy(3) | | 0.411 | 0.401 | 0.377 | 0.375 | 0.045 |
| -Basic net income per ADS after discontinued operation and cumulative effect of change in accounting policy(4) | | 4.107 | 4.012 | 3.773 | 3.752 | 0.453 |
| | | | | | | |
| **Balance sheet Data:** | | | | | | |
| | | | | | | |
| Hong Kong GAAP (As restated)(2) | | | | | | |
| Bank balances and cash | 44,717 | 18,413 | 14,433 | 9,220 | 4,655 | 562 |
| Property, plant and equipment, net | 52,864 | 75,748 | 107,487 | 118,105 | 118,904 | 14,366 |
| Total assets | 113,057 | 128,278 | 149,628 | 149,838 | 145,629 | 17,595 |
| Net assets | 58,336 | 62,884 | 67,219 | 69,615 | 72,810 | 8,797 |
| Short-term debt and current portion of other long-term debt | 8,501 | 7,933 | 15,330 | 18,173 | 20,015 | 2,418 |
| Obligations under finance lease-current portion | | 8 | 17 | 25 | 938 | 113 |
| Obligations under finance lease-non current portion | | 101 | 101 | 100 | 489 | 59 |
| Other long-term debt | 27,151 | 36,337 | 37,686 | 36,213 | 26,137 | 3,158 |
| Shareholders equity | 57,452 | 62,054 | 66,653 | 69,615 | 72,810 | 8,797 |

| | As of or for the year ended December 31 | | | | | |
|---|---|---|---|---|---|---|
| | 2000 | 2001 | 2002 | 2003 | 2004 | 2004 |
| | RMB | RMB | RMB | RMB | RMB | US$(1) |
| | (in millions, except number of shares and per share data) | | | | | |
| US GAAP (As restated)[(2)&(5)] | | | | | | |
| Property, plant and equipment, net | | | 118,787 | 118,171 | 118,701 | 14,342 |
| Total assets | | | 164,636 | 150,477 | 146,615 | 17,715 |
| Obligations under finance lease-current portion | | | 17 | 25 | 938 | 113 |
| Obligations under finance lease-non current portion | | | 101 | 100 | 489 | 59 |
| Other long-term debt | | | 45,520 | 36,213 | 26,137 | 3,158 |
| Shareholders equity | | | 64,215 | 65,946 | 69,442 | 8,390 |
| | | | | | | |
| **Other Financial Data:** | | | | | | |
| | | | | | | |
| Hong Kong GAAP: | | | | | | |
| Net cash provided by operating activities | 9,344 | 11,078 | 13,054 | 22,565 | 23,819 | 2,878 |
| Net cash used in investing activities | (30,551) | (46,125) | (5,166) | (19,051) | (18,958) | (2,291) |
| Net cash provided by (used in) financing activities | 59,921 | 8,743 | (11,868) | (8,778) | (9,401) | (1,136) |
| | | | | | | |
| US GAAP (As restated)[(5)]: | | | | | | |
| Net cash provided by operating activities | | 15,320 | 18,235 | 25,993 | 24,510 | 2,961 |
| Net cash used in investing activities | | (62,971) | (10,261) | (20,295) | (19,668) | (2,376) |
| Net cash provided by (used in) financing activities | | 21,015 | (12,773) | (11,397) | (9,440) | (1,141) |

(1) The translation of RMB into US dollars has been made at the rate of RMB8.2765 to US$1.00, the noon buying rate in New York City for cable transfer in RMB as certified for customs purposes by the Federal Reserve Bank of New York on December 31, 2004. The translations are solely for the convenience of the reader.

(2) The adoption of HK SSAP12 Income Tax (revised) in 2003 represents a change in accounting policy which has been applied retrospectively so that the comparative data presented have been restated to conform to the changed policy.

(3) See Notes 16 and 40 to the financial statements included in this Form 20-F on how basic and diluted net income per share are calculated under HK GAAP and US GAAP, respectively.

(4) Net income per ADS is calculated by multiplying net income per share by 10, which is the number of shares represented by each ADS.

(5) The US GAAP amounts as of December 31, 2004 and 2003 and for each of the years in the three-year period ended December 31, 2004 are presented as if the acquisitions of Unicom New Century, Unicom New World and Unicom International had been in existence since the beginning of the earliest period presented.

**Historical Exchange Rates Information**

We publish our financial statements in Renminbi, or RMB, the legal tender currency in the People s Republic of China, or PRC. In this annual report, references to US dollars or US$ are to United States dollars and references to Hong Kong dollars , HK dollars or HK$ are to Hong Ko dollars. Solely for the convenience of the reader, this annual report contains translations of certain RMB and Hong Kong dollar amounts into US dollar amounts and vice versa at specified rates. These translations should not be construed as representations that the RMB or Hong Kong dollar amounts actually represent such US dollar amounts or could be converted into US dollar amounts at the rates indicated or at all. Unless otherwise stated, the translations of RMB and Hong Kong dollars into US dollars and vice versa have been made at the rate of RMB8.2765 to US$1.00 and HK$7.7723 to US$1.00, the noon buying rates in New York City for cable transfers payable in RMB or Hong Kong dollars as certified for customs purposes by the Federal Reserve Bank of New York on December 31, 2004.

The noon buying rates on June 24, 2005 were RMB8.2765 to US$1.00 and HK$7.7719 to US$1.00, respectively. The average noon buying rates for 2000, 2001, 2002, 2003 and 2004 were RMB8.2784, RMB8.2772, RMB8.2771, RMB8.2772 and RMB8.2768, respectively, to US$1.00, and HK$7.7936, HK$7.7996, HK$7.7996, HK$7.7864 and HK$7.7899, respectively, to US$1.00, calculated as the average of the noon buying rates on the last day of each month during each applicable year. The following table sets forth the high and low noon buying rates between RMB and the US dollar (in RMB per US dollar) and Hong Kong dollar and the US dollar (in Hong Kong dollar per US dollar) for each month during the previous six months:

| **Period** | **High** | **Low** | **High** | **Low** |
|---|---|---|---|---|
| | **(RMB per US$1.00)** | | **(HK$ per US$1.00)** | |
| December 2004 | 8.2767 | 8.2765 | 7.7821 | 7.7698 |
| January 2005 | 8.2765 | 8.2765 | 7.7994 | 7.7775 |
| February 2005 | 8.2765 | 8.2765 | 7.7999 | 7.7984 |
| March 2005 | 8.2765 | 8.2765 | 7.7998 | 7.7987 |
| April 2005 | 8.2765 | 8.2765 | 7.7995 | 7.7946 |
| May 2005 | 8.2765 | 8.2765 | 7.7995 | 7.7767 |

## *B.* Capitalization and Indebtedness

Not applicable.

## *C.* Reasons for the Offer and Use of Proceeds

Not applicable.

## *D.* Risk Factors

**Risks Relating to Our Business**

***Our cellular businesses face intense competition from China Mobile Communications Corporation, or China Mobile, China Telecom Corporation Limited, or China Telecom, and China Network Communications Group Corporation, or China Netcom. Such competition may result in slower subscriber growth, lower tariffs and higher customer acquisition costs for us, which would adversely affect our results of operations, financial condition and growth prospects.***

Our cellular businesses face intense competition from China Mobile. China Mobile is the largest cellular operator in China and in our cellular service areas and has competitive advantages over us in customer base, overall network coverage and quality, financial resources, network management, technical expertise and brand recognition. We are experiencing intense competition from China Mobile in many of our cellular service areas, and such competition may continue and further intensify. In particular, continued price competition between China Mobile and us in many service areas has accelerated the decline of the average revenue per user per month, or ARPU, of our cellular services, and adversely affected our profitability.

Our cellular services also compete with the local wireless telecommunications services of China Telecom and China Netcom, known as Little Smart services, that are based on their fixed line networks and primarily utilize the personal handyphone system, or PHS, technology. They are offered as extensions of fixed line services and, with such features as calling-party-pays arrangements, carry significantly lower tariffs than cellular services. The Little Smart services were previously offered primarily in small- to medium-sized cities, but have been introduced in most major cities nationwide since 2003. According to public reports, currently these services have attracted over 70 million users in China and their subscriber base is continuing to grow. In addition, both China Telecom and China Netcom have indicated their interests in developing 3G wireless telecommunications services in the future, which could impose direct competition with our cellular business.

Increased competition from the cellular services of China Mobile and the Little Smart services of China Telecom and China Netcom may lead to slower subscriber growth, lower usage of our services, continued price pressure and higher costs of customer acquisition, which would adversely affect our results of operations, financial condition and growth prospects.

***Our CDMA services have yet to gain a broad market acceptance in China and there is uncertainty over whether our CDMA services will succeed in gaining a broader market acceptance.***

We launched our CDMA services in January 2002 and introduced CDMA 1X wireless data services in March 2003. Prior to the introduction of our CDMA services, digital cellular services in China were mostly based on the global system for mobile communications, or GSM, technology. The majority of cellular subscribers in China today continues to be GSM subscribers. CDMA cellular services compete with GSM services for cellular subscribers, who may be reluctant to switch to CDMA cellular services because of the need to obtain a new CDMA handset and phone number. CDMA services are also perceived to have limitations in international roaming due to the lack of CDMA networks in many countries. As of March 31, 2005, the total number of our CDMA subscribers has reached 29.43 million in our service areas. Nevertheless, CDMA technology and services have yet to gain broader market acceptance in China.

Whether our CDMA services can gain broader market acceptance will continue to be subject to a number of uncertainties, including:

- whether we can effectively retain our existing subscribers and attract sufficient new CDMA cellular subscribers;
- whether we can effectively reduce the cost of CDMA handsets and marketing expenses and strengthen the management of the purchase and distribution processes of the CDMA handsets;
- whether we can effectively promote our CDMA services and successfully execute our strategy of expanding market share among industry-specific customers and the young population; and
- whether we can optimize the CDMA network utilization rates and generate more revenues from value-added services by capitalizing the technological advantages of CDMA 1X.

Any of these uncertainties may adversely affect the growth and profitability of our CDMA cellular services and our overall business results of operation and financial condition.

***Our CDMA and GSM businesses may compete with each other, which may adversely affect the growth and profitability of these businesses..***

Although we are committed to coordinating the development of our CDMA and GSM businesses, these two businesses may compete with each other for our financial, management, human and other resources as well as cellular subscribers. For example, while we have focused on the development of our CDMA business in recent years, our investments on our GSM network has been relatively limited, which has hindered us from improving our GSM network in certain of our services areas. In addition, since we have started expanding our CDMA services to the mass market, our CDMA business may compete with our GSM business for cellular subscribers, especially mid- and low-end cellular subscribers. A portion of our CDMA subscribers were former subscribers of our GSM services. If the development of our CDMA and GSM services is not coordinated effectively or we cannot obtain adequate resources for both our GSM and CDMA cellular services, the growth and profitability of these businesses and our results of operations, financial condition and growth prospects may be adversely affected.

***Our churn rates may increase.***

In 2004, the monthly average churn rate of our CDMA cellular services increased to 1.5% from 1.0% in 2003. The increase in the churn rate of our CDMA cellular services was primarily due to the following factors:

- intense competition from the GSM services of our main competitor and the Little Smart services;

- the termination of CDMA services by some CDMA subscribers at the end of their contract periods under the CDMA handset promotional packages we began to offer in 2002;

- the increase in the proportion of cost-sensitive subscribers among new subscribers as a result of continuing expansion of our CDMA cellular services in the mass market; and an increase in the proportion of subscribers to our pre-paid CDMA services which are characterized by a higher churn rate than post-paid services.

While the monthly average churn rate of our GSM cellular services slightly decreased to 2.3% in 2004 from 2.4% in 2003, there is no assurance that it will not increase in the future due to increased competition. Increased churn rate may adversely affect our market share and increase our costs of additional customer acquisitions and bad debt, which would adversely affect our results of operations, financial condition and growth prospects.

***Failure or inability to continue to expand and upgrade our networks timely and effectively and changes in telecommunications technology and technological standards could hinder our growth.***

The growth of our businesses depends on whether we are able to continue to expand the coverage and capacity of our networks, to upgrade the technology and to improve the quality of our networks in a timely and effective manner. We also need to continue to improve the quality of our existing networks in order to enhance the quality of our telecommunications services.

In addition, the telecommunications industry in China and elsewhere in the world is subject to rapid and significant changes in technology and technological standards, including, among others, the migration from second generation mobile telecommunications to third generation mobile telecommunication, or 3G, and the development of voice-over-internet protocol technology, or VOIP. Such changes may render our networks and systems obsolete or inadequate. As a result of such changes, we may need to make significant changes and upgrades to existing networks and infrastructure or build new networks, which may require substantial capital expenditures and other resources.

Our ability to expand and upgrade our networks is subject to a number of uncertainties, including our ability to achieve the following on a timely basis and on acceptable terms:

obtain adequate financing;

retain experienced management and technical personnel;

obtain relevant government permits and approvals and gain access to office towers, residential buildings and other sites for network construction;

enter into interconnection and other arrangements with other operators;

obtain adequate network equipment and software; and

manage the technology migration in an effective manner.

Difficulties we may encounter in expanding and upgrading our networks, if not adequately resolved on a timely basis, could adversely affect our competitive position, results of operations, financial condition and growth prospects.

***Our long distance, data and Internet businesses remain relatively small*** comparing to the fixed line operators, and competition from China Telecom, China Netcom and other cellular service providers may adversely affect our growth and profitability in these businesses.

The fixed line operators of China Telecom and China Netcom currently hold a dominant market position in the public switched long distance telephony and data services markets in China in their respective service areas. They are also the dominant providers of Internet protocol telephony, or IP telephony, and Internet access services in China. China Telecom and China Netcom have competitive advantages over us in customer base, financial resources, network coverage and last-mile access. Our IP telephony services compete with other service providers including China Satellite Communication, or China SatCom and China Railway Communications Co. Ltd., or China Railcom. In 2004, the increasingly intense competition has contributed to the decrease in average realised tariff rates for long distance services and a 19.1% decrease in our operating revenue from long distance business. The growth of our long distance, data and Internet businesses has been further hindered by our lack of licenses to operate local telephony networks as well as our lack of sufficient network number resources. Competition from China Telecom, China Netcom and other service providers may continue to adversely affect the growth and profitability of our long distance, data and Internet businesses and consequently our overall results of operations, financial condition and growth prospects.

***In order to accelerate the growth of our CDMA business, we offered CDMA handset promotional packages, which increased our operating expenses in the short-term and may adversely affect our profitability.***

In order to accelerate the development of the CDMA business and subscriber growth during the product introduction period, we began to offer certain CDMA handset promotional packages in the second half of 2002. Under those arrangements, CDMA handsets were provided to the subscribers for their use at no additional cost to them during the specified contract periods as long as such subscribers agreed to incur a minimum amount of service fees during the contract period. The cost of the handsets provided to subscribers under these contractual arrangements, treated as deferred customer acquisition costs, were deferred, to the extent recoverable, and amortized over the contractual periods to match with minimum contract revenue. As of December 31, 2004, amortization of such deferred customer acquisition costs amounted to approximately RMB6,121 million and the carrying amount of such costs amounted to RMB4,745 million for our wholly-owned operating subsidiaries, China Unicom Corporation Limited, or CUCL, and Unicom New World. These promotional packages tend to increase our operating expenses. In addition, some of those subscribers terminated our CDMA services at the end of their contractual periods and therefore increased our churn rate. While we substantially reduced the use of such arrangements since 2003, the carrying amount of the deferred customer acquisition costs remain significant. As of March 31, 2005, the carrying amount of such costs amounted to RMB4,408 million for us. As a result, although the use of these CDMA promotional packages has accelerated the growth of our CDMA business, they may adversely affect the profitability of our CDMA business and our overall results of operations.

In order to control the costs of our CDMA promotional packages, we have adopted the policy to centralize the purchases of CDMA handsets. As a result, we usually maintain a significant level of inventory of CDMA handsets, which is subject to the risk of inventory obsolescence. As of December 31, 2004, we maintained an inventory of CDMA handsets of RMB1,881 million.

***Obstacles in interconnection with networks of other operators could jeopardize our operations.***

The effective provision of our cellular, long distance telephony and other services requires the interconnection between our networks and the networks of China Telecom, China Netcom, China Mobile and other operators. Any obstacles in existing interconnection arrangements or any significant change of their terms, as a result of natural events, accidents, or for regulatory, technological, competitive or other reasons, could lead to temporary service disruptions and increased costs that can seriously jeopardize our operations and adversely affect our growth and profitability. Difficulties in the execution of new interconnection arrangements on a timely basis and on acceptable terms, including the inability to promptly establish additional interconnection links or increase interconnection bandwidths as required, could also adversely affect our operations, growth and profitability.

***Unicom Group, as our controlling shareholder, can exert influence on us and cause us to make decisions that may not always be in the best interests of our other shareholders.***

Unicom Group indirectly controls an aggregate of 77.37% of our issued share capital as of May 31, 2005. As our controlling shareholder, it is able to influence our major business decisions through its control of our board of directors. Some of our executive directors and executive officers also serve as directors or executive officers of Unicom Group. In addition, our operations depend on a number of services provided by Unicom Group. It leases to us, on an exclusive basis, capacity on the CDMA network located in our cellular service areas, provides us with access to international gateways, supplies us with SIM cards and calling cards and provides equipment procurement services, customer services, and certain value-added services to us. Unicom Group and we also provide a number of services to each other, including interconnection and roaming services, sales agency and collection services and provision of premises. See A. History and Development of the Company – Our Relationship with Unicom Group under Item 4 of this annual report. The interests of Unicom Group and our interests in these transactions may differ and Unicom Group may cause us to make decisions that conflict with the interests of our other shareholders.

***The internal reorganization of Unicom Group for the A Share offering has created a two-step voting mechanism that will require the approval of the minority shareholders of both our Company and the A Share Company for significant connected transactions between us and Unicom Group.***

In October 2002, Unicom Group completed an internal reorganization of its shareholding in our company and the initial public offering in China of the ordinary shares, or A Shares, of its newly established subsidiary, China United Telecommunications Corporation Limited, or A Share Company. As part of this restructuring, a portion of Unicom Group s indirect shareholding in our company was transferred to the A Share Company, whose business is limited to indirectly holding the equity interest of our company without any other direct business operations. A voting mechanism was established to allow public shareholders of the A Share Company to indirectly participate in our shareholders meetings and a two-step voting mechanism was established for the approval of connected transactions. See A. History and Development of the Company – Further Restructuring of Unicom Group and Initial Public Offering of the A Share Company in 2002 under Item 4 below. As a result, significant connected transactions between us or our subsidiaries and Unicom Group or its subsidiaries will require the separate approval of the independent minority shareholders both of our company and of the A Share Company. Connected transactions approved by our independent minority shareholders nevertheless cannot proceed if they are not approved by the independent minority shareholders of the A Share Company. This adds another necessary step of approval process for those transactions.

***Our inability to fund our capital expenditure requirements may adversely affect our growth and profitability.***

Although we have gradually reduced our capital expenditure in recent years, we continue to have a reasonable level of capital expenditure requirements. We expect to require approximately RMB18.23 billion for capital expenditure in 2005. As of December 31, 2004, the sum of our long-term and short-term interest bearing debt exceeded the amount of our cash, cash equivalents and short-term bank deposits by RMB40.83 billion. See Liquidity and Capital Resources – Capital Expenditures under Item 5. In the future we may be unable to obtain the necessary financing on a timely basis and on acceptable terms, and our failure to do so may adversely affect our financial position, competitive position, growth and profitability. Our ability to obtain acceptable financing at any time may depend on a number of factors, including:

- our financial condition and results of operations,
- the condition of the economy and the telecommunications industry in China,
- conditions in relevant financial markets in China and elsewhere in the world, and
- our ability to obtain any required government approvals for our market financings.

***Fluctuations in the value of the Renminbi could adversely affect our share price and profitability and changes in the interest rate could adversely affect our cost of financing.***

***Substantially all of our revenues and operating expenses are denominated in Renminbi, while a portion of our*** borrowings, equipment purchases and other capital expenditures are denominated in foreign currencies. Although the exchange rate between Renminbi and US dollars has been stable, the exchange rate of the Renminbi may become volatile against the US dollar or other currencies in the future. Fluctuations of the Renminbi could adversely affect the value in foreign currency terms of cash flow generated from our operations or any dividends payable on our shares and ADSs, and therefore the price of our shares and ADSs. Any future Renminbi devaluations could also increase our equipment acquisition costs and operating expenses or lead to significant fluctuations in the exposure of our foreign-currency-denominated liabilities, thereby adversely affecting our profitability.

***Most of our bank loans are borrowed from domestic banks at interest rates that vary in accordance with the standard guidance interest rates announced by relevant Chinese government authorities. In addition, we entered into a US$700 million term loan facility in September 2003 and a US$500 million term loan facility in February 2004, both carrying variable interest rates based on the US$ LIBOR. As a result, a significant increase in interest rates would increase our cost of new debt and the interest cost of our outstanding borrowings, which could have a material adverse effect on our financial position.***

***Our doubtful debt ratio may increase.***

China has yet to develop an effective credit control system, and with more intense competition in the market, our doubtful debt ratio for cellular services in our service areas, calculated as the amount of provision for doubtful debt divided by revenue from cellular services may increase. As of December 31, 2004, such ratio is 2.9%, compared to 2.9% in 2003 and 2.7% in 2002. If the ratio further increases, our results of operations and financial condition could be adversely affected.

***Investor confidence and the market prices of our shares and ADSs may be adversely impacted if we or our independent registered public accounting firm is unable to conclude that our internal control over financial reporting is effective as of December 31, 2006 as required by Section 404 of the Sarbanes-Oxley Act of 2002.***

We are subject to the SEC s reporting obligations. The SEC, as directed by Section 404 of the Sarbanes-Oxley Act of 2002, adopted rules requiring each public company to include a report of management on the company s internal control over financial reporting in its Annual Report on Form 10-K or Form 20-F, as the case may be, that contains an assessment by management of the effectiveness of the company s internal control over financial reporting. In addition, the company s independent registered public accounting firm must attest to and report on management s assessment of the effectiveness of the company s internal control over financial reporting. These requirements will first apply to our Annual Report on Form 20-F for the fiscal year ending December 31, 2006. Our management may not conclude that our internal control over financial reporting is effective. Moreover, even if our management concludes that our internal control is effective, our independent registered public accounting firm may disagree. If our independent registered public accounting firm is not satisfied with our internal control over our financial reporting or the level at which our controls are documented, designed, operated or reviewed, or if the independent registered public accounting firm does not agree with our interpretation or understanding of the relevant requirements, rules or regulations, then it may decline to attest to our management s assessment or may issue an adverse opinion. Any of these possible outcomes could result in an adverse reaction in the financial marketplace due to a loss of investor confidence in the reliability of our consolidated financial statements, which ultimately could negatively impact the market prices of our shares and ADSs.

**Risks Relating to the Overall Telecommunications Industry in China**

***Regulatory or policy changes relating to telecommunications industry may adversely affect our results of operations, financial condition and business prospects.***

The Chinese government currently regulates many aspects of the telecommunications industry in China. Potential deregulation or restructuring of the telecommunications industry or changes in regulations and policies and their implementation could lead to changes in the overall industry environment. These changes may include, among others, new regulatory measures relating to issuance of licenses for cellular business, calling-party-pays arrangements or other tariff adjustments, fulfillment of telecommunications service providers universal service obligations and the associated expenses, usage of numbers or frequency resources and the associated fees, or standards and mechanisms of interconnection settlement, and could significantly affect our results of operations, financial condition and business prospects. For example, if the Chinese government deregulates or reduces state tariff rates applicable to some of our services or modifies other regulations of the telecommunications industry in China, our results of operations and financial condition may be adversely affected.

The Chinese government has restructured the telecommunications industry through a number of initiatives that were rolled out in stages in the past and may initiate further industry restructuring in the future. Potential restructuring of the PRC telecommunications industry, if any, may affect the overall business environment and the operations of telecommunications operators in China, including us. We cannot predict the timing for, and any implications and effect of, any future restructuring of the PRC telecommunications industry, or give any assurance that we will not be adversely affected by any such industry restructuring.

***New entrants in the telecommunications industry in China, including potential 3G operators, may further intensify industry competition and adversely affect our results of operations.***

Since mid-1990s, the Chinese government has taken various measures, including licensing more providers of telecommunications services, to encourage competition in the telecommunications industry. Currently, the Chinese telecommunications market has six basic telecommunications service providers China Telecom, China Mobile, China Netcom, China Satcom, China Railcom, and our company and thousands of value-added service providers. In addition, the government may grant additional telecommunications service licenses in the future, including additional licenses to provide cellular services.

The Chinese government has not publicly announced its decisions on whether it will grant any 3G licenses, and if so, the timing of the grant of the 3G licenses, the number of 3G licenses to be granted, any technical requirements, or the selection of preferred technologies. The issuance of 3G licenses to cellular service providers may significantly change the overall competition environment of the wireless telecommunications industry. While we have been preparing for developing 3G business, we cannot assure you that we will be granted the requisite approvals and licenses by the Chinese government in a timely manner, or at all. Even if we are granted a 3G license, we cannot assure you that we will successfully operate the 3G business and effectively compete with other 3G or other cellular services providers.

After its accession to the World Trade Organization, or WTO, in December 2001, China promulgated the Administrative Regulations on Telecommunications Companies with Foreign Investment, implementing its commitments to the WTO. Those commitments include the gradual reduction of foreign ownership restrictions in the telecommunications industry and the step-by-step opening of the telecommunications market in China to foreign operators. When the government licenses additional telecommunications service providers in the future, licensees may include operators with foreign investment. Foreign-invested operators entering into China s telecommunications market may have competitive advantages over us in financial resources, network management and technical expertise.

Increased competition from new entrants in China s telecommunications services industry could impede the growth of our businesses, further increase competition for skilled and experienced employees, result in or exacerbate price competition and increase our customer acquisition costs and other operating expenses, and thereby adversely affect our results of operations, financial condition and growth prospects.

***The*** telecommunications sector in China may not sustain its pace of rapid growth, which may adversely affect the growth and profitability of our business.

The telecommunications industry in China has experienced rapid growth in the last several years, especially in the cellular communications sector. The total number of cellular subscribers in China increased from 43.2 million at the end of 1999 to 334.8 million by December 31, 2004. Cellular penetration increased from 3.0% to 25.9% nationwide during the same period. The growth in cellular subscribers may slow down as cellular penetration continues to increase in our cellular service areas. In addition, ARPU for the cellular communications market in China continues to decline. For example, ARPU of our GSM subscribers declined from RMB56.7 in 2003 to RMB49.4 in 2004. Any slow-down in the growth in China s telecommunications sector may adversely affect the growth and profitability of our business.

***The Chinese government may require us, along with other telecommunication service 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 MII has the authority to delineate the scope of universal service obligations. The MII may also select universal service providers through a tendering process. The MII, 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.

While the scope of specific universal services obligations is not yet clear, we believe that such services may include mandatory provision of basic telecommunications services in less economically developed areas in China and mandatory contribution to a universal service fund. In addition, as part of the transitional measures prior to the formalization of a universal service obligation framework, the MII has recently required major telecommunication service providers in China, including Unicom Group, to participate in a project to provide telephone services in a number of remote villages in China. However, it is currently uncertain as to whether we will be required by the MII to maintain and expand network facilities and provide telephone services as part of such transitional measures. Furthermore, to the extent we are required to do so, it is currently uncertain whether we will be adequately compensated by the government or be able to realize an adequate return on investments for expanding networks to, and providing telecommunications services in, those less economically developed areas due to potentially higher capital expenditure requirements, lower usage by customers and lack of flexibility in setting our tariffs. We also cannot predict whether we will be required to make contribution to the universal service fund. Either of these events may adversely affect our financial condition and and results of operations.

***Actual or perceived health risks associated with the use of mobile devices could impair our ability to retain and attract customers, reduce cellular service usage or result in litigation.***

Concerns have been expressed in some countries that the electromagnetic signals emitted by wireless telephone handsets and base stations may pose health risks at exposure levels below existing guideline levels, and interfere with the operation of electronic equipment. In addition, cellular operators have been subject to lawsuits alleging various health consequences as a result of cellular handset usage or proximity to base stations or seeking protective or remedial measures. While we are not aware that such health risks have been substantiated, there can be no assurance that the actual, or perceived, risks associated with the transmission of electromagnetic signals will not impair our ability to retain customers and attract new customers, reduce cellular service usage or result in litigation.

**Risks Relating to China**

***If the Chinese government revises the current regulations that allow a foreign investment enterprise to pay foreign exchange in current account transactions, our subsidiaries ability to satisfy their foreign exchange obligations and to pay dividends to us in foreign currencies may be restricted.***

The ability of our wholly-owned operating subsidiaries, CUCL and Unicom New World, to satisfy their foreign exchange obligations and to pay dividends to us depends on existing and future foreign exchange regulations in China. The Renminbi is currently convertible by foreign investment enterprises in China to settle transactions under the current account, which include trade and service related foreign exchange transactions and payments of dividends and interest on foreign loans. Renminbi currently cannot be freely converted without regulatory approval for transactions under the capital account, which include outbound foreign investment and principal payments on foreign loans. CUCL and Unicom New World, which hold substantially all of our assets and through which we conduct substantially all of our business, are foreign investment enterprises in China. This status allows them to purchase foreign exchange at designated foreign exchange banks for settlement of current account transactions without the approval of the State Administration for Foreign Exchange. However, the relevant Chinese government authorities may in the future impose limitation on the ability of foreign investment enterprises to purchase foreign exchange to satisfy their foreign exchange obligations or to pay dividends in the future. In that event, our subsidiaries ability to satisfy their foreign exchange obligations and to pay dividends to us in foreign currencies may be restricted.

***Uncertainties in the Chinese legal system could limit the legal protections available to us and to foreign investors.***

Our wholly-owned operating subsidiaries, CUCL and Unicom New World, are organized under the laws of China and are generally subject to laws and regulations applicable to foreign investment enterprises in China. The Chinese legal system is a civil law system based on written statutes. Unlike common law systems, it is a system in which decided legal cases 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 volume of published cases and their non-binding nature, interpretation and/or enforcement of these laws and regulations involves uncertainties. Therefore, the Chinese legal system may not afford the same legal protection available to investors in the United States or elsewhere.

## Item 4. Information on the Company

## *A.* History and Development of the Company

**Industry Restructuring and Grant of New Licenses**

Since 1993, the Chinese government has implemented a number of measures to restructure and introduce competition in the telecommunications industry. Prior to June 1994, China Telecom was the sole provider of telecommunications services in China. In June 1994, Unicom Group was established in accordance with the State Council s approval to introduce competition in the telecommunications industry. Since then, the Chinese government has approved Jitong Network Communications Company Limited, or Jitong, and China Netcom Corporation Ltd., or CNCL, to provide IP telephony, Internet and data services. It has also approved China Railcom to provide most telecommunications services other than cellular services.

In 1999, the State Council approved a plan to restructure the former China Telecom along four business lines: fixed line, cellular, paging and satellite communications. As a result of the restructuring, China Telecom retained the fixed line, data and Internet businesses, while China Mobile assumed the cellular business previously operated by China Telecom. In 2002, the Chinese government further separated China Telecom into two companies, with the southern company retaining the name of China Telecom and assets and businesses in 21 provinces in southern and western China and the northern company retaining assets and businesses in 10 provinces in northern China and merging with CNCL and Jitong to form China Netcom. As a result of the Chinese government s efforts to introduce competition in the telecommunications industry, there is currently more than one service provider in most of the sectors within the telecommunications industry. See B. Business Overview – Competition below.

**History of Unicom Group**

As part of its efforts to introduce orderly competition to the telecommunications sector in China, the State Council approved the establishment of Unicom Group in December 1993 and authorized it to build and operate cellular networks and local and long distance networks.  Unicom Group first developed a nationwide cellular network using GSM technology and a nationwide long distance telephony network.

In May 1997, the State Council granted approval to Unicom Group to provide data services.  The MII licensed Unicom Group to begin to provide Internet services in July 1999 and IP telephony services on a trial basis in 12 cities in April 1999 and on a nationwide basis in March 2000.  Unicom Group also offers local telephony services in the municipalities of Chengdu, Chongqing and Tianjin.  It offers satellite transmission services through its subsidiary, China United Telecommunications Satellite Communication Co. Ltd., or Unisat.

**The Restructuring of Unicom Group and Our Initial Public Offering in 2000**

We are a company limited by shares incorporated under the Companies Ordinance of Hong Kong on February 8, 2000. Our registered office and principle executive offices are located at 75th Floor, The Center, 99 Queen s Road Central, Hong Kong (telephone number: 852-2126-2018).

Under a reorganization agreement, dated April 21, 2000, between Unicom Group and CUCL, Unicom Group transferred to CUCL certain of its assets, rights and liabilities in preparation for our initial public offering, or IPO.

Under an equity transfer agreement, dated April 21, 2000, among us, Unicom Group, China Unicom (Hong Kong) Group Limited and China Unicom (BVI) Limited, or Unicom BVI, Unicom Group transferred to us its 100% equity interest in CUCL, which became our wholly-owned operating subsidiary in China. In return, we issued 9,725 million shares to Unicom BVI, then an indirect wholly-owned subsidiary of Unicom Group.

In June 2000, we successfully completed our IPO, raising approximately US$5.65 billion. Upon completion of our IPO, our shares became listed and traded on the Hong Kong Stock Exchange and ADSs representing our shares became listed and traded on the New York Stock Exchange.

**Further Restructuring of Unicom Group and Initial Public Offering of the A Share Company in 2002**

After our IPO, Unicom BVI, which was a wholly-owned subsidiary of China Unicom (Hong Kong) Group Limited, or Unicom HK, a wholly-owned subsidiary of Unicom Group, directly held 77.47% of our outstanding shares. In October 2002, Unicom Group completed an internal restructuring of its shareholding in our company. Unicom HK transferred the total issued capital of Unicom BVI held by it to Unicom Group and Unicom BVI became a direct wholly-owned subsidiary of Unicom Group. Unicom Group then transferred 51% of its equity interest in Unicom BVI to the A Share Company, a newly established holding company and subsidiary of Unicom Group. The A Share Company s business is limited to indirectly holding the equity interest of our company without any other direct business operations.

Following the restructuring, Unicom Group successfully completed the IPO of the A Shares of the A Share Company in mainland China and the listing of the A Shares on the Shanghai Stock Exchange. After the IPO of the A Share Company, the A Share Company transferred all of its net offering proceeds to Unicom Group in return for an additional 22.84% equity interest in Unicom BVI. As of May 31, 2005, Unicom Group holds a 69.32% equity interest in the A Share Company. The A Share Company in turn holds 82.09% of the total equity interest in Unicom BVI, with the remaining 17.91% held directly by Unicom Group. Unicom BVI continues to hold 77.37% of our outstanding shares and Unicom Group remains our ultimate controlling shareholder. See also the chart on page 19 below for the current shareholding structure of our company.

In accordance with the articles of association of the A Share Company and Unicom BVI, before Unicom BVI votes on a certain proposal at our shareholders meeting, the A Share Company must first convene its shareholders meeting to consider the same proposal and has the right to direct Unicom BVI to vote the shares in our company indirectly held by the A Share Company through Unicom BVI. Unicom Group can similarly direct the voting in respect of its direct equity interest in Unicom BVI. This mechanism for voting is designed to allow public shareholders of the A Share Company to indirectly participate in our shareholders meeting.

The voting mechanism described above, however, will not apply to the approval process for any connected transactions between us or our subsidiaries and Unicom Group or its subsidiaries, on which Unicom BVI will not be permitted to vote under the Listing Rules of the Hong Kong Stock Exchange. Instead, our significant connected transactions would require the separate approvals of the public shareholders both of our company and of the A Share Company. According to the two-step voting arrangements we and the A Share Company have established, each connected transaction between us or our subsidiaries and Unicom Group or its subsidiaries will consist of an initial agreement and a further agreement. The initial agreement would be entered into by Unicom Group or its subsidiaries (excluding the A Share Company and its subsidiaries) on the one hand and the A Share Company or Unicom BVI on the other hand. This agreement would contain the following terms:

the closing of the initial agreement would be subject to the (i) successful transfer of all rights and obligations of the A Share Company or Unicom BVI under the initial agreement to us or our subsidiaries, and (ii) the approval of the further agreement by our independent shareholders, and

Unicom Group or its subsidiaries (excluding the A Share Company and its subsidiaries) would agree and acknowledge that all rights and obligations under the initial agreement can be transferred to us or our subsidiaries without any further consent requirements.

The initial agreement will constitute a connected transaction of the A Share Company and, if certain thresholds are met, will require the approval of the public or independent shareholders of the A Share Company under the rules of the Shanghai Stock Exchange. The further agreement would be entered into by the A Share Company or Unicom BVI on the one hand and us or our subsidiaries on the other hand, and would provide for the transfer of all rights and obligations of the A Share Company or Unicom BVI on the one hand under the initial agreement to us or our subsidiaries on the other hand. The further agreement will constitute a connected transaction of our company and, if certain thresholds are met, will require the approval of our public or independent shareholders under the Listing Rules of the Hong Kong Stock Exchange. We expect, to the extent the nature of a particular connected transaction allows, the two-step voting arrangements to apply as described above. However, there may be circumstances where the nature of the connected transaction requires the application of the two-step voting arrangements to be adjusted. This may arise where we or our subsidiaries are the providers, rather than recipients, of certain services. In this event, the two-step voting arrangements will need to be adjusted so that the process as described above is effectively reversed, such that the initial agreement is entered into by us or our subsidiaries rather than Unicom Group or its subsidiaries (excluding the A Share Company and its subsidiaries) with the A Share Company or Unicom BVI. Unicom Group or its subsidiaries (excluding the A Share Company and its subsidiaries), rather than us or our subsidiaries, will be party to the further agreement. The arrangements (including the conditions) will apply correspondingly. This two-step structure will be used in all future connected transactions between us and Unicom Group and will effectively require the separate approvals of the public or independent shareholders both of our company and of the A Share Company for such connected transactions.

**Restructuring and Acquisition of Unicom New Century**

On December 31, 2002, in accordance with the two-step approach outlined above, we successfully completed the acquisition from Unicom Group of Unicom New Century, which holds cellular telecommunications businesses (including GSM assets and businesses and CDMA businesses) in the following nine provinces, autonomous regions and municipalities in China: Jilin, Heilongjiang, Jiangxi, Henan, Shaanxi and Sichuan provinces, Guangxi Zhuang Autonomous Region, Xinjiang Uygur Autonomous Region and Chongqing municipality. The total purchase price was HK$4,523,181,304 (approximately RMB4.8 billion), payable in cash.

**Acquisition of Unicom New World and the Sale of Guoxin Paging**

On December 31, 2003, we successfully completed the acquisition from Unicom Group of Unicom New World, which holds cellular telecommunications businesses (including GSM assets and businesses and CDMA businesses) in the following nine provinces and autonomous regions in China: Shanxi, Hunan, Hainan, Yunnan, Gansu and Qinghai provinces and Inner Mongolia, Ningxia Hui and Tibet autonomous regions. The total purchase price was HK$3,014,886,000 (approximately RMB3.2 billion), payable in cash. On the same date, we also completed the sale of the entire equity interests of Guoxin Paging to Unicom Group for a total sale price of HK$2,590,917,656 (approximately RMB2.75 billion), and such proceeds were applied to our general working capital. Both the acquisition of Unicom New World and the sale of Guoxin Paging were completed in accordance with the two-step approach outlined above.

**Merger between CUCL and Unicom New Century**

On July 30, 2004, Unicom New Century was merged into CUCL and legally dissolved upon the completion of such merger. As a result, CUCL extended its cellular businesses to 21 provinces, autonomous regions and municipalities in China.

**Acquisition of China Unicom International Limited**

In September 2004, we acquired from Unicom Group of Unicom International, a limited liability company established in Hong Kong engaging in voice wholesale business, telephone cards business, line leasing services, managed bandwidth services and mobile virtual network services. Unicom s wholly-owned US subsidiary, China Unicom USA Corporation, or Unicom USA, carries wholesale business of voice traffic between the United States and mainland China. The total purchase price was HK$37,465,996 (approximately RMB39.74 million), payable in cash.

**Establishment of China Unicom (Macau) Company Limited**

On October 15, 2004, we set up China Unicom (Macau) Company Limited, or Unicom Macau, in Macau Special Administrative Region of the PRC, or Macau. In March 2005, the Macau government granted Unicom Macau a CDMA license, which will allow Unicom Macau to provide roaming services to our CDMA subscribers as well as CDMA users of other service providers who visit Macau during the first year of its operation. After the first year of its operation, Unicom Macau will be eligible to provide cellular services to local residents upon receiving approval from local telecommunications regulatory authority.

Set forth below is our shareholding structure and subsidiaries as of December 31, 2004.

**Our Relationship with Unicom Group**

Unicom Group continues to own and manage the international gateways that provide international connections to our long distance network. Unicom Group also continues to operate the following telecommunications networks:

- its cellular networks in Guizhou province,
- its local telephony networks in Chengdu, Chongqing and Tianjin municipalities,
- the satellite transmission networks operated through Unisat, and
- the paging networks operated through Unicom Paging and Guoxin Paging.

Unicom Group holds the licenses required for our telecommunications businesses and we derive our rights to operate our businesses from our status as a majority owned subsidiary of Unicom Group. Under the respective reorganization agreements entered into by CUCL, Unicom New Century and Unicom New World with Unicom Group referred to above, Unicom Group undertook to hold and maintain all licenses received from the MII in connection with our businesses solely for our benefit during the term of the licenses and at no cost to us. In addition, Unicom Group undertook to take all actions necessary to obtain and maintain for our benefit such governmental licenses or approvals as we shall require to continue to operate our businesses. Unicom Group also agreed not to engage in any business which competes with our businesses except for the then-existing competing businesses of Unicom Group and to grant us a right of first refusal in relation to any government authorization, license or permit, or other business opportunity to develop any new telecommunications technology, product or service. Finally, Unicom Group also gave us an undertaking not to seek an overseas listing for any of its businesses or the businesses of its subsidiaries in which we are engaged or may engage in the future, except through us.

In connection with the restructuring of Unicom Group and the acquisitions of Unicom New Century, Unicom New World and Unicom International, we entered into a number of agreements with Unicom Group pursuant to the two-step process described in Further Restructuring of Unicom Group and the Initial Public Offering of A Shares above. These include arrangements for interconnection and roaming services between the telecommunications networks owned by us and Unicom Group and for the provision or sharing of telecommunications and ancillary services and facilities between us and Unicom Group. Unicom Group also retains its interests in its other subsidiaries that provide ancillary services to us, including the procurement of telecommunications equipment and the supply of SIM cards and calling cards. In March 2005, we entered into several new agreements with Unicom Group to replace the existing arrangements. See B. Related Party Transactions under Item 7.

Unicom Group has constructed nationwide cellular networks based on CDMA technology. The first phase of the construction was completed at the end of 2001. We entered into lease agreements with Unicom Group to lease a portion of the network capacity and began to offer CDMA cellular services on an exclusive basis in our cellular service areas in early 2002. In 2003, Unicom Group completed the second phase of the CDMA network construction, which included the upgrade of the network to CDMA 1X technology. Wireless data services that utilize CDMA 1X technology have been introduced throughout our service areas. In 2004, Unicom Group substantially completed the construction of the third phase of the CDMA network, which increased the total network capacity to approximately 72 million subscribers. In March 2005, we entered into a new CDMA lease agreement with Unicom Group to replace the then existing CDMA lease agreement. Unicom Group operates its CDMA networks outside of our cellular service areas, in Guizhou province. We also have an option to acquire the CDMA networks from Unicom Group. See B. Related Party Transactions – Leasing of CDMA Network Capacity under Item 7.

**Capital Expenditures and Divestitures**

See Liquidity and Capital Resources – Capital Expenditures under Item 5 for information concerning our principal capital expenditures for the previous three years and those planned for 2005. We have not undertaken any significant divestitures.

## *B.* Business Overview

**General**

We are an integrated telecommunications operator in China, offering a wide range of telecommunications services, including cellular, international and domestic long distance, data and Internet services based on our advanced, uniform nationwide network system.

Prior to the acquisition of Unicom New World on December 31, 2003, we offered cellular communications services based on both GSM and CDMA technologies in 21 provinces, autonomous regions and municipalities in China. After the acquisition of Unicom New World, our cellular service area encompassed a total of 30 provinces, autonomous regions and municipalities (i.e., all provinces, autonomous regions and municipalities in China except for Guizhou province). See A. History and Development of the Company Acquisition of Unicom New World and the Sale of Guoxin Paging above under this Item 4. As a result, our operating results for the year ended December 31, 2004, which include the operating results of Unicom New World, are not necessarily comparable to our operating results for the year ended December 31, 2003, which does not include the operating results of Unicom New World.

We and China Mobile are the two cellular service providers in our cellular service areas. We had a total of 84.27 million GSM cellular subscribers in our cellular service areas at the end of 2004, representing a 31.8% increase from 63.92 million subscribers at the end of 2003. Our GSM cellular business is our largest business, which accounted for 59.8% of our total operating revenue in the year ended December 31, 2004. We had approximately 27.81 million CDMA cellular subscribers in our cellular service areas as of December 31, 2004, representing a 64.5% increase from 16.91 million subscribers as of December 31, 2003. At the end of 2004, our market share was 35.6% in our cellular service areas, relatively stable compared to the market share at the end of 2003.

We provide traditional public switched and IP telephony international and domestic long distance, data and Internet services nationwide in China. All of these services were launched in 2000, with the exception of our IP telephony long distance service, which was launched in 1999. These businesses currently represent a relatively small portion of our overall business, but are growing in absolute terms. Our long distance, data and Internet businesses accounted for 6.9% of our total operating revenue in 2004, compared to 8.4% in 2003.

Outgoing public switched and IP telephony long distance calls totaled 10.10 billion and 13.95 billion minutes, respectively, in 2004, compared to 8.44 billion and 11.39 billion minutes, respectively, in 2003. Our market share slightly decreased from approximately 14.0% in 2003 to 12.7% in terms of total outgoing long distance call minutes in 2004. Our incoming international long distance calls (including incoming calls from Hong Kong, Macau and Taiwan) totaled 2.75 billion minutes in 2004, up from 1.91 billion minutes in 2003.

Our data and Internet business maintained steady growth in 2004. Our broadband data and Internet services currently cover over 300 cities nationwide. As of December 31, 2004, the bandwidth of our data network, international interconnection bandwidth and domestic interconnection bandwidth had reached 136Gbps, 3.34Gbps and 14.88Gbps, respectively. Our Internet subscribers grew to 13.63 million by the end of 2004 from 12.43 million in 2003.

Our fiber optic transmission network continued to expand in 2004. As of December 31, 2004, the total cable length of our transmission network reached 712,000 km, including 120,000 km for our backbone transmission network, representing an increase of 25.0% and 4.7%, respectively, from the end of 2003.

**Recent Developments**

As of March 31, 2005, the total number of our GSM subscribers in all of our cellular service areas has increased to 86.98 million, including 44.05 million post-paid subscribers and 42.93 million pre-paid subscribers. As of March 31, 2005, we also had a total of 29.43 million subscribers to our CDMA services. Average minutes of usage, or MOU, per subscriber per month for GSM services in our combined service areas were 186.5 minutes for the three months ended March 31, 2005. Average MOU per subscriber per month for CDMA services in combined service areas were 275.5 minutes for the three months ended March 31, 2005. ARPU for GSM services in our combined service areas was RMB46.9 for the three months ended March 31, 2005. ARPU for CDMA services in our combined service areas was RMB77.5 for the three months ended March 31, 2005.

For the three months ended March 31, 2005, outgoing public switched long distance calls totaled 2.63 billion minutes, including 2.59 billion minutes of domestic long distance calls and 0.04 billion minutes of international long distance calls (including calls to Hong Kong, Macau and Taiwan). Outgoing IP telephony long distance calls totaled 3.51 billion minutes for the first three months of 2005, including 3.48 billion minutes of domestic long distance calls and 0.03 billion minutes of international long distance calls (including calls to Hong Kong, Macau and Taiwan). As of March 31, 2005, our Internet subscribers reached 10.03 million.

**Cellular Services**

Our cellular business is our largest business, with our GSM and CDMA businesses together having contributed 93.0% of our total operating revenue in 2004. We offer cellular services in 30 provinces, autonomous regions and municipalities in China.

We offer both GSM and CDMA cellular services in our service areas. We began to offer GSM cellular services in 1995 and currently a majority of our existing cellular users subscribe to our GSM cellular services. We began to offer CDMA cellular services in 2002. In 2003, we introduced wireless data services that utilize CDMA 1X technology. We also offer GSM international roaming services in conjunction with 211 operators in 101 countries and regions and CDMA international roaming services in conjunction with 15 operators in 12 countries and regions. In August 2004, we launched dual mode cellular service under the brand name Worldwind, leveraging our existing GSM and CDMA networks to achieve seamless roaming worldwide.

We also offer short message services, or SMS, and a number of other value-added services to our cellular subscribers, including CDMA 1X wireless data services and GSM wireless data services, under the integrated service brand of uni and sub-brands of uni-Info , uni-Mail , uni-Magic , uni-Map , uni-Wap and Uni-Web , and U-Net , which represents various wireless internet access services for laptop or mobile han

In 2004, our market share in our cellular service areas grew slightly, from 34.6% in 2003 to 35.6% in 2004.

***GSM Cellular Services***

We centrally plan and oversee our provincial GSM cellular businesses, which are operated by provincial branches of our operating subsidiaries, CUCL and Unicom New World. We centrally manage the key aspects of network construction such as network planning and design and selection of major equipment. We also centrally devise the overall business strategies to be carried out by the provincial operating branches.

Our GSM cellular networks reach all cities, county centers, major towns, major highways and railways in our cellular service areas. We continue to selectively deploy GSM systems that operate in the 1800 MHz frequency band in high-density population and high call volume centers to supplement our GSM networks operating in the 900 MHz frequency band. In 2004, we focused on optimizing the operational efficiency and stability of our GSM networks, and will continue to manage our GSM networks to support the development of our various cellular services.

*Post-paid Services and Pre-paid Services*

We offer two main categories of GSM cellular services: post-paid and pre-paid services that target different consumer segments. Generally, we promote our pre-paid services to migrant population and temporary residents as well as lower-usage subscribers and target our post-paid services at long-term residents in our GSM cellular service areas.

To subscribe for our post-paid services, a customer generally needs to produce proof of local residency or a guarantee from a local resident and sign a service contract. A post-paid subscriber pays a monthly fee and per-minute usage and roaming charges. In many of our cellular service areas, we require most post-paid subscribers to pay a deposit directly to us or to give a direct debit authorization to one of the commercial banks that collect service charges for us.

To subscribe for our pre-paid services, a customer simply purchases a SIM card with a pre-paid amount of service charges. The customer can add to the pre-paid balance by purchasing rechargeable cards. A customer of pre-paid services does not need to register with us. In addition, pre-paid services do not have monthly fees, but carry higher per-minute usage and roaming charges. This fee structure is generally more attractive to lower-usage subscribers.

We market pre-paid services under the service brand of Ruyi Tong . These services are generally supported by intelligent networks built by us. The intelligent networks enable us to offer nationwide roaming services and monitor in real time the account balance of pre-paid subscribers. We also offer pre-paid services in some service areas that are based on the local billing systems and use local service brands.

*Subscribers and Usage*

The following table sets forth selected historical information about our GSM cellular operations and our subscriber base for the periods indicated.

| | CUCL and Unicom New Century only, as of or for the year ended December 31, | | Unicom New World only, as of or for the year ended December 31, | CUCL(5) and Unicom New World, as of or for the year ended December 31 | CUCL(5) and Unicom New World, as of or for the three months ended March 31, |
|---|---|---|---|---|---|
| | 2002 | 2003 | 2003 | 2004 | 2005 |
| Number of subscribers (in thousands) | 53,465 | 63,923 | 8,647 | 84,267 | 86,982 |
| Post-paid | 29,718 | 32,458 | 7,105 | 42,844 | 44,048 |
| Pre-paid | 23,747 | 31,465 | 1,542 | 41,423 | 42,934 |
| Estimated market share in our service areas(1) | 29.8% | 27.4% | 27.1% | 26.8% | 26.2% |
| Average churn rate(2) | 15.5% | 29.1% | 46.9% | 27.6% | 6.5% |
| Average minutes of usage per subscriber per month(3) | 165.49 | 173.70 | 204.55 | 188.9 | 186.5 |
| Average revenue per subscriber per month (in RMB)(4) | 67.34 | 56.74 | 58.34 | 49.4 | 46.9 |
| SMS Volume (in billions) | 8.495 | 25.034 | 2.959 | 32.39 | 8.72 |

(1) Market share in a given area is determined by dividing the number of our GSM subscribers in the area by the total number of cellular subscribers in the area. *Source*: Ministry of Information Industry.

(2) Average churn rate is the rate of subscriber disconnections from our GSM cellular network, which we have determined by dividing the sum of voluntary and involuntary deactivations during the period by the average of the number of our GSM subscribers during the period.

(3) Average minutes of usage per subscriber per month is calculated by dividing the total minutes of usage during the period by the average of the number of our GSM subscribers during the period, and dividing the result by the number of months in the relevant period.

(4) Average revenue per subscriber per month, or ARPU, is calculated by dividing the sum of GSM cellular services revenue during the relevant period by the average of the number of our GSM subscribers during the period, and dividing the result by the number of months in the period.

(5) Includes Unicom New Century, which merged into CUCL on July 30, 2004.

*Subscriber Increase:* Our subscriber count continued to grow rapidly. As of December 31, 2004, the total number of GSM subscribers in our cellular service areas increased to 84.27 million, including 42.84 million post-paid subscribers and 41.42 million pre-paid subscribers. Our share of the cellular market in terms of total cellular subscribers in our GSM cellular service areas was 26.8% as of December 31, 2004. We attracted 35.5% of the net cellular subscriber additions in those service areas during 2004. We believe that this growth was attributable to a number of factors, including, among others, (i) continued growth of the Chinese cellular telecommunications market, driven by economic growth and reduction in the cost of cellular handsets and services, (ii) relatively flexible marketing, sales and distribution, (iii) relatively competitive pricing of our services and (iv) our continuing focus on customer service.

*Pre-paid Subscribers:* The rate of increase in our pre-paid subscribers has generally exceeded the rate of increase in our post-paid subscribers in recently years. As of December 31, 2004, we had 41.42 million pre-paid subscribers in our cellular service areas, representing 49.2% of our total subscriber base, the same percentage as at the end of 2003. Pre-paid subscribers represented 71.9% of our net subscriber additions in our cellular service areas during 2004.

*MOU and ARPU:* Our total minutes of usage, or MOU, and average revenue per subscriber per month, or ARPU, were 178.16 billion minutes and RMB49.4, respectively, in 2004. The average MOU per subscriber per month was 188.9 minutes in 2004, an increase of 15.2 minutes from 173.7 minutes in 2003. The increase in MOU was attributable to increased tariff competition with our competitor, which resulted in the provision of more free minutes to subscribers. The decreasing tariffs as a result of such competition also encouraged higher usage among subscribers. Our ARPU continued to decline from RMB56.7 in 2003 to RMB49.4 in 2004. The decline in ARPU was attributable to intensified market competition and regional promotional activities that led to a decline in effective tariffs. Our pre-paid subscribers in general have lower MOUs and ARPUs compared to our post-paid subscribers. For the year ended December 31, 2004, the average MOU per subscriber per month and ARPU were 125.3 minutes and RMB40.0 respectively, for our pre-paid subscribers, compared to 247.5 minutes and RMB58.1, respectively, for our post-paid subscribers.

*Churn Rate:* For the year ended December 31, 2004, the churn rate for GSM services in our cellular service areas decreased from 29.1% in 2003 to 27.6% as a result of our emphasis on customer retention. Our calculation of churn rate reflects those subscribers who switch to services of other operators and those whose services we disconnect as a result of account inactivity or payment delinquency.

The Chinese government eliminated connection fees in 2001 and, as competition continues to intensify, our churn rate from subscribers voluntarily discontinuing our services may increase in the future. The churn rate for our pre-paid services is generally higher than that for our post-paid services because of the migrant and temporary nature of most pre-paid subscribers. It is also difficult for us to develop and maintain customer relationships with pre-paid subscribers from whom we do not require registration.

*Payment Delinquency:* Payment delinquency stabilized in 2004. As of December 31, 2004, the doubtful debt ratio for GSM cellular services in our cellular service areas, calculated as the amount of provision for doubtful debt divided by revenue from GSM cellular services, is 2.8%, same as the ratio at the end of 2003 for CUCL and Unicom New Century. In some of our cellular service areas we require our post-paid subscribers to deposit service charges and maintain a certain level of account balances with us or with commercial banks that collect service fees for us. We classify the creditworthiness of our subscribers into various levels and have adopted other credit control measures. We also closely manage payment delinquencies through confirmation of customer address and other registration information, expansion of collection channels, advance notification of inadequate deposits, close monitoring of call patterns and account balances and prompt termination of services.

*Tariffs*

Generally we charge our post-paid cellular subscribers the following categories of tariffs: basic monthly fees, usage charges for both incoming and outgoing calls, roaming charges, long-distance call charges and charges for value-added services. Pre-paid subscribers do not pay monthly fees but pay higher per-minute usage and roaming charges.

The cellular tariffs are subject to regulation by various government authorities, including the MII, the National Development and Reform Commission and provincial price regulatory authorities. The following table summarizes the present State guidance tariff rates for post-paid and pre-paid cellular services:

| | Post-paid Services | Pre-paid Services |
|---|---|---|
| | **RMB** | **RMB** |
| Basic monthly fee | 50 | 0 |
| Basic usage charge (per minute) | 0.4 | 0.6 |
| Domestic roaming charge (per minute) | 0.6 | 0.8 |

*Source:* MII.

Intense competition in our cellular service areas has resulted in tariff discounts and service promotions offered by both us and our main competitor from time to time, which may lower effective tariffs. These discounts and promotions have taken many forms, including promotional tariff rates, free call minutes, off-peak discounts or discounts for high-usage subscribers and package service plans with fixed monthly fees. While various features of our package service plans are coordinated on a nationwide basis, the tariff structure of the various plans are determined by us based on the local competitive environment. See D. Risk Factors Risks Relating to the Overall Telecommunications Industry in China regulatory or policy changes relating to telecommunications industry may adversely affect our results of operations, financial condition and business prospects under Item 3.

We have introduced a number of package service plans in our cellular service areas. Under these plans, subscribers pay a fixed monthly fee for a specified number of call minutes. The plans vary in the level of the fixed monthly fee, the number of specified call minutes and the tariff rates for call minutes in excess of the specified call minutes. The terms of these plans also vary depending on the local markets and generally offer some price discounts to similar plans of our main competitor. We have also introduced in selected cities promotional plans for certain qualified subscribers, which allow such subscribers to receive incoming calls without incurring per-minute usage charges in exchange for a fixed monthly fee.

In 1997, the Chinese government granted us preferential treatment by allowing us to reduce our tariffs by up to 10% below the State guidance tariff rates. In the past, this preferential treatment has helped us capture a significant number of cellular subscribers by allowing us to market our cellular services at discounted rates. As we and our main competitor, introduced various package service plans and other promotional programs, the tariff structure has become more complex. While we continue to maintain tariff levels that are generally lower than those of our main competitor, the more complex tariff structure has, to some extent, made our price advantages less obvious to subscribers compared to previous tariff schemes that were largely based on simple per-minute charges. In 2004, as we continued to offer package service plans in our service areas, we have significantly reduced the variety of such plans and stopped offering service plans that were not profitable.

***CDMA Cellular Services***

Our controlling shareholder, Unicom Group, currently has the exclusive license to offer CDMA cellular services in China. It has constructed CDMA networks nationwide through its wholly-owned subsidiary Unicom Horizon. We have leased capacity on the network and operate the CDMA network in our cellular service areas. After a trial period of three months, we formally launched our CDMA services in April 2002. In 2003, Unicom Group completed the second phase of the CDMA network construction, which included the upgrade of the network to CDMA 1X technology, and we introduced wireless data services that utilize CDMA 1X technology. In August 2003, we introduced pre-paid CDMA services. In 2004, Unicom Group substantially completed the third phase of the CDMA network construction. In August 2004, we launched the Worldwind CDMA and GSM dual-mode handset cellular services.

*Unicom Group s Construction of CDMA Networks*

In May 2001, Unicom Group began to build CDMA networks nationwide. The networks are expected to be expanded in phases. The number and size of each phase will depend upon actual and forecast CDMA subscriber growth and anticipated capacity requirements. In the first phase of the construction, which was completed by the end of 2001, the networks achieved a nationwide coverage of approximately 330 cities in China, with a total capacity of 15.81 million subscribers. The portion of this network within our cellular service areas has a total capacity of approximately 15.62 million subscribers.

Through a competitive bidding process, Unicom Group was able to obtain highly attractive terms for its CDMA equipment supply contracts. The construction of the first phase of its CDMA networks utilized to a significant extent the existing GSM infrastructure, such as base stations and related equipments, switching centers and related equipments, transmission capacity and relevant equipments.

In 2003, Unicom Group completed the second phase of the CDMA network construction, which included the upgrade of the network to CDMA 1X technology. The second phase of the construction also added capacity for 20.69 million additional subscribers, bringing the total capacity of the nationwide CDMA networks to approximately 36.50 million subscribers. The portion of the CDMA networks within our cellular service areas has a capacity of approximately 20.38 million subscribers. In addition, the second phase of the construction focused on improving the breadth and depth of network coverage, by deepening coverage to the level of almost all of the county-level towns and cities and increasing indoor coverage.

In 2004, Unicom Group substantially completed the third phase of the CDMA network construction, which increased the total CDMA network capacity to approximately 72.74 million subscribers, with approximately 71.81 million of capacity within our service areas. Such level of capacity improved our CDMA nationwide network coverage and telecommunications quality, including both outdoor and indoor coverage, as well as the data-processing capacity of our CDMA 1X services. After the substantial completion of the third phase of network construction, Unicom Group has built a CDMA network with relatively comprehensive nationwide coverage.

*Our Lease of CDMA Networks from Unicom Group*

Our wholly-owned operating subsidiary, CUCL, entered into a lease agreement with Unicom Group and its subsidiary Unicom Horizon, dated November 22, 2001, which sets forth the principal terms of the network capacity leasing arrangement between us and Unicom Group. Unicom New Century and Unicom New World have also entered into lease agreements, dated November 20, 2002 and November 20, 2003, respectively, with Unicom Group and Unicom Horizon on similar terms and conditions. We entered into a new, consolidated lease agreement, or the New CDMA Lease, with Unicom Group and Unicom Horizon on March 24, 2005 to replace the three lease agreements, or the Old CDMA Leases, entered into in the past individually by CUCL, Unicom New Century and Unicom New World. We lease network capacity from Unicom Group and operate these CDMA networks in our cellular service areas on an exclusive basis and receive all revenue generated from the operation. We may terminate the lease arrangements upon giving at least six months prior notice to Unicom Group.

Under the Old CDMA Leases, the term of each lease was for an initial period of one year and could be renewed for further one-year terms at our option. We leased network capacity in our cellular service areas on a quarterly basis during the first year and, thereafter, would lease network capacity on an annual basis, with the ability to request to adjust lease capacity pursuant to the Old CDMA Leases. See B. Related Party Transactions – Leasing of CDMA Network Capacity under Item 7. We have leased capacity for 31 million subscribers in our cellular service areas in 2004.

Under the OLD CDMA Leases, we were required to make quarterly lease payments to Unicom Group for the actual amount of network capacity we leased. The lease fee was charged on a per line basis and determined so as to enable Unicom Group to recover its total investment in constructing the network in seven years together with a rate of return on its investment of 8%. To the extent that we had not leased the full capacity of the CDMA network in the particular period, we did not have to compensate Unicom Group for unused capacities not leased by us. The quarterly lease fee for the first two phases of the CDMA network in our cellular service areas was RMB56.4 and RMB61.5 per subscriber line leased in 2004, respectively.

The New CDMA Lease has an initial term of two years commencing from January 1, 2005, during which (i) the lease fee for the first year will be 29% of the audited service revenue generated by our CDMA cellular business and (ii) the lease fee for the second year will be 30% of the audited service revenue generated by our CDMA business. We lease all constructed network capacity from Unicom Group under the New CDMA Lease. The term of the New CDMA Lease may be renewed at our option, with the length of the renewed term to be agreed upon.

In addition to leasing network capacity, we also have the option, exercisable at any time during the lease period and for an additional year thereafter, to purchase the CDMA network in our cellular service areas. The acquisition price will be negotiated between Unicom Horizon and us. It will be based on the appraisal value of the CDMA network determined in accordance with applicable PRC laws and regulations and take into account the then prevailing market conditions and other factors. However, the purchase price will not exceed an amount which will, taking into account all lease fee payments made by us to Unicom Horizon and lease fee discounts as a result of delay of delivery, enable Unicom Horizon to recover its total network construction costs, together with an internal rate of return of 8%. The exercise of the purchase option will be subject to the relevant laws, regulations and listing rules in Hong Kong and the PRC, particularly those governing connected transactions, including approvals of our minority shareholders. See B. Related Party Transactions Leasing of CDMA Network Capacity under Item 7 for a more detailed description of the New CDMA Lease.

*Services*

The CDMA services we offer in our cellular service areas include basic voice and value added services such as call forwarding and voicemail, caller identity display, SMS services and CDMA 1X data services. In addition to post-paid CDMA services, we offer pre-paid CDMA services under the service brand of Ruyi133 in our cellular service areas. The features of our pre-paid and post-paid CDMA services are similar to pre-paid and post-paid GSM services. See B. Business Overview Cellular Services GSM Cellular Services Post-paid Services and Pre-paid Services under this Item 4. We have begun operations of the CDMA 1X networks in all of the cities in our cellular service areas.

In August 2004, we launched CDMA and GSM dual-mode cellular services under the brand name Worldwind , leveraging our existing GSM and CDMA networks to achieve seamless roaming worldwide. As of December 31, 2004, we sold approximately 200,000 Worldwind dual-mode handsets and had approximately 160,000 subscribers of the dual-mode cellular services. Worldwind services, which are available to our subscribers who use either a dual-mode handset or a dual-mode user card, have the following features:

Users can switch between our GSM and CDMA networks in China, thereby offering wireless coverage in areas of the country covered by any one of these networks;

When roaming in areas outside of China, users can use the cellular services of local operators, whether they are GSM or CDMA, who signed roaming agreements with us; and

Our GSM users who sign up for Worldwind can continue to use the basic GSM services, while enjoying the additional benefits of the CDMA 1X services.

*Subscriber Base*

The following table sets forth selected historical information about our CDMA cellular operations and our subscriber base for the periods indicated.

| | CUCL and Unicom New Century only, as of or for the year ended December 31, | | Unicom New World only, as of or for the year ended December 31, | CUCL(5) and Unicom New World, as of or for the year ended December 31, | CUCL(5) and Unicom New World, as of or for the three months ended March 31, |
|---|---|---|---|---|---|
| | 2002 | 2003 | 2003 | 2004 | 2005 |
| Number of subscribers (in thousands) | 6,245 | 16,910 | 2,036 | 27,814 | 29,432 |
| Post-paid | 6,245 | 16,046 | 1,934 | 25,824 | 27,227 |
| Pre-paid | | 864 | 102 | 1,991 | 2,205 |
| Estimated market share in our service areas(1) | 3.5% | 7.2% | 6.4% | 8.8% | 8.9% |
| Average churn rate(2) | 0.8% | 11.5% | 25.9% | 17.9% | 4.1% |
| Average minutes of usage per subscriber per month(3) | 328.1 | 337.5 | 335.4 | 292.3 | 275.5 |
| Average revenue per subscriber per month (in RMB)(4) | 172.2 | 128.4 | 123.4 | 85.3 | 77.5 |
| SMS Volume (in billions) | 0.516 | 6.231 | 0.623 | 11.83 | 3.41 |

(1) Market share in a given area is determined by dividing the number of our CDMA subscribers in the area by the total number of cellular subscribers in the area. *Source*: Ministry of Information Industry.

(2) Average churn rate is the rate of subscriber disconnections from our CDMA cellular network, which we have determined by dividing the sum of voluntary and involuntary deactivations during the period by the average of the number of our CDMA subscribers during the period.

(3) Average minutes of usage per subscriber per month is calculated by dividing the total minutes of usage during the period by the average of the number of our CDMA subscribers during the period, and dividing the result by the number of months in the relevant period.

(4) Average revenue per subscriber per month, or ARPU, is calculated by dividing the sum of CDMA cellular services revenue during the relevant period by the average of the number of our CDMA subscribers during the period, and dividing the result by the number of months in the period.

(5) Includes Unicom New Century, which merged into CUCL on July 30, 2004.

As of December 31, 2004, our total CDMA subscriber base in our cellular service areas reached 27.81 million, representing an increase of 64.5% from 16.91 million subscribers at December 31, 2003. Among the total CDMA subscribers, post-paid subscribers increased by 60.9% from 16.05 million as of December 31, 2003 to 25.82 million as of December 31, 2004, while prepaid subscribers increased by 130.4% from 0.86 million as of December 31, 2003 to 1.99 million as of December 31, 2004. Pre-paid subscribers represented 7.2% of the total number of CDMA subscribers in 2004. We believe the rapid growth in our CDMA subscriber base was primarily attributable to:

expansion of our CDMA cellular services areas as a result of the acquisition of Unicom New World,

the advantages of the CDMA technology, including the lower radio transmitting power of CDMA handsets as compared to GSM handsets, better voice quality and enhanced security,

improved network coverage and quality, and

increased brand awareness and our promotions and marketing efforts.

*MOU, ARPU and Churn Rate*

In 2004, total MOU for our CDMA services was 82.96 billion minutes, an increase of 89.8% from 43.70 billion minutes in 2003, and ARPU for our CDMA services was RMB85.3, a decrease from RMB128.4 in 2003. Average MOU per subscriber per month for our CDMA services was 292.3 minutes, 54.7% higher than the average MOU of 188.9 minutes for GSM services, while our CDMA ARPU was 72.7% higher than the ARPU of RMB49.4 for our GSM subscribers. The reasons for the increase in MOU and the decrease in ARPU for our CDMA services in 2004 are similar to the reasons for similar trends in GSM services. See B. Business Overview Cellular Services GSM Cellular Services MOU and ARPU under this Item 4.

The churn rate for our CDMA services is calculated in the same way as the churn rate for our GSM services and was 17.9% in 2004, higher than the 11.5% in 2003, but significantly lower than the 27.6% churn rate for our GSM services. Loss of CDMA subscribers was primarily attributable to the following reasons:

(i) the termination of some CDMA subscribers at the end of their contract periods under the CDMA handset promotional packages we began to offer in 2002;

(ii) increased competition as the focus of growth gradually shifts from new subscribers to increased usage; and

(iii) an increasing percentage of our CDMA subscribers are subscribing to pre-paid CDMA services, which are characterized by a higher churn rate than post-paid services and led to some subscribers switching from post-paid services to pre-paid services.

*Payment Delinquency*

As of December 31, 2004, the doubtful debt ratio for CDMA cellular services in our cellular service areas, calculated as the amount of provision for doubtful debt divided by revenue from CDMA cellular services, is 2.7%, compared to 2.4% in 2003 for CDMA cellular services in the service areas of CUCL and Unicom New Century. We have taken various measures to control payment delinquency for our CDMA services, which measures are similar to the ones taken to control payment delinquency for our GSM services. See B. Business Overview Cellular Services GSM Cellular Services Payment Delinquency under this Item 4.

*Tariffs and Promotion*

The tariff rates for our CDMA services are generally the State guidance rates for cellular services without the 10% discount we are permitted to adopt for GSM services. However, we have adopted other promotional programs. Generally we charge our post-paid cellular subscribers the following categories of tariffs: basic monthly fees, usage charges for both incoming and outgoing calls, roaming charges, long-distance call charges and charges for value-added services. Pre-paid subscribers do not pay monthly fees but pay higher per-minute usage and roaming charges.

To accelerate the growth in our CDMA subscriber base, we began offering special handset promotional packages in the second half of 2002. Under the handset promotional packages, CDMA mobile handsets purchased by us from handset suppliers were given to certain CDMA subscribers for their use at no additional cost during specified contract periods, ranging from 6 months to 2 years. In return, subscribers were required to incur a minimum amount of service fees during the contract period. If the contractual subscribers can fulfill the minimum contract spending amounts, they will not need to repay the remaining costs of the CDMA handsets.

Due to the high cost of the handset promotional packages, we have attempted to reduce the use of such packages, and concentrated instead on alternative promotional programs to develop our CDMA services. We focused on expanding the sales and marketing channels for our CDMA services by significantly increasing the number of sales agents. We emphasize improving our customer services and introducing new value-added data services to our CDMA subscribers. We also launched several marketing campaigns in 2004, which included increased advertising for our CDMA services, promotion of various customized package service plans that gave subscribers more choices, promotion of our CDMA 1X value-added services and promotion of our Worldwind CDMA and GSM dual-mode services. In addition, we have adopted the policy to centralize the purchases of CDMA handsets to control the costs of our CDMA promotional packages.

***See D. Risk Factors*** – Risks Relating to Our Business – Our CDMA services have yet to gain a broad market acceptance in China and there is uncertainty over whether our CDMA services will succeed in gaining a broader market acceptance. under Item 3.