

CHINA UNICOM LTD  
Form 20-F  
June 29, 2006

# SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

## FORM 20-F

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

OR

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

**For the fiscal year ended December 31, 2005**

OR

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

**For the transition period from                      to /**

OR

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

**Date of event requiring this shell company report**

**Commission file number 1-15028**

## CHINA UNICOM LIMITED

(Exact Name of Registrant as Specified in Its Charter)

**N/A**

(Translation of Registrant's Name Into English)

**Hong Kong**

(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**

Ordinary shares, par value HK\$0.10 per share

**Name of Each Exchange On Which Registered**

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)

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

**None**  
(Title of Class)

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

As of December 31, 2005, 12,574,265,270 ordinary shares were issued and outstanding.

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes  No

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

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

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

Large Accelerated Filer  Accelerated Filer  Non-Accelerated Filer

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

Item 17  Item 18

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

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**NOTE REGARDING FORWARD-LOOKING STATEMENTS**

This annual report for the year ended December 31, 2005 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 upgrade and expand our networks and increase network efficiency,
- our ability to improve our existing services and offer and market new services,
- 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,
- our ability to upgrade and develop technology applications, and
- future regulatory and other developments in the Chinese telecommunications industry.

These 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 that may be beyond our control, 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 the People's Republic of China, or the PRC,
- the PRC government's decision in relation to the technology standards and licenses of third generation mobile telecommunication, or 3G,
- 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 PRC government's policies with respect to economic growth, consolidations of and other structural changes in the PRC telecommunications industry, foreign exchange, foreign investment and entry by foreign companies into China's telecommunications market.

In addition, our future capital expenditure and development plans are dependent on various factors, including, among others:

- the availability of adequate financing on acceptable terms,



- the adequate and timely supply of equipment when required, and
- the adequacy of currently available spectrum or availability of additional spectrum.

Please also see the D. Risk Factors section under Item 3.

#### **CERTAIN DEFINITIONS**

As used in this annual report, references to we, us, our, the Company and Unicom are to China Unicom Limited. Unless the context otherwise requires, these references include all of our subsidiaries. In respect of any time prior to our incorporation, references to we, us, 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, 2001, 2002, 2003, 2004 and 2005 and our selected consolidated balance sheet data as of December 31, 2001, 2002, 2003, 2004 and 2005. The selected consolidated balance sheet data as of December 31, 2004 and 2005 and income statement and cash flow data for the years ended December 31, 2003, 2004 and 2005 have been derived from our audited consolidated financial statements included in this annual report. The selected consolidated balance sheet data as of December 31, 2001, 2002 and 2003 and income statement and cash flow data for the years ended December 31, 2001 and 2002 have been derived from our audited consolidated financial statements that are not included in this annual report.

Our financial statements are prepared in accordance with Hong Kong Financial Reporting Standards and Hong Kong Accounting Standards, or HKFRS, which became effective on January 1, 2005. Prior to January 1, 2005, our financial statements were prepared in accordance with generally accepted accounting principles in Hong Kong, or HK GAAP. The adoption of HKFRS resulted in changes in certain accounting policies which have been reflected in the financial statements either in accordance with the transitional provisions in the applicable accounting standards or, to the extent there are no transitional provisions, applied retrospectively. Accordingly, the comparative financial data presented in this annual report for the years ended December 31, 2001, 2002, 2003 and 2004 have been restated, as applicable, to conform to the changed accounting policies. A detailed description is set forth in Note 2.2 to our consolidated financial statements.

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Financial statements prepared in accordance with HKFRS vary in certain material respects from generally accepted accounting principles in the United States, or US GAAP. In accordance with HKFRS, 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 HKFRS 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 HKFRS 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 have been accounted for as transfers of entities under common control. The financial statements prepared under US GAAP would have been retroactively 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 have been accounted for at historical cost and the results of operations of the acquired businesses would have been included in the consolidated financial statements for the earliest period presented.

Under HKFRS, 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.

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See Note 37 to the consolidated financial statements included in this annual report for a summary of the principal differences between HKFRS and US GAAP that have a significant effect on our financial statements.

	As of or for the year ended December 31						
	2001		2002		2003		2004
	(Restated)(1)		(Restated)(1)		(Restated)(1)		(Restated)(1)
	RMB		RMB		RMB		RMB
							2005
							US\$(2)
	(in millions, except number of shares and per share data)						
<b>Income Statement Data:</b>							
HKFRS							
Revenue (Turnover):							
Cellular Business	20,640		31,112		57,819		71,887
-GSM Business	20,640		27,890		41,153		47,509
-CDMA Business			3,222		16,667		24,378
Paging Business	4,342		2,161		1,403		
Long Distance Business	1,489		2,766		2,273		1,848
Data and Internet Business	1,820		2,793		3,437		3,663
Total service revenue	28,291		38,832		64,933		77,397
Sales of telecommunications Products	556		1,411		2,221		1,690
Total revenue	28,847		40,243		67,154		79,087
Costs and expenses	(23,554)	)	(32,912)	)	(58,538)	)	(71,127)
Income before income tax	5,493		6,311		6,198		6,471
Net income	4,660		4,649		4,269		4,493
-Basic net income per share(3)	0.37		0.37		0.34		0.36
-Number of shares outstanding for basic net income per share (in thousands)(3)	12,552,996		12,552,996		12,553,010		12,561,242
-Diluted net income per share(3)	0.37		0.37		0.34		0.36
-Number of shares outstanding for diluted net income per share (in thousands)(3)	12,552,996		12,552,996		12,556,728		12,593,054
-Basic net income per ADS(4)	3.68		3.69		3.41		3.58
-Number of ADS outstanding for basic net income per ADS (in thousands)(3)	1,255,300		1,255,300		1,255,301		1,256,124
-Diluted net income per ADS(4)	3.68		3.69		3.41		3.57
-Number of ADS outstanding for diluted net income per ADS (in thousands)(3)	1,255,300		1,255,300		1,255,673		1,259,305
US GAAP(5)							
Revenue	32,501		50,421		71,980		79,388
Operating income from continuing operations	7,921		9,759		10,710		8,185
Net income before discontinued operation, and cumulative effect of change in accounting policy	5,866		5,500		6,078		4,713
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
-Basic net income per share before discontinued operation and cumulative effect of change in	0.47		0.44		0.48		0.38
							0.40
							0.05

accounting policy(3)

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	As of or for the year ended December 31									
	2001 (Restated)(1)		2002 (Restated)(1)		2003 (Restated)(1)		2004 (Restated)(1)		2005	2005
	RMB		RMB		RMB		RMB		RMB	US\$(2)
	(in millions, except number of shares and per share data)									
-Basic net income per ADS before discontinued operation and cumulative effect of change in accounting policy(4)	4.67		4.38		4.84		3.75		3.99	0.49
-Basic net income per share after discontinued operation and cumulative effect of change in accounting policy(3)	0.41		0.40		0.38		0.38		0.40	0.05
-Basic net income per ADS after discontinued operation and cumulative effect of change in accounting policy(4)	4.11		4.01		3.77		3.75		3.97	0.49
<b>Balance sheet Data:</b>										
<b>HKFRS</b>										
Bank balances and cash	18,413		14,433		9,220		4,655		5,472	678
Property, plant and equipment	75,493		107,216		117,863		118,492		116,056	14,381
Total assets	130,118		152,095		152,870		149,038		142,630	17,674
Short-term debt and current portion of other long-term debt	7,933		15,330		18,173		20,015		22,035	2,730
Obligations under finance lease-current portion	8		17		25		938		421	52
Obligations under finance lease-non-current portion	101		101		100		489		145	18
Other long-term debt	36,337		37,686		36,213		26,137		11,982	1,485
Shareholders' equity	61,943		66,572		69,052		72,442		76,287	9,453
<b>US GAAP (Restated)(5)</b>										
Property, plant and equipment			118,787		118,171		118,701		116,232	14,403
Total assets			164,636		150,477		146,615		139,958	17,343
Obligations under finance lease-current portion			17		25		938		421	52
Obligations under finance lease-non-current portion			101		100		489		145	18
Other long-term debt			45,520		36,213		26,137		11,982	1,485
Shareholders' equity			64,215		65,946		69,442		73,265	9,078
<b>Other Financial Data:</b>										
<b>HKFRS:</b>										
Net cash provided by operating activities	11,078		13,054		22,565		23,819		30,804	3,817
Net cash used in investing activities	(46,125)	)	(5,166)	)	(19,051)	)	(18,958)	)	(16,748)	(2,075)
Net cash provided by (used in) financing activities	8,743		(11,868)	)	(8,778)	)	(9,401)	)	(13,213)	(1,637)
<b>US GAAP (Restated)(5):</b>										
Net cash provided by operating activities	15,320		18,235		25,993		24,510		31,486	3,902
Net cash used in investing activities	(62,971)	)	(10,261)	)	(20,295)	)	(19,668)	)	(17,431)	(2,160)



	As of or for the year ended December 31							
	2001 (Restated)(1)	2002 (Restated)(1)	2003 (Restated)(1)	2004 (Restated)(1)	2005	2005		
	RMB	RMB	RMB	RMB	RMB	US\$(2)		
	(in millions, except number of shares and per share data)							
Net cash provided by (used in) financing activities	21,015	(12,773)	(11,397)	(9,440)	(13,213)	(1,637)		

(1) The adoption of HKFRS on January 1, 2005 resulted in changes in certain accounting policies which have been reflected in the financial statements either in accordance with the transitional provisions in the applicable accounting standards or, to the extent there are no transitional provisions, applied retrospectively. Accordingly, the comparative financial data prior to January 1, 2005 presented herein have been restated, as applicable, to conform to the changed accounting policies. See Note 2.2 to our consolidated financial statements included in this Form 20-F for detailed discussion.

(2) The translation of RMB into US dollars has been made at the rate of RMB8.0702 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 30, 2005. The translations are solely for the convenience of the reader.

(3) See Notes 29 and 37 to the financial statements included in this Form 20-F on how basic and diluted net income per share are calculated under HKFRS 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 and for each of the relevant years ended on December 31, 2005, 2004, 2003 and 2002 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 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 Kong 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 RMB8.0702 to US\$1.00 and HK\$7.7533 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 30, 2005.

The noon buying rates on June 28, 2006 were RMB7.9970 to US\$1.00 and HK\$7.7678 to US\$1.00, respectively. The average noon buying rates for 2001, 2002, 2003, 2004 and 2005 were RMB8.2772, RMB8.2771, RMB8.2772, RMB8.2768 and RMB8.1826, respectively, to US\$1.00, and HK\$7.7996, HK\$7.7996, HK\$7.7864, HK\$7.7899 and HK\$7.7755, 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 (RMB per US\$1.00)	Low (RMB per US\$1.00)	High (HK\$ per US\$1.00)	Low (HK\$ per US\$1.00)
December 2005	8.0808	8.0702	7.7548	7.7516

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January 2006	8.0702	8.0596	7.7571	7.7506
February 2006	8.0616	8.0415	7.7618	7.7564
March 2006	8.0415	8.0167	7.7618	7.7564
April 2006	8.0248	8.0040	7.7598	7.7529
May 2006	8.0300	8.0005	7.7575	7.7510

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**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 intensify and result in slower subscriber growth, lower tariffs and higher customer acquisition costs for us, which would materially adversely affect our financial condition, results of operations and growth prospects.*

Our cellular businesses face intense competition from China Mobile. China Mobile is the largest cellular operator in China and has competitive advantages over us in areas such as customer base, financial resources and brand recognition. We are experiencing intense competition from China Mobile in our cellular service areas, and such competition may continue and 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. Moreover, China Mobile has announced its intention to launch 3G cellular services in the future, which could further intensify the competition with our cellular businesses, particularly our CDMA services.

Our cellular services also compete with the local wireless telecommunications services of China Telecom and China Netcom in their respective service areas, known as Little Smart services, which are based on their fixed line networks and primarily utilize the personal handy-phone 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. Currently these services have attracted over 90 million users in China and their subscriber base is continuing to grow. In addition, both China Telecom and China Netcom have announced their intention to develop 3G cellular services in the future, which would impose direct competition with our cellular business.

Increased competition from China Mobile, China Telecom and China Netcom could lead to slower subscriber growth, lower traffic volume of our services, continued price pressure and higher costs of customer acquisition, which may materially adversely affect our financial condition, results of operations and growth prospects.

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***Our CDMA services may not succeed in gaining a broader market acceptance in China.***

We are the only cellular operator offering CDMA services in China. Prior to the introduction of our CDMA services in 2002, 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 continue 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 a new phone number. CDMA services are also perceived to have limitations in international roaming due to the lack of CDMA networks in many countries. In addition, CDMA handsets are generally more expensive than GSM handsets. As of December 31, 2005, the total number of our CDMA subscribers has reached 32.72 million in our service areas. Nevertheless, in comparison with 393 million cellular subscribers in China as of December 31, 2005, CDMA services have yet to gain a 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, among others:

- 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; and
- whether we can generate more revenues from value-added services by capitalizing the technological advantages of CDMA 1X wireless data services.

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

***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, since we have expanded our CDMA services into the mass market, our CDMA business may compete with our GSM business for 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 financial condition, results of operations and growth prospects may be adversely affected.

***Failure to continually expand and upgrade our networks and infrastructure or changes in telecommunications technology and technological standards could adversely affect our competitive position and 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 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 technology migration to 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 our existing networks and infrastructure or construct new networks and infrastructure, which may require substantial capital expenditures and other resources.

Our ability to expand and upgrade our networks and infrastructure 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;
- obtain relevant government licenses, permits and approvals;
- manage the technology migration in an effective manner;
- obtain adequate network equipment and software;
- retain experienced management and technical personnel;
- obtain sufficient spectrum frequencies, network numbers and other telecommunication resources controlled by the PRC government;
- gain access to the sites for network construction or upgrade; and
- enter into interconnection and other arrangements with other operators.

If we are not able to timely and effectively overcome these uncertainties and other difficulties we may encounter in expanding and upgrading our networks and infrastructure, our competitive position, financial condition, results of operations and growth prospects may be adversely affected.

***We may be unable to fund our capital expenditure and debt service requirements, which may adversely affect our financial condition and growth prospects.***

We continue to have a significant level of capital expenditure and debt service requirements. We plan to spend approximately RMB22.00 billion for capital expenditure in 2006, an increase of RMB4.39 billion or 24.9% from 2005. As of December 31, 2005, 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 RMB28.3 billion. See

Liquidity and Capital Resources 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 condition, competitive position and growth prospects. Our ability to obtain acceptable financing at any time may depend on a number of factors, including, among others:

- our financial condition and results of operations,
- our creditworthiness and relationship with lenders,
- 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 financings.



***The CDMA handset promotional packages have increased our costs and expenses 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 maximum contract period is two years. 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 period during which we expect to receive the minimum contract revenue. Therefore, these promotional packages tend to increase our costs and expenses.

While we substantially reduced the use of such CDMA handset promotional packages since 2003, the carrying amount of the deferred customer acquisition costs remain significant. For the year ended December 31, 2005, amortization of such deferred customer acquisition costs amounted to approximately RMB5,948 million and the carrying amount of such costs amounted to RMB2,944 million as of December 31, 2005. As a result, while 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 financial condition and 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 since 2005. In July 2005, we established a subsidiary, Unicom Huasheng Telecommunications Technology Company Limited, or Unicom Huasheng, which primarily manages the purchase and distribution of CDMA handsets for us. Such centralized purchase policy has resulted in us maintaining a certain level of inventory of CDMA handsets that is subject to the risk of inventory obsolescence. As of December 31, 2005, we maintained an inventory of CDMA handsets of RMB930 million.

***Our long distance, data and Internet businesses remain relatively small*** comparing to China Telecom and China Netcom, and competition from China Telecom, China Netcom and other telecommunication service providers may adversely affect our profitability and growth 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, or PSTN, 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, fixed 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 2005, intense competition has continued to contribute to the decreases in average realized tariff rates for long distance services and in our 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. Competition from China Telecom, China Netcom and other service providers may continue to adversely affect the profitability and growth of our long distance, data and Internet businesses and consequently our overall financial condition and results of operations.

***Our churn rates and doubtful debt ratio*** may increase.

The monthly average churn rate of our GSM cellular services slightly increased from 2.30% in 2004 to 2.41% in 2005. Such increase was primarily due to the following factors:

- intense competition from the GSM services of China Mobile and the Little Smart services of China Telecom and China Netcom;
- the increase in the proportion of cost-sensitive subscribers among new subscribers as a result of continuing expansion of our GSM cellular services in the mass market; and
- an increase in the proportion of subscribers to our pre-paid GSM services which are characterized by a higher churn rate than post-paid services.

Although the monthly average churn rate of our CDMA cellular services stood at 1.49% in 2005, the same level in 2004, there is no assurance that it will not increase in the future. Increased churn rates of our GSM and CDMA services may adversely affect our market share and increase our costs of additional customer acquisitions and bad debt, which would adversely affect our financial condition, results of operations and growth prospects.

China has yet to develop an effective credit control system, and with intense competition in the cellular telecommunication market, our doubtful debt ratio for cellular services, calculated as the amount of provision for doubtful debt divided by revenue from our cellular services, may increase in the future. While our doubtful debt ratio decreased from 2.8% as of December 31, 2004 to 1.8% as of December 31, 2005 due to our improved management of payment delinquency in 2005, there is no assurance that it will not increase in the future. If such ratio increases in the future, our financial condition and results of operations could be adversely affected.

***Obstacles in interconnection with networks of other telecommunication 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 telecommunication 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 profitability and growth. 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 financial condition, results of operation and growth prospects.

***Our controlling shareholder, Unicom Group, 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 52.36% of our issued share capital as of May 31, 2006. As our controlling shareholder, it is able to influence our major business decisions through its control of our board of directors. All 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. For example, Unicom Group 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 and customer 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 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.

***Investor confidence and the market prices of our shares and ADSs may be materially and adversely impacted if we are 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.***

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We are a public company in the United States that is subject to, among other things, the Sarbanes-Oxley Act of 2002. Section 404 of the Sarbanes-Oxley Act of 2002 requires that we include a report of management on our internal control over financial reporting in our Annual Report on Form 20-F that contains an assessment by management of the effectiveness of our internal control over financial reporting. In addition, our independent registered public accounting firm must audit and report on management's assessment of the effectiveness of our 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 conclude that our internal control over financial reporting is not effective. Even if our management concludes that our internal control over financial reporting 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 financial reporting or the level at which our controls are documented, designed, operated, reviewed or evaluated, or if the independent registered public accounting firm interprets the relevant requirements, rules or regulations differently from us, 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 could materially and adversely affect the market prices of our shares and ADSs.

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***We may incur increased costs as a result of being a public company.***

As a public company listed on the New York Stock Exchange and The Stock Exchange of Hong Kong Limited, we incur a higher level of accounting, legal and other expenses than many private companies. In addition, the Sarbanes-Oxley Act of 2002, as well as new rules subsequently implemented by the Securities and Exchange Commission, or the SEC, and the New York Stock Exchange, have required changes in corporate governance and internal control practices of public companies. We expect these new rules and regulations to increase our legal and financial compliance costs and to make certain corporate activities more time-consuming and costly. We are currently evaluating and monitoring developments with respect to these new rules, and we cannot predict the amount of additional costs we may incur or the timing of such costs.

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

***Regulatory or policy changes relating to the PRC telecommunications industry or future industry restructuring may materially adversely affect our financial condition, results of operations and growth prospects.***

The PRC government continues to regulate many aspects of the telecommunications industry in China. Potential 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 decisions or measures relating to issuance of 3G licenses or selection of 3G technology standards, 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 substantially affect our financial condition, results of operations and growth prospects. For example, if the PRC government decides to grant 3G licenses to one or more of our competitors but not to us, or deregulates or reduces state tariff rates applicable to some of our services, our results of operations and financial condition may be materially and adversely affected.

In addition, the PRC government has in the past restructured the telecommunications industry through a number of initiatives that were rolled out in stages 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 materially adversely affected by any such industry restructuring.

***Issuance of additional telecommunication service licenses, including 3G licenses, may further intensify competition in the PRC telecommunications industry and materially adversely affect our financial condition, results of operations and growth prospects.***

Since mid 1990s, the PRC 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 3G cellular services.



The PRC government has not publicly announced its decisions on the timing of the grant of the 3G licenses, the number of 3G licenses to be granted, or the selection of preferred 3G technology standards. The issuance of 3G licenses to cellular service providers may significantly change the overall competition environment of the wireless telecommunications industry and further intensify the competition among cellular service providers. While we have participated in the 3G trial tests sponsored by the MII and have been preparing for developing 3G business by upgrading our CDMA and/or GSM network and services, we cannot assure you that the PRC government will grant us the requisite approvals and license(s) in a timely or favorable manner, or at all. We cannot predict the 3G technology standards that may be selected by the PRC government for the 3G license(s) that may be granted to us. Even if we are granted one or more 3G licenses, we cannot assure you that we will successfully manage the technology migration to 3G and 3G operations and effectively compete with 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. By the end of 2006, there will be no geographic restriction for foreign telecommunication service provider to provide mobile voice and data telecommunication services in China. See *Regulatory and Related Matters* *Entry into the Industry* under Item 4. When the PRC government grants licenses to additional telecommunications service providers in the future, licensees may include foreign-invested operators. Such foreign-invested operators entering into China's telecommunications market may have competitive advantages over us in areas such as financial resources, network management and technical expertise.

Increased competition 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 costs and expenses, and thereby adversely affect our results of operations, financial condition and growth prospects.

*The telecommunications industry 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 43.3 million at the end of 1999 to 393 million by December 31, 2005. Cellular penetration increased from 3.5% to 30.3% nationwide during the same period. The growth in cellular subscribers has been slowing 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 RMB49.4 in 2004 to RMB48.5 in 2005. Any slow-down in the growth in China's telecommunications industry may adversely affect the growth and profitability of our business.

*The PRC 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 PRC government authorities, and the MII has the authority to delineate the scope of universal service obligations. 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 specific universal services obligations are 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 required major telecommunication service providers in China, including Unicom Group, to participate in a project to provide telephone services in thousands of remote villages in China. In participating in such project, Unicom Group, with our assistance, undertook the universal service obligation to extend telecommunication service coverage to a total of more than 4,600 administrative-level villages in 2004 and 2005 primarily through its CDMA and satellite transmission networks. In 2006, Unicom Group is required to extend telecommunication service coverage to more than 1,500 additional villages in remote areas. See B. Business Overview Regulatory and Related Matters Universal Services under Item 4.

We cannot predict whether the PRC government will specifically require us to undertake universal service obligations in the future. To the extent we are required to do so, it is currently uncertain whether we will be adequately compensated by the government or by the universal service fund. We cannot assure you that we will 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. Any of these events may adversely affect our financial condition 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 Doing Business in China**

*Our operations may be adversely affected by changes in China's economic, political and social conditions.*

Substantially all of our business operations are conducted in China and substantially all of our revenues are derived from our operations in China. Accordingly, our business, financial condition, results of operations and prospects are affected to a significant degree by economic, political and social conditions in China. The PRC economy differs from the economies of most developed countries in many respects, including with respect to the amount of government involvement, level of development, growth rate, control of foreign exchange and allocation of resources. While the PRC economy has experienced significant growth in the past three decades, growth has been uneven across different regions and among various economic sectors. The PRC government has implemented various measures to encourage economic development and guide the allocation of resources. Some of these measures benefit the overall PRC economy, but may also have a negative effect on us. For example, our financial condition and results of operations may be adversely affected by government control over capital investments or changes in tax regulations that are applicable to us. Since early 2004, the PRC government has implemented certain measures to control the pace of economic growth. These measures may cause a decrease in the level of economic activity in China, including a decline in individual spending activities, which in turn could adversely affect our financial condition and results of operations.

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

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The ability of our wholly-owned operating subsidiary, China Unicom Corporation Limited, or CUCL, 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-invested 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, which holds substantially all of our assets and through which we conduct substantially all of our business, is a foreign-invested enterprise 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, there is no assurance that the relevant PRC government authorities will not in the future impose any limitation on the ability of foreign-invested enterprises to purchase foreign exchange to satisfy their foreign exchange obligations or to pay dividends. In that event, CUCL's ability to satisfy its foreign exchange obligations and to pay dividends to us in foreign currencies may be restricted.

*Fluctuations in the value of the Renminbi could adversely affect the prices of our shares and ADSs as well as our profitability.*

Substantially all of our revenues and costs and expenses are denominated in Renminbi, while a portion of our borrowings, equipment purchases and other capital expenditures are denominated in foreign currencies. On July 21, 2005, the PRC government changed its decade-old policy of pegging the value of Renminbi to that of U.S. dollar. Under the new policy, the Renminbi is permitted to fluctuate within a narrow and managed band against a basket of certain foreign currencies determined by the People's Bank of China. The Renminbi may appreciate or depreciate significantly in value against the U.S. dollar or other foreign currencies in the long term, depending on the fluctuation of the basket of currencies against which it is currently valued, or it may be permitted to enter into a full float, which may also result in a significant appreciation or depreciation of the Renminbi against the U.S. dollar or other foreign currencies. 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 costs and expenses or lead to significant fluctuations in the exposure of our foreign-currency-denominated liabilities, thereby adversely affecting our profitability.

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

Our wholly-owned operating subsidiary, CUCL, is organized under the laws of PRC and is generally subject to laws and regulations applicable to foreign-invested 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 PRC 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 PRC legal system may not afford the same legal protection available to investors in the United States or elsewhere.

*Any future outbreak of health epidemics or other adverse public health developments may severely disrupt our business and operations.*

Adverse public health epidemics or pandemics could disrupt businesses and the national economy of China and other countries and regions where we do business. From December 2002 to June 2003, China and other countries experienced an outbreak of a new and highly contagious form of atypical pneumonia now known as severe acute respiratory syndrome, or SARS. Recently, some Asian countries, including China, have encountered incidents of the H5N1 strain of bird flu, or avian flu. We are unable to predict the effect, if any, that avian flu may have on our business. In particular, any future outbreak of SARS, avian flu or similar adverse public health developments may, among other things, significantly disrupt our ability to adequately staff our business, and may adversely affect our operations. Furthermore, an outbreak may severely restrict the level of economic activity in affected areas, which may in turn materially and adversely affect our business and prospects. As a result, we cannot assure you that any future outbreak of SARS, avian flu or similar adverse public health developments would not have a material adverse effect on our financial condition and results of operations.

#### **Item 4. Information on the Company**

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

###### **Industry Restructuring**

Since 1993, the PRC 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 PRC 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 PRC 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 PRC 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 proposal to establish Unicom Group in December 1993 and authorized it to build and operate cellular networks and local and long distance networks. Since its establishment in June 1994, 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 offers local telephony services in the municipalities of Chengdu, Chongqing and Tianjin. It also 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 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 indirectly controlled 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 Stock Exchange of Hong Kong Limited 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, the A Share Company successfully completed its IPO in the PRC and the listing of its ordinary shares on the Shanghai Stock Exchange, or A Shares. 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.

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 Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited, or the HKSE Listing Rules. 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 HKSE Listing Rules. 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 applied 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.

#### **Acquisitions of Unicom New Century and Unicom New World and the Sale of Guoxin Paging**

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.



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 Xizang Zang 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.

As a result of the acquisitions of Unicom New Century and Unicom New World, CUCL extended its cellular businesses to 30 provinces, autonomous regions and municipalities in China.

**Mergers of Unicom New Century and Unicom New World into CUCL**

On July 30, 2004, Unicom New Century was merged into CUCL and legally dissolved upon the completion of such merger. On September 1, 2005, Unicom New World was merged into CUCL and legally dissolved upon the completion of such merger.

**Acquisition of China Unicom International Limited**

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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 International'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 Unicom Macau and the Launch of CDMA Services in Macau**

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On October 15, 2004, we set up China Unicom (Macau) Company Limited, or Unicom Macau, in the Macau Special Administrative Region of the PRC, or Macau. In March 2005, the Macau government granted Unicom Macau a CDMA license, which allows Unicom Macau to provide roaming services and, subject to the Macau government's further approval, provide CDMA cellular services to local CDMA users in Macau after the first year of its operation. In October 2005, Unicom Macau completed the construction of CDMA network in Macau and launched the CDMA roaming service to CDMA users in Macau.

### **Incorporation of Unicom Huasheng**

On July 1, 2005, CUCL and Unicom Xingye Science and Technology Trade Co., or Unicom Xingye, a subsidiary of Unicom Group, incorporated Unicom Huasheng, a 95%-owned subsidiary of CUCL. Unicom Huasheng is principally engaged in sales of handsets and telecommunication equipment and provision of technical services for us.

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### **Share Segregation Reform of the A Share Company**

On May 11, 2006, the relevant shareholders of the A Share Company approved a proposal by all the holders of the non-tradable shares of the A Share Company, including Unicom Group, to convert their non-tradable shares into shares that are listed and tradable on the Shanghai Stock Exchange. This proposal was made pursuant to and in compliance with PRC regulations in respect of share segregation reform of companies listed in the PRC. In connection with the conversion of all non-tradable shares into tradable shares, holders of the non-tradable shares of the A Share Company will transfer to each holder of tradable shares 2.8 non-tradable shares for every ten tradable shares held by such holder as of May 17, 2006. The tradable shares converted from non-tradable shares are subject to certain lock-up restrictions as required by the relevant PRC regulations. As a result of the implementation of this proposal, Unicom Group's ownership interest in the A Share Company decreased from 69.32% to 60.74%.

As of May 31, 2006, Unicom Group held a 60.74% equity interest in the A Share Company. The A Share Company in turn held 82.10% of the total equity interest in Unicom BVI, with the remaining 17.90% held directly by Unicom Group. Unicom BVI continues to hold 77.27% of our outstanding shares and Unicom Group remains our ultimate controlling shareholder. See also the chart below for the current shareholding structure of our company.

Set forth below is our shareholding structure and subsidiaries as of May 31, 2006.

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**Our Relationship with Unicom Group**

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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 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 for a detailed description of our agreements with Unicom Group.

Unicom Group has constructed nationwide cellular networks based on CDMA IX technology. 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 March 2005, we entered into a new CDMA lease agreement with Unicom Group to replace the then existing CDMA lease agreements. Unicom Group only operates its CDMA networks in Guizhou province, which is outside of our cellular service areas. 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 2006. We have not undertaken any significant divestitures.

### **B. Business Overview**

#### **General**

We are an integrated telecommunications operator in China, offering a comprehensive range of telecommunications services, including cellular, international and domestic long distance, data and Internet services based on our advanced, uniform nationwide network system. We offered cellular communications services based on both GSM and CDMA technologies in 30 provinces, autonomous regions and municipalities in China (i.e., all provinces, autonomous regions and municipalities in China except for Guizhou province). We and China Mobile are currently the two cellular service providers in our cellular service areas.

We had a total of 95.07 million GSM cellular subscribers in our cellular service areas as of December 31, 2005, representing a 12.7% increase from 84.27 million subscribers as of December 31, 2004. Our GSM cellular business accounted for 59.9% of our total revenue in the year ended December 31, 2005. We had approximately 32.72 million CDMA cellular subscribers in our cellular service areas as of December 31, 2005, representing a 17.6% increase from 27.81 million subscribers as of December 31, 2004. Our CDMA Cellular business contributed 34.8% of our total revenue in the year ended December 31, 2005. At the end of 2005, our market share in our cellular service areas was 34.5%, slightly decreasing from 35.6% at the end of 2004.

We provide international and domestic long distance, data and Internet services nationwide in China. These businesses currently represent a relatively small portion of our overall business. Our long distance, data and Internet businesses collectively accounted for 5.3% of our total revenue in 2005, compared to 7.0% in 2004. Outgoing public switched and IP telephony long distance calls totaled 10.48 billion and 14.73 billion minutes, respectively, in 2005, compared to 10.10 billion and 13.95 billion minutes, respectively, in 2004. Our incoming international long distance calls (including incoming calls from Hong Kong, Macau and Taiwan) totaled 2.59 billion minutes in 2005, down from 2.75 billion minutes in 2004. As of December 31, 2005, the bandwidth of our data network, international interconnection bandwidth and domestic interconnection bandwidth had reached 54,828MGbps, 4,272MGbps and 17,755MGbps, respectively. We had 8.53 million Internet subscribers at the end of 2005.

Our fiber optic transmission network continued to expand in 2005. As of December 31, 2005, the total cable length of our transmission network reached 796,000 km, including 122,000 km for our backbone transmission network, representing an increase of 11.8% and 1.7%, respectively, from the end of 2004.

#### **Recent Developments**

As of March 31, 2006, the total number of our GSM subscribers in our cellular service areas has increased to 97.91 million, including 49.71 million post-paid subscribers and 48.20 million pre-paid subscribers. As of March 31, 2006, we also had a total of 33.64 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 218.9 minutes for the three months ended March 31, 2006. Average MOU per subscriber per month for CDMA services in combined service areas were 264.1 minutes for the three months ended March 31, 2006. ARPU for GSM services in our combined service areas was RMB49.4 for the three months ended March 31, 2006. ARPU for CDMA services in our combined service areas was RMB68.5 for the three months ended March 31, 2006. For the three months ended March 31, 2006, outgoing public switched and IP telephony long distance calls totaled 2.40 billion minutes and 3.28 billion minutes, respectively. As of March 31, 2006, we had 8.04 million Internet subscribers.

On June 20, 2006, we entered into a strategic alliance framework agreement with SK Telecom Co., Ltd., or SKT, a mobile telecommunications service provider in Korea. Pursuant to this agreement, we and SKT agreed to cooperate on the further development of CDMA cellular communication services in China. We have appointed SKT as our sole and exclusive partner in relation to our CDMA cellular communication business operations for a maximum period of 18 months in PRC in the areas of CDMA handsets, value-added services and related business platform, marketing, information technology infrastructure and network technologies. Detailed terms of our business cooperation with SKT will be negotiated in the future and set forth in definitive legal agreements to be entered into by us and SKT. We and SKT will establish a joint designated team to implement the business cooperation initiatives. In addition, pursuant to this agreement, if SKT and/or any of its affiliates, individually or collectively, hold more than 5% of our issued share capital, SKT will be entitled to nominate a representative to our board of directors. SKT has undertaken to cause such director to resign if it and/or its affiliates, individually or collectively, hold no more than 5% of our issued share capital for a period of three months.

On June 20, 2006, we and SKT also entered into a subscription agreement whereby SKT agreed to subscribe for US\$1,000,000,000 zero coupon convertible bonds due 2009 to be issued by us on July 5, 2006, or such other date agreed by us and SKT which may not be later than July 12, 2006. Subject to certain adjustments pursuant to the terms of the bonds, such bonds can be converted into our ordinary shares one year after the issuance at an initial conversion price of HK\$8.63 (US\$1.11) per share, representing a 28.8% premium over the closing price of our ordinary shares on the Hong Kong Stock Exchange on June 20, 2006. Assuming a full conversion of the bonds at this initial conversion price, the bonds would be convertible into 899,745,075 ordinary shares, representing approximately 7.15% of our issued and outstanding share capital as of June 20, 2006 and approximately 6.67% of our enlarged issued and outstanding share capital as of the date of the conversion. Unless previously redeemed, converted or purchased and cancelled pursuant to the terms of the bonds, we will redeem all the outstanding bonds at 104.26% of their principal amount on July 5, 2009. In addition, the holders of such bonds, with prior written notice to us, may require us to redeem, on July 5, 2008, all or a portion of their bonds at 102.82% of the principal amount of the bonds to be redeemed. The proceeds from this issuance of convertible bonds are currently intended to be used for general operational purposes.

### **Cellular Services**

Our cellular business is our largest business, with our GSM and CDMA businesses together having contributed 94.7% of our total revenue in 2005.

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 248 operators in 118 countries and regions and CDMA international roaming services in conjunction with 18 operators in 15 countries and regions.

In 2004, we began to offer GSM and CDMA dual mode cellular handset service under the brand name Worldwind. In April 2005, we launched Worldwind dual-mode card service based on the handset business. As of December 31, 2005, we had 254,000 Worldwind dual-mode service subscribers.

In October 2005, we successfully launched the CDMA network in Macau to provide roaming services for all CDMA users in Macau. This was the first time a PRC telecommunications operator launched a cellular network outside mainland China.

We also offer a broad range of value-added services to our cellular subscribers, including short message services, or SMS, personalized call-back ring tone services, CDMA 1X wireless data services and GSM wireless data services, under the integrated business brand of uni, which represents various wireless value-added services we offer for our cellular subscribers. In 2005, the proportion of our total cellular service revenue generated from value-added services increased to 15.0% from 10.1% in 2004.

### **GSM Cellular Services**

We centrally plan and oversee our GSM cellular business, which are operated by provincial branches of our operating subsidiary, CUCL. 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 2005, 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. In addition, we upgraded our GSM networks in 2005 to launch general packer radio service, or GPRS, services in Beijing, Shanghai, Guangzhou,



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Shenzhen, Zhuhai, Dongguan and Suzhou. In 2006, we plan to upgrade our GSM networks in additional 50 to 100 major cities to offer GPRS services in those cities.

### *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 mass market subscribers and target our post-paid services at consumers who have relatively high usage of telecommunication services.

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We grant tailored credit lines to post-paid service subscribers based on their usage and creditworthiness. 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 per-minute usage and roaming charges. We maintain and update detailed customer data for post-paid subscribers and implement other credit control measures to ensure they generally have good creditworthiness.

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. We do not grant credit lines to our pre-paid service subscribers.

Our pre-paid services target mass market cellular subscribers. These services are generally supported by intelligent networks built by us. The intelligent network platform enables us to offer nationwide roaming services and monitor in real time the account balance of pre-paid subscribers.

*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, 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(6) as of or for the year ended December 31	CUCL(6), as of or for the three months ended March 31,
	2003	2004	2005	2006
Number of subscribers (in thousands)	63,923	84,267	95,071	97,908
Post-paid	32,458	42,844	48,166	49,711
Pre-paid	31,465	41,423	46,905	48,197
Estimated market share in our service areas(1)	27.4	% 26.8	% 25.6	% 25.2
Average churn rate(2)	29.1	% 27.6	% 28.9	% 7.2
Average minutes of usage per subscriber per month(3)	173.70	188.9	202.2	218.9
Average revenue per subscriber per month (in RMB)(4)	56.74	49.4	48.5	49.4
SMS Volume (in billions)	25.034	32.39	39.51	12.91

(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.

(6) Includes Unicom New Century and Unicom New World, which merged into CUCL on July 30, 2004 and September 1, 2005, respectively.

*Subscriber Increase:* Our subscriber base continued to grow rapidly. As of December 31, 2005, the total number of GSM subscribers in our cellular service areas increased to 95.07 million, including 48.17 million post-paid subscribers and 46.91 million pre-paid subscribers. Our share of the cellular market in terms of total cellular subscribers in our GSM cellular service areas was 34.5% as of December 31, 2005. We attracted 27.4% of the net cellular subscriber additions in those service areas during 2005. 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) our sales and marketing efforts, (iii) relatively competitive pricing of our services and (iv) our customer service.

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*Pre-paid Subscribers:* The rate of increase in our pre-paid subscribers has generally been at the same level as the rate of increase in our post-paid subscribers in recent years. As of December 31, 2005, we had 46.91 million pre-paid subscribers in our cellular service areas, representing 49.3% of our total subscriber base, an increase of 0.1% from 49.2% as at the end of 2004.

*MOU and ARPU:* MOU and ARPU of our GSM services were 217.44 billion minutes and RMB48.5, respectively, in 2005. The average MOU per subscriber per month was 202.2 minutes in 2005, an increase of 13.3 minutes from 188.9 minutes in 2004. The increase in MOU was attributable to increased competition with our competitor, which resulted in the provision of more call minutes in the package service plans offered to subscribers. The decreasing effective tariffs as a result of such competition also encouraged higher usage among subscribers. ARPU of our GSM services continued to decline from RMB49.4 in 2004 to RMB48.5 in 2005, which decline was attributable to intensified market competition and regional promotional activities that led to a decline in effective tariffs, as well as the fact that an increasing proportion of our new subscribers are mid- to low-end users. Our pre-paid subscribers in general have lower MOUs and ARPUs compared to our post-paid subscribers.

*Churn Rate:* For the year ended December 31, 2005, the churn rate for GSM services in our cellular service areas increased from 27.6% in 2004 to 28.9% primarily as a result of intensified competition and the fact that a larger portion of our GSM subscribers are low- to mid-end subscribers. Our calculation of churn rate reflects those subscribers who switch to services of other operators and those whose services we terminate as a result of account inactivity or payment delinquency.

As competition continues to intensify, our churn rate from subscribers voluntarily discontinuing our services may further 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 price sensitivity and the migrant and temporary nature of many pre-paid subscribers.

*Payment Delinquency:* Payment delinquency stabilized in 2005. As of December 31, 2005, 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 1.7%, significantly lower than the 2.8% at the end of 2004. The decrease was primarily due to our improved management of payment delinquencies. 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 the categories of tariffs we charge our cellular subscribers include, among others, basic monthly fees, usage charges for both local incoming and outgoing calls, domestic and international roaming charges, long-distance call charges and charges for value-added services.

The cellular tariffs are set forth by the MII and tariff adjustments are subject to regulation by various government authorities, including the MII, the National Development and Reform Commission and 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 the PRC telecommunications industry or future industry restructuring may materially adversely affect our financial condition, results of operations and growth 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 PRC 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 2005, 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. We also further centralized the package service planning to provincial-level branches and higher.

#### **CDMA Cellular Services**

Our controlling shareholder, Unicom Group, currently has the exclusive license to offer CDMA cellular services in China. It has constructed a CDMA network with comprehensive nationwide coverage through its wholly-owned subsidiary, Unicom New Horizon Mobile Telecommunications Company Limited, or Unicom New Horizon. We have leased CDMA network capacity from Unicom Group and offer CDMA cellular services and CDMA 1X wireless data 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.

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.

By the end of 2005, Unicom Group has substantially completed the third phase of the CDMA network construction, which increased the total CDMA network capacity to 82.2 million subscribers, with 80.8 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.

#### *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 New 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 New Horizon on similar terms and conditions. We entered into a new, consolidated lease agreement, or the New CDMA Lease, with Unicom Group and Unicom New Horizon on March 24, 2005 to replace the three then existing lease agreements, or the Old CDMA Leases. See B. Related Party Transactions Leasing of CDMA Network Capacity under Item 7.

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. The term of the New CDMA Lease may be renewed at our option, with the length of the renewed term to be agreed upon. We are currently considering our renewal option upon the expiration of the initial two-year term of the New CDMA Lease.

We lease all constructed CDMA 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.

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 New Horizon and us. It will be based on the appraisal value of the CDMA network determined by an independent appraiser 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 would, taking into account all lease fee payments made by us to Unicom New Horizon and lease fee discounts as a result of any delay of delivery, enable Unicom New 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 the HKSE Listing Rules, including approvals of our minority shareholders for connected transactions. 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 wireless data services. 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.

In August 2004 and April 2005, we launched CDMA and GSM dual-mode cellular handset and card services, respectively, under the brand name Worldwind. As of December 31, 2005, we had approximately 254,000 subscribers of the Worldwind dual-mode cellular services.

Worldwind dual-mode 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, 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(6) as of or for the year ended December 31	CUCL(6) as of or for the three months ended March 31,
	2003	2004	2005	2006
Number of subscribers (in thousands)	16,910	27,814	32,722	33,636
Post-paid	16,046	25,824	30,010	30,888
Pre-paid	864	1,991	2,713	2,748
Estimated market share in our service areas(1)	7.2	% 8.8	% 8.8	% 8.7
Average churn rate(2)	11.5	% 17.9	% 17.9	% 4.6
Average minutes of usage per subscriber per month(3)	337.5	292.3	276.9	264.1
Average revenue per subscriber per month (in RMB)(4)	128.4	85.3	75.1	68.5
SMS Volume (in billions)	6.231	11.83	15.02	4.15

(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.
- (6) Includes Unicom New Century and Unicom New World, which merged into CUCL on July 30, 2004 and September 1, 2005, respectively.

As of December 31, 2005, our total CDMA subscriber base in our cellular service areas reached 32.72 million, representing an increase of 17.7% from 27.81 million subscribers at December 31, 2004. Among the total CDMA subscribers, post-paid subscribers increased by 16.2% from 25.82 million as of December 31, 2004 to 30.01 million as of December 31, 2005, while pre-paid subscribers increased by 36.2% from 1.99 million as of December 31, 2004 to 2.71 million as of December 31, 2005. Pre-paid subscribers represented 8.3% of the total number of CDMA subscribers in 2005. We believe the growth in our CDMA subscriber base was primarily attributable to:

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- increased brand awareness and our promotions and marketing efforts, including our adoption of new handset subsidizing policy that ties the handset subsidy to subscribers committed service fees,
- the availability of more affordable quality CDMA handsets as a result of our centralized purchasing policy,
- improved network coverage and quality, and
- 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.

*MOU, ARPU and Churn Rate*

In 2005, total MOU for our CDMA services was 101.75 billion minutes, an increase of 22.6% from 82.96 billion minutes in 2004, and ARPU for our CDMA services was RMB75.1, a decrease from RMB85.3 in 2004. Average MOU per subscriber per month for our CDMA services was 276.9 minutes, 36.9% higher than the average MOU of 202.2 minutes for GSM services, while our CDMA ARPU was 54.8% higher than the ARPU of RMB48.5 for our GSM subscribers. The reasons for the increase in MOU and the decrease in ARPU for our CDMA services in 2005 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 17.8% in 2005, same as that in 2004, but is significantly lower than the 28.9% churn rate for our GSM services.

*Payment Delinquency*

As of December 31, 2005, 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 1.7%, significantly lower than 2.6% in 2004. 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 CDMA subscribers the following categories of tariffs: basic monthly fees, usage charges for both local incoming and outgoing calls, domestic and international roaming charges, long-distance call charges and charges for value-added services.

To accelerate the growth in our CDMA subscriber base, we have been offering certain CDMA handset promotional packages since the second half of 2002, providing discounts towards our customers' CDMA handset purchase prices on the basis of their committed minimum amount of monthly service fees.

Due to the high cost of the handset promotional packages and the improved coverage of CDMA network, as well as the increasing CDMA 1X functions, we have reduced the use of such packages recently, and concentrated instead on alternative promotional programs to develop our CDMA services. We offer differentiated services with various combination of voice and value-added services to effectively target various market sectors. In addition, we focused on expanding the sales and marketing channels for our CDMA services by significantly increasing the number of sales agents. Moreover, we have established a subsidiary, Unicom Huasheng, in 2005 to centralize the purchases and distribution of CDMA handsets to control the costs of our CDMA promotional packages.

*See D. Risk Factors Risks Relating to Our Business Our CDMA services may not succeed in gaining a broader market acceptance in China.* under Item 3.

#### **Value-added Services**

By leveraging our integrated telecommunication operations and advanced network system, we offer a broad range of value-added cellular services under a uniform business brand of uni , including SMS, wireless internet services, personalized call-back ring tone services and other wireless information services. Our value-added services have achieved rapid growth in recent years.

The volume of our SMS continued to increase rapidly in 2005. A total number of 54.53 billion short messages were transmitted by our GSM and CDMA subscribers in 2005, an increase of 23.3% over 2004. Our SMS services mainly include the following services: SMS transmission and receipt through handsets, service provider-assisted SMS, business SMS platform, voice SMS and other information services. We continue to promote the use of SMS as a convenient and cost effective method of business and personal communication. The SMS platforms of our GSM and CDMA networks are interconnected with each other. Our SMS platforms are also interconnected with the SMS platforms of China Mobile s GSM network, China Telecom s Little Smart network, and China Netcom s Little Smart network.

In August 2001, Unicom Group and we launched our nationwide GSM wireless data services under the service brand of Uni-Info . The Uni-Info services are based on a nationwide wireless information services platform and offer a variety of services including games, downloads and other entertainment services, information and notification services, personal information management and transactions services. We and Unicom Group cooperate with a number of national and regional service providers that supply our subscribers with Uni-Info services.

In March 2003, we launched CDMA 1X wireless value-added services under the uniform business brand of uni , with individual services offered under various sub-brands, including Uni-Info , U-Info , U-Net , U-Mail , U-Magic , U-Map and Uni-Web . U-Info services allow users and browse the Internet on their CDMA handsets. U-Net provides high-speed wireless Internet access to laptop computers and mobile handheld devices equipped with a wireless Internet card. U-Mail services allow users to (i) send and receive e-mails, either from other e-mail accounts or from the Internet and (ii) download and read attachments to the e-mail sent to the user s handset. U-Magic services allow users to download certain applications from the Internet to expand the functions of their handsets. These expanded functions include games, entertainment services, information services, image browsing and download services, music listening and browsing services and other applications. U-Map services provide location-based information to users handsets. Retail users can find locations and research information with respect to a particular location. This service also offers industrial applications, such as the logistics industry and sea rescue services. Uni-Web offers a series of services based on CDMA 1X technology, such as video pay-per-view, video download and video streams. In 2005, we focused our efforts in promoting CDMA 1X wireless value-added services in three areas: (1) increasing the market penetration, (2) easing the handset supply bottleneck by centralizing the purchase and distribution of CDMA handsets and (3) offering new services and service contents to activate more market demand. By the end of 2005, we had 15.05 million subscribers of CDMA 1X wireless value-added service, an increase of 72.7% over 2004.

In late 2003, we began to provide personalized call-back ring tone service under the brand name Cool Ringtong, which allows a cellular subscriber to select personalized ring tones that his or her callers will hear after dialing his or her cell phone number. This new value-added service has grown rapidly since its introduction. As of December 31, 2005, we had a total number of 21.95 million subscribers of our Cool Ringtong services, representing 17.2% of our total cellular subscriber base.

In 2004 and 2005, in order to develop our value-added services, we took the following measures:

- Through the improvement of the value-added services, more staff training, advertising and promotions, trial programs and our various other efforts, we strengthened marketing efforts for our value-added services under the uniform business brand of uni;
- We improved the content of our value-added services, through strengthening service support of and cooperation with content providers and service providers, in order to increase the appeal of these services;
- Through cooperation with partners in specific industries, we launched new applications such as Police Horizon, Maritime Horizon, Stock-in-Palm and Traffic Horizon; and
- We introduced value-added services specifically catering to the youth to support the launch of the U-Power customer brand that is designed for the youth market.

We have designed a fee structure under which we earn transmission fees from the use of our GSM and CDMA value-added services and charge a certain percentage of information service fees for the billing and collection services we provide to content providers and service providers.

#### **Long Distance, Data and Internet Services**

We offer international and domestic long distance services in China based on both the PSTN standard and the IP telephony standard. We leverage our ability to integrate our long distance services with a broad range of services to target different customer segments. We have also developed a nationwide video-conferencing network that reaches over hundreds of cities. We also offer data and Internet services throughout China. Our long distance, data and Internet services are supported by our advanced, unified nationwide network system.

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The following table sets forth the total number of outgoing call minutes for our long distance services, leased bandwidth of our data services and number of dedicated access subscribers of Internet services for the periods indicated.

	As of or for the year ended December 31,		
	2003	2004	2005
Public switched telephony (in billions of minutes):			
Domestic	8.31	9.94	10.33
International	0.13	0.16	0.15
Total	8.44	10.10	10.48
IP telephony (in billion of minutes):			
Domestic	11.25	13.81	14.60
International	0.14	0.14	0.13
Total	11.39	13.95	14.73
Data Services			
Bandwidth leased to customers (2Mbps)	7,194	9,007	8,706
Internet Services			
Dedicated access subscribers	47,750	61,569	38,000

**Public Switched Telephony Services**

We offer PSTN services to business and residential customers who register their telephone numbers with us. They can access our services by dialing a prefix of 193 . We also distribute pre-paid long distance calling cards that purchasers can use to access our services by dialing a prefix of 193300 . For some corporate and government customers, we also offer our public switched long distance services over dedicated lines, frequently as part of our integrated offerings of long distance and data services.

The following table sets forth selected information about our PSTN services for the periods indicated.

	As of or for the year ended on December 31,		
	2003	2004	2005
Number of cities reached	329	332	333
Minutes of outgoing long distance calls (in billion)	8.44	10.10	10.48
Market share of outgoing long distance call minutes(1)	14.33	% 13.6	% 11.57
Minutes of incoming international calls (in billion)	1.78	2.47	2.34

(1) *Source:* MII. In calculating market share, the total minutes of outgoing long distance calls include ours and those of the incumbent operators.

Starting from October 2005, the PRC government regulates the tariff rates for PSTN services by setting the maximum tariff rates. The following table sets forth our present tariff rates (including rates applicable to domestic and international long distance calls made by our cellular subscribers):

	Maximum Tariff Rates	Preferential Rates
	RMB per six seconds	RMB per six seconds
Public switched Domestic Long Distance:	0.06	0.03
Public switched International Long Distance:		
To Hong Kong, Taiwan and Macau	0.18	0.15
To all other international destinations	0.72	0.38

Effective August 21, 2001, we adjusted the discount rates set forth in the table above as follows:



- RMB0.04 per six seconds every day from 8pm to 10pm;
- RMB0.03 per six seconds every day from 10pm to 7am of the following day; and
- RMB0.04 per six seconds on public holidays and weekends from 7am to 8pm.

Settlement of outgoing and incoming international calls with international operators is conducted through negotiated contracts with such individual international operators, which contracts must be approved by the MII.

*IP Telephony Services*

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We offer domestic and international long distance IP telephony services through interconnection of our IP network with the Internet and other telecommunications networks based on a manageable IP network configuration to enhance service quality. The following table sets forth selected information about our IP telephony services for the periods indicated.

	As of or for the year ended December 31,		
	2003	2004	2005
Number of cities reached	337	341	341
Minutes of outgoing IP telephony calls (in billion)	11.39	13.95	14.73
Minutes of incoming international calls (in billion)	0.13	0.28	0.25

Our IP telephony services include the following services:

- IP telephony services using the 17910 access code, which allows users to dial long distance phone numbers as follows: 17910 + IP card number + password + long distance number . There are three types of such services: (i) users can register for an IP card, pay the accumulated charges on the card on a monthly basis after receipt of a bill from us, (ii) users can purchase an IP telephony card with a pre-paid value, which can be re-filled after the user has used up the value on the card, or (iii) users can purchase an IP card with a one-time-only pre-paid value.
- IP telephony services using the 17911 access code, which allows users to dial long distance phone numbers as follows: 17911 + long distance number . There are two types of such services: (i) users can register for our services at any of our offices or our designated agents' offices free of charge, or (ii) users can purchase a pre-paid IP card from us, input the card number and password the first time the IP card is used, and thereafter dial international or domestic long distance calls only with the 17911 prefix.
- Dedicated IP telephony services users of these services only need to dial the long distance phone number to be connected.
- Direct IP telephony services Pursuant to authorization from the MII, we are providing fixed long distance direct-dialing IP telephony services nationwide. To promote our direct IP telephony services, we have set up many IP convenient stores nationwide. IP convenient stores are fixed-line long distance call centers in locations with a high concentration of the population who do not otherwise have access to fixed or wireless telephony services. These call centers provide long distance telephony services to customers on a pre-paid basis.

In February 2001, the PRC government ceased regulatory control of tariffs for IP telephony long distance calls and allowed operators to set their own rates. The following table sets forth our present tariff rates for our IP telephony services (including rates applicable to IP long distance calls made by our cellular subscribers).

	Our Tariff Rates (RMB)
IP Telephony Domestic Long Distance	0.30 per minute
IP Telephony International Long Distance	
To Hong Kong, Taiwan and Macau	1.5 per minute
To U.S. and Canada	2.6 per minute
To other international destinations	3.6 per minute

Effective September 1, 2001, we adjusted our tariff rates for our IP telephony services for certain international destinations. The tariff rate for calls to 14 countries, including India, was adjusted to RMB4.60 per minute, and the tariff rate for calls to the U.S. and Canada was adjusted to RMB2.40 per minute.

**Data Services**

We presently provide data services in 328 cities in China. We target high volume users of integrated voice, data and video communications and offer them data services as part of our integrated offerings of long distance, data and Internet services. Our target customer groups are government offices, financial institutions, multinational or multi-regional corporations, large- and medium-sized enterprises in China, and Internet service providers and Internet content providers that provide telecommunications services. As of December 31, 2005, the total leased bandwidth of our ATM and FR data services was 8,706 x 2 Mbps.

Our data service offerings mainly consist of broadband, managed data services, including:

- Frame relay, or FR, services, which provide high speed and cost effective data communications services linking remote business sites using FR technology;
- Asynchronous transfer mode, or ATM, services, which employ ATM technology and are able to handle high bandwidth, integrated voice, video, data and Internet traffic; and
- Broadband video-conferencing and video-telephony services, which are provided under the brand name of Uni-Video. These services currently include video-conferencing, video-telephony, video conference room leasing and video public telephony services. These services are based on our existing unified data network platform. Two or more users can use our services by connecting to the Internet or our video network through video-conferencing terminals or computer terminals.

The following table sets forth selected information about our data services for the periods indicated.

	As of December 31,		
	2003	2004	2005
Number of cities reached	316	328	328
Bandwidth leased to customers	7,194	9,007	8,706

We provide data services through an advanced, unified nationwide network system, the backbone of which is our advanced nationwide fiber optic transmission network. This network is the second largest fiber optic transmission network in China. We have also built metropolitan area networks in many cities throughout China. These networks provide local transmission capacity for our different services. See Networks Transmission Network below.





We believe that our ability to offer integrated access to customers premises is important to the success of our data services. We continue to build integrated access networks linking major office buildings to our networks in major cities. See Networks Long Distance, Data and Internet Networks below.

Our charges for ATM and FR services include one-time, up-front charges for installation materials (currently RMB500 per port for ATM services and RMB300 per port for FR services) and testing (currently RMB500 per circuit or port for ATM services and RMB300 per circuit or port for FR services), a monthly port fee and a monthly circuit fee. Our tariff charges are generally offered at a 10% discount from the State guidance tariffs.

The following table sets forth our tariff rates for monthly port fees for FR data services of selected bandwidths.

FR Services Port Fee (RMB per month)	
Bandwidth (bps)	Port Fee
64k	260
128k	300
256k	400
384k	450
512k	500
768k	650
1M	750
2M	1,000

The following table sets forth our tariff rates for monthly permanent virtual circuit (PVC) fees for FR data services of selected bandwidths and selected distance categories.

Bandwidth	FR Services PVC Fee (RMB per month)					
	Local (intra-district)	Local (inter-district)	Domestic long distance	Hong Kong, Macau & Taiwan	International long distance (Asia)	International long distance (outside of Asia)
8kbps	290	440	990	1,550	8,800	9,400
16kbps	390	540	1,190	1,800	10,000	10,500
32kbps	450	650	1,300	2,000	11,500	11,500
48kbps	500	750	1,500	2,300	13,000	13,500
64kbps	550	800	1,700	2,600	14,500	14,600
128kbps	700	1,000	2,100	3,400	18,000	18,400
256kbps	800	1,150	2,200	3,500	19,000	19,600
384kbps	850	1,350	2,300	3,800	20,000	20,500
516kbps	1,000	1,450	2,500	4,100	22,300	23,100
768kbps	1,150	1,600	2,700	4,600	25,800	26,550
1Mkbps	1,250	2,000	3,000	5,200	28,900	30,050
2Mkbps	1,500	2,200	4,000	7,000	39,000	39,000

The following table sets forth our tariff rates for monthly port fees for ATM services of selected bandwidth.

ATM Services Port Fee (RMB per month)

Bandwidth	Port Fee
256K	400
512K	500
1M	750
2M	1,000
4M	2,000
6M	3,000
8M	4,000
10M	5,000
12M	6,000
34M	7,000
45M	8,000
100M	9,000
155M	10,000

The following table sets forth our tariff rates for monthly circuit fees for ATM data services of selected bandwidths and selected distance categories.

Bandwidth	ATM Services Circuit Fee (RMB per month)						
	Local (intra-district)	Local (inter-district)	Domestic long distance	Hong Kong, Macau & Taiwan	International long distance (Asia)	International long distance (outside of Asia)	
256Kbps	800	1,150	2,200	3,500	19,000	19,600	
512Kbps	1,000	1,450	2,500	4,100	22,300	23,100	
1Mbps	1,250	2,000	3,000	5,200	28,900	30,050	
2Mbps	1,500	2,200	4,000	8,000	39,000	39,000	
4Mbps	2,000	3,000	6,000	12,900	72,200	72,200	
6Mbps	2,500	5,500	9,000	19,800	105,400	105,400	
8Mbps	3,500	8,500	12,000	26,700	138,700	138,700	
10Mbps	5,000	11,500	15,500	30,600	157,800	157,800	
15Mbps	7,000	15,000	22,000	40,000	205,000	205,000	
20Mbps	7,500	17,500	29,000	49,000	252,300	252,300	
25Mbps	8,000	21,000	36,000	59,000	300,000	300,000	
30Mbps	9,000	24,000	42,000	69,000	348,500	348,500	
40Mbps	10,000	29,000	52,000	88,500	416,000	416,000	
50Mbps	10,500	32,000	60,000	108,200	486,600	486,600	
60Mbps	11,000	33,000	68,000	122,600	567,900	567,900	
70Mbps	11,500	35,000	76,000	137,000	649,100	649,100	
80Mbps	12,000	36,000	84,000	151,300	730,400	730,400	
90Mbps	12,500	37,000	92,000	165,700	811,600	811,600	
100Mbps	13,000	37,500	100,000	180,100	892,900	892,900	
110Mbps	13,500	38,000	107,500	187,300	933,500	933,500	
130Mbps	13,800	38,500	122,500	201,600	1,014,800	1,014,800	
155Mbps	14,500	39,000	130,000	216,000	1,096,000	1,096,000	

Effective April 2003, we began charging our corporate customers fees for our Uni-Video services based on package service plans, including up-front charges for testing, a monthly fee and usage charges. Retail customers of our Uni-Video services purchase re-chargeable cards to pay for such services.



**Internet Services**

We offer the following Internet services:

- **Dedicated Internet Access.** We began to offer business customers high speed Internet access through dedicated lines in 2000. As of December 31, 2005, we had a total of 38,000 subscribers for dedicated Internet access. We package this service with voice and data services to provide integrated communications solutions to our business customers and cooperate with cable operators and real estate developers to offer broadband access to residential customers.
- **IDC Services.** We have built Internet data centers, or IDCs, in selected cities including Shanghai, Beijing, Guangzhou and certain provincial capitals, and provide server hosting, server rental, virtual servers and other IDC services to commercial customers and virtual IDC operators.
- **Dial-up Internet Access.** We began to offer dial-up Internet access services to customers in 2000. As of December 31, 2005, the total number of our dial-up subscribers decreased to 7.15 million from 13.56 million in 2004. This decrease is primarily the result of many dial-up subscribers switching to broadband Internet services that offer better quality and higher connection speed.
- **Ruyi Mailbox Services.** This service allows our cellular subscribers to use their cellular phone numbers as e-mail address. As of December 31, 2005, the number of Ruyi Mailbox subscribers was 8.47 million.
- **Others Internet Services.** Other Internet services we offer include a chain of Internet cafes (Unicom's Internet Plaza services), international Internet Protocol-Virtual Private Network (or IP-VPN), Virtual Private Data Network (or VPDN), Virtual Internet Service Provider (or VISP), Uninet international roaming and corporate e-mail services.

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

	As of December 31,		
	2003	2004	2005
Number of cities reached by our dedicated Internet access services	323	327	334
Number of cities reached by our dial-up Internet access services	325	328	329
Number of subscribers of dedicated Internet access services	47,750	61,569	38,000

Our tariff charges for dedicated Internet access include a network usage fee, an account set-up fee and a fixed telecommunications fee. Network usage fee is calculated based on monthly service plans. The account set-up fee is RMB100. The fixed telecommunications charge is based on the relevant tariff for the particular type and bandwidth of leased lines used to access the Internet. The following table summarizes the monthly network usage fees for selected bandwidths denoted as R .

Bandwidth	Network usage fees (RMB per month)
R≤64Kbps	2,700-3,600
64Kbps<R≤128Kbps	3,600-4,900
128Kbps<R≤256Kbps	4,800-6,600
384Kbps <R<512Kbps	8,500-12,000
1024Kbps<R≤2Mbps	18,000-27,000
8Mbps <R≤10Mbps	59,400-70,000
20Mbps<R≤34Mbps	165,900-195,200
34Mbps <R≤45Mbps	210,000-250,000
45Mbps<R≤100Mbps	428,400-504,000
100Mbps<R≤155Mbps	664,100-781,200

Our provincial and local branches are permitted to make tariff decisions within the range set forth above. For customers who lease a high number of dedicated access lines, we provide discounts of up to 20% of the tariffs set forth in the table above.

We charge a monthly usage fee for our Ruyi Mailbox services, which is currently RMB6 per month. We do not charge for SMS notifications of e-mail receipt. Other e-mail functions performed through SMS are charged based on the SMS tariff rates for our uni-Info services.

We charge a network usage fee and a fixed telecommunications fee for our dial-up Internet services. The network code for our nationwide dial-up Internet services is 16500 . We distribute dial-up Internet access services through a variety of methods. A customer can pre-register for our dial-up services or purchase dial-up passwords with a pre-paid amount of on-line charges that can be used nationwide to access the Internet. We also have arrangements with a number of commercial banks that allow the banks' customers to access our dial-up services using their bank account numbers, with on-line charges being automatically debited from their bank accounts.

#### *Leased Line Services*

We began to lease transmission lines to large business customers and other telecommunications operators in April 2000. Our leased line services provide customers with dedicated digital links directly connecting customer sites. As of December 31, 2005, we had a total leased bandwidth of an equivalent of 55,741 x 2 Mbps circuits, representing an 8.0% increase from 51,598 x 2 Mbps circuits at the end of 2004.

Leased line tariffs are primarily based on the bandwidths of the lines leased and the distance of transmission. The following table sets forth State tariff rates for monthly fees of selected types and bandwidths of leased lines and selected distance categories:

	State Tariff Rates (RMB per month)		
	Local (intra-district)	Local (inter-district)	Long distance
Digital Line (2 Mbps)	2,000	4,000	6,000
Digital Line (34 Mbps)	16,000	31,000	47,000
Digital Line (155 Mbps)	44,000	88,000	132,000

Source: MII.

Similar to PSTN services, operators other than incumbent operators, including us, can adopt tariffs that are different from the above State tariff rates upon approval by the MII as long as they do not offer services at tariff rates below cost. We generally offer leased line services at a 10% discount to the State tariff rates and market these services to institutional customers through our own dedicated teams and our sales agents.

### ***Sale and Lease of Other Network Elements***

We have substantially completed the construction of our nationwide transmission network. See – Networks- Transmission Network below. We have started to offer some network elements such as optic fibers or fiber channels for lease to other telecommunications operators or corporate customers.

### **Interconnection and Roaming Arrangements**

#### ***Interconnection***

Interconnection refers to various arrangements that permit the connection of our telecommunications networks to other networks. Our cellular and long distance networks interconnect with Unicom Group's cellular networks. Under current arrangements, settlement between Unicom Group and us is based on an internal settlement standard that takes into account either the internal costs of the relevant networks or the government standard applicable between third-party operators, whichever is the more favorable to us.

Unicom Group's cellular networks, our cellular networks and our long distance networks interconnect with the fixed telephone networks of China Telecom, China Netcom and China Railcom. Unicom Group's cellular networks and our cellular networks also interconnect with China Mobile's cellular networks. Our Internet network interconnects with the Internet networks of China Telecom and China Netcom. Although we continue to encounter some difficulties in the execution of our interconnection arrangements with other operators in some service areas, the situation has been improved since 2004 due to improved regulatory supervision by the PRC government in this area.

In October 2003, the MII issued regulations relating to settlement between telecommunications networks. These new regulations contain provisions regarding revenue sharing methods and settlement mechanisms for interconnection arrangements between us and other operators. These interconnection arrangements under the new regulations are described in – Regulatory and Related Matters- Interconnection Arrangements below.

Unicom Group entered into interconnection arrangements with China Telecom, China Netcom and China Mobile with the following agreements, which equally apply to us.

- Framework interconnection and settlement agreement between Unicom Group and the former China Telecom, dated September 30, 2001, the rights and obligations of which were divided and continued after the former China Telecom was split into China Telecom and China Netcom pursuant to an agreement among Unicom Group, China Telecom and China Netcom, dated April 23, 2003. These interconnection and settlement arrangements with China Telecom and China Netcom were superseded by the interconnection and settlement agreement between Unicom Group and China Telecom, dated March 29, 2004 and the interconnection and settlement agreement between Unicom Group and China Netcom, dated April 2, 2004. The 2004 agreements contained more detailed provisions relating to interconnection quality, pursuant to new MII directives in this area.
- Agreement between Unicom Group, China Telecom and China Netcom, relating to the continuation and division of rights and obligations of the parties under Unicom Group's prior interconnection agreement with the former China Telecom, dated April 23, 2003.

- Interconnection and settlement agreements between Unicom Group and China Mobile relating to the interconnection between Unicom Group's GSM and CDMA cellular networks and China Mobile's GSM cellular networks, both dated November 14, 2001, which were amended by the parties on December 31, 2003.
- Interconnection and settlement agreement between Unicom Group and China Mobile regarding the interconnection of point-to-point short messaging services, dated April 1, 2002.
- Interconnection and settlement agreement between Unicom Group and China Mobile regarding the interconnection between China Mobile's GSM cellular networks and Unicom's telecommunications networks, including its local fixed line telephony networks, cellular networks, domestic long distance telephony networks, international telephony networks and IP telephony network, and the interconnection between China Mobile's international gateways and IP telephony network and Unicom Group's cellular networks and local fixed line telephony networks, dated December 31, 2003.
- Agreement between Unicom Group and China Mobile regarding the mutual provision of open service platforms, dated November 5, 2003.

Unicom Group has also entered into the following interconnection arrangements, which equally apply to us.

- Interconnection and settlement agreements between Unicom Group and China Railcom relating to the interconnection of Unicom Group's cellular networks and local fixed line telephony networks and China Railcom's local fixed line telephony networks, domestic long distance networks and IP telephony networks, dated January 25, 2002 and April 9, 2002.
- Supplemental agreements between Unicom Group and China Railcom, which allows each party to offer its domestic and international long distance telephony services and IP telephony services to the cellular or fixed line telephony service subscribers of the other party, dated April 23, 2003.
- Interconnection and settlement agreement between Unicom Group and China Satellite Communications Corp, or China Satcom, relating to the interconnection between Unicom Group's networks and China Satcom's Global Star satellite mobile communications network, dated September 27, 2003.
- Framework interconnection and settlement agreement between Unicom Group and China Satcom relating to the interconnection between Unicom Group's cellular networks and China Satcom's IP telephony networks, dated September 24, 2003.
- Interconnection agreement among major Internet operators, including Unicom Group, and three national Internet switching centers relating to the interconnection of Internet backbone networks, dated December 20, 2001.
- Interconnection and settlement agreement between Unicom Group and China Telecom relating to the provision of point-to-point SMS services between Unicom Group's and China Telecom's networks, dated October 10, 2004.
- Interconnection and settlement agreement between Unicom Group and China Netcom relating to the provision of point-to-point SMS services between Unicom Group's and China Netcom's networks, dated October 11, 2004.



For all interconnection services, we are required to pay the interconnection fees regardless of our ability or inability to collect the tariff from our subscribers. The fixed line operators are required to pay interconnection fees regardless of their ability or inability to collect the tariff from their subscribers. Interconnection charges are accrued on a monthly basis based on the actual call volume and applicable tariff rate. See B. Related Party Transactions Provision of Ongoing Telecommunications and Ancillary Services and Premises Interconnection Arrangements under Item 7 below for the interconnection and settlement arrangements between Unicom Group and us.

### **Roaming**

As of December 31, 2005, our cellular subscribers can roam on cellular networks in Europe, North America and other Asian countries and regions through Unicom Group's international roaming agreements with 248 GSM operators in 118 countries and regions and 18 CDMA operators in 15 countries and regions. Unicom Group has also agreed to arrange for us to participate in its future international roaming arrangements.

A cellular subscriber using roaming services is charged at our roaming usage rate for both incoming and outgoing calls, plus applicable long distance tariffs. Under our roaming agreement with Unicom Group, our subscribers who roam on Unicom Group's networks are charged for each call made or received. We collect this tariff, retain RMB0.20 and pay the remaining amount to Unicom Group. On the other hand, when Unicom Group's subscribers roam on our networks, Unicom Group collects the roaming tariff, retains only RMB0.04 and pays us the remaining amount.

The following table is a summary of roaming settlement between Unicom Group and us:

<b>For our subscribers roaming on Unicom Group's networks</b>	<b>Roaming Tariff</b>	<b>Paid to Unicom Group</b>	<b>Retained by Us</b>
GSM pre-paid users (RMB/minute)	0.60	0.40	0.20
GSM post-paid users (RMB/minute)	0.60	0.40	0.20
CDMA users (RMB/minute)	0.60	0.40	0.20

<b>For Unicom Group's subscribers roaming on our networks</b>	<b>Roaming Tariff</b>	<b>Paid to Us</b>	<b>Retained by Unicom Group</b>
GSM pre-paid users (RMB/minute)	0.60	0.56	0.04
GSM post-paid users (RMB/minute)	0.60	0.56	0.04
CDMA users (RMB/minute)	0.60	0.56	0.04

With respect to international roaming, we settle roaming revenue with international operators through Unicom Group in accordance with roaming agreements between Unicom Group and each of the international operators.

See B. Related Party Transactions Provision of Ongoing Telecommunications and Ancillary Services and Premises Roaming Arrangements under Item 7 below for further information regarding the roaming arrangements between Unicom Group and us.

### **Networks**

We operate an advanced network system to support our integrated operations. The backbone of the system is a nationwide fiber optic transmission network, which serves as the common platform for our cellular, long distance, data and Internet networks. In addition, we continue to develop management and network support systems to enhance the quality and reliability of our networks and improve our customer service and operating efficiency. We generally utilize a centralized network planning and equipment selection process, which ensures uniform nationwide design and network compatibility.

### *Transmission Network*

We own and operate an advanced nationwide fiber optic transmission network (except for the Xizhang Autonomous Region, in which we lease capacity from other operators). As of December 31, 2005, our fiber optic transmission network reached 333 cities with a total cable length of approximately 796,000 km, of which fiber optic backbone transmission network accounted for approximately 122,000 km.

Our fiber optic transmission network is designed for broadband capacity with superior security and reliability, which supports our integrated telecommunications services and allows us to lease capacity to other telecommunications operators and corporate customers. The network deploys:

- synchronous digital hierarchy, or SDH, architecture with protective two- or four-fiber rings, a self-healing system that allows for instantaneous rerouting, automatically protects service circuits and minimizes down time in the event of a fiber cut or equipment malfunction;
- dense wave division multiplexing, or DWDM, technology, a means of increasing transmission capacity by transmitting signals over multiple wavelengths through a single fiber; and
- digital cross connection, or DXC, system, a specialized high-speed data channel exchange and connection system that effectively manages the routing and channeling of our services.

Our SDH fiber rings have transmission bandwidths of 2.5 Gb/s in most routes and 10 Gb/s for the fiber ring that covers the eastern and southern coastal areas of China. We deploy mainly transmission equipment and technology supplied by Siemens, Nortel, Lucent, Alcatel, Huawei, ZTE and other vendors.

Concurrent with the construction and expansion of our domestic backbone transmission network, we also seek to expand our international bandwidth. Through our participation in the Asia Pacific Cable Network No. 2 Project (APCN 2), a trans-pacific submarine cable project that connects major countries and regions in eastern Asia and southeastern Asia and links them to North America through Japan, and our membership in the US-Japan Sub-marine Cable Organization, we are linked with 11 operators in Japan, U.S., South Korea, Singapore and Taiwan with 155x30 Mbps capacity. We also lease 3669 Mbps of international broadband transmission capacity. We have also opened transmission lines on land with the main operators in Hong Kong and Macau, with 15Gbps and 622Mbps of transmission capacity. In addition, we have established fiber-optic interconnections among China, Mongolia and Russia, between China and North Korea and between China and Russia, with transmission capacity of 622Mbps, 622Mbps and 10Gbps, respectively.

As of March 31, 2006, our metropolitan area networks cover 341 cities throughout China, with a total length of approximately 681,000 km. These networks provide a unified, high-speed local transmission platform for our cellular, data and Internet services.

### *Cellular Networks*

A cellular network consists of:

- cell sites, which are physical locations, each equipped with a base station that houses transmitters, receivers and other equipment used to communicate through radio channels with subscribers' cellular handsets within the range of a cell;
- base station controllers, which connect to, and control, the base stations;

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- mobile switching centers, which control the base station controllers and the routing of telephone calls; and
- transmission lines, which link the mobile switching centers, base station controllers, base stations and the public switched telephone network.

We own most of the GSM cellular transmission network at the local and provincial level. We lease a portion of our inter-provincial transmission capacity for our GSM cellular networks as well as the CDMA cellular transmission network. We also use our own backbone fiber optic transmission network to provide transmission capacity for our cellular networks. We continue to focus on the management and operation of our cellular networks.

*GSM Cellular Networks.* The following table sets forth selected information regarding our GSM cellular networks in our service areas as of the dates indicated.

	As of December 31,		
	2003	2004	2005
Network subscriber capacity (in thousands of subscribers)	68,050	84,552	89,461
Base stations	56,653	81,819	94,444
Base station controllers	1,345	1,653	1,781
Mobile switching centers	469	477	502

Currently our GSM cellular network mainly operates at 900 MHz. We have deployed GSM technology that operates at 1800 MHz in some major metropolitan areas to supplement the capacity of our existing cellular network. We have the right to use 6 x 2 MHz of spectrum in the 900 MHz frequency band and 10 x 2 MHz in the 1800 MHz frequency band for our GSM network.

Our cellular networks are supported by an advanced SS7 signaling system, which fosters efficient use of network capacity, reduces call set up time and enhances transmission capabilities. We have also installed intelligent networks that enable us to provide pre-paid services and a wide range of call features and value-added services.

In 2005, we upgraded our GSM networks in Beijing, Shanghai, Guangzhou, Shenzhen, Zhuhai, Dongguan and Suzhou to GPRS networks. In 2006, we plan to expand such upgrade to 50 to 100 major cities in China.

*CDMA Cellular Network.* Unicom Group completed the construction of the first phase of its nationwide CDMA network at the end of 2001. In 2003, Unicom Group completed the second phase of the CDMA network construction, which added an additional capacity of 20.69 million subscribers nationwide and included the upgrade of the network to CDMA 1X technology. The CDMA networks constructed in the second phase did not share as much infrastructure with the GSM network. By the end of 2005, Unicom Group has substantially completed the third phase of the CDMA network construction, adding an additional capacity of approximately 45.69 million subscribers nationwide and significantly improving the coverage and quality of the CDMA network. We lease CDMA network capacity in our cellular service areas and have the exclusive right to operate its network in those areas. We have the right to use 10x2 MHz of spectrum in the 800 MHz frequency band for our CDMA services.

***Long Distance, Data and Internet Networks***

By the end of 2005, our PSTN network reached 333 cities, while the coverage of our Internet networks, including our IP telephony networks, included over 300 cities throughout China.

*Long Distance Network.* Our long distance network is supported by a nationwide billing system and an intelligent network, which allows us to provide multiple services. Our cellular subscribers can access these services directly through our cellular networks, but our other customers typically access our long distance telephony, IP telephony and Internet services through the public switched telephone networks of China Telecom and China Netcom. As of December 31, 2005, the total network capacity for our IP telephony services reached 22,919E1, or a voice capacity of 20 billion minutes per year. E1 is the European format for digital transmission and carries signals at 2Mbps.

*Data and Internet Networks.* Our broadband data and Internet networks utilize a unified IP and ATM design, which is particularly suited for real-time, multimedia applications such as video and voice. ATM switches perform high-speed switching of voice and data traffic and minimize time delay and congestion. They can also prioritize applications that least tolerate time delay, such as telephony and video, over less time-sensitive applications such as e-mails and file transfer. As of December 31, 2005, the international and domestic interconnection bandwidths have reached 4.27Gbps and 17Gbps, respectively.

*Internet Network.* Our Internet network, branded as Uninet, is also centrally designed and has a nationwide uniform architecture. It is supported by a nationwide, advanced billing system that facilitates roaming access and delivery of virtual ISP services and other value added services.

*Broadband Video Network.* Our broadband video network utilizes the H.323 technological standard and two-tier network structure. H.323 is a widely used multi-media conferencing protocol approved by the International Telecommunications Union. As of December 31, 2005, it can provide video conference and video telephone services and currently reaches 330 cities nationwide as well as the United States and Hong Kong.

*Integrated Access Networks.* We believe that the key to the success of our data services is our ability to offer integrated access to customers premises. We are building integrated access networks in many cities throughout China. We focus the construction of our access networks on linking major office buildings to our metropolitan area transmission networks. We rely mainly on fiber optic cables to link office buildings to our networks and have offered narrow-band wireless access at the 3.5 GHz frequency band in approximately 3 municipalities, 18 provincial capitals and 14 provinces.

#### ***Integrated Management and Network Support Systems***

We have developed various management and network support systems to support and manage our various networks. We have established, in each province, municipality or autonomous region, an integrated billing and settlement system that supports the billing and settlement services of our cellular, data and long distance businesses. We have also developed a management support system (MSS) that supports our business support system (BSS) and enterprise resource planning systems (ERP). We have integrated the billing and settlement system and business management system at our headquarters to manage our businesses.

#### **Marketing, Sales and Distribution**

We centrally plan our nationwide marketing and sales strategies, but the implementation of these strategies is carried out at the provincial level by operating branches tailored to their specific markets. In 2005, we focused our marketing strategies on enhancing efficiency and satisfying customer needs.

### *Sales and Marketing*

We focus on developing a strong brand image of "Connecting you freely" that conveys our strengths in high quality services, comprehensive network coverage, integrated solution offerings, advanced technology and customer focus. We market all of our services under the China Unicom brand name. We continued to emphasize brand management in 2005, by implementing a customer-oriented branding system focusing on four customer brands: Worldwind, U-Power, Ruyi Tong and Unicom Horizon. We offer customized service packages under these four customer brands that are targeted to different market segments. Worldwind is our premier customer brand for offering high quality and differentiated services to mid- to high-end individual cellular customers; U-Power is designed for the youth market; Ruyi Tong is targeted to offer mainstream cellular services to individual customers in the mass market; Unicom Horizon focuses on providing industry applications or integrated telecommunication solutions to institutional customers, including corporate, industry and government entities. In addition to the four customer brands, we recently launched two business brands: uni and Unicom Commerce, which are used to market our value-added services to cellular subscribers and long-distance, data and Internet services to primarily institutional customers, respectively.

Our marketing strategy utilizes our image as an integrated telecommunications service provider and leverages on our comprehensive services and nationwide sales and distribution network. By using direct sales forces and sale agents and active market analysis and through sales channels such as service centers, sales outlets and large-scale chain stores, our marketing strategy can be targeted at different customer segments and adjusted timely in accordance with the demands of different markets. In addition, we also seek to enter into strategic alliances in order to further expand the breath and depth of our marketing and sales efforts. In September 2004, we entered into a wireless Internet joint marketing agreement with Intel, HP, IBM, Lenovo and Digital China to develop the industry value chain for our U-Net services based on the CDMA 1X network. In June 2005, the Unicom Group and the Lenovo Group entered into a business cooperation agreement on Lenovo's notebook computers and U-Net business to expand the Palm Broadband business. In December 2005, the Unicom Group entered into a full and exclusive strategic partnership with the Chinese Table Tennis Association to leverage the popularity of table tennis in China to enhance our brand recognition. We expect these arrangements will enhance our marketing ability and promote our brand recognition and our marketing in China.

Moreover, we seek to formulate effective marketing strategies through customer relations management and analysis of customer segmentation, customer demand and consumption trends.

*Customer Segmentation:* We have two main categories of customers: (i) institutional customers, comprised of mainly corporate, industry and government customers, and (ii) individual customers. We have set up dedicated sales and service departments for institutional customers, both at our headquarters and at our provincial and local branches. We focus on promoting our integrated solutions to these institutional customers. For individual customers, we conduct our sales through our own service centers and the retail outlets of independent sales agents.

*Cellular services:* We promote our CDMA services by leveraging our abundant network resources of CDMA network and the technology advantage of CDMA 1X to provide differentiated services targeted at different market segments, including tailoring different service packages for different consumer groups. In 2005, we focused on resolving the bottleneck in CDMA handset supply by strengthening centralized handsets purchasing and implementing marketing strategy of matching handset subsidies with subscribers' committed service fees. We have established Unicom Huasheng to centralize our purchasing of the CDMA handsets in an attempt to lower the entry barrier of our CDMA services caused by high handset price and make the CDMA services more attractive and affordable to the mass market. In addition, by offering a one-stop solution for customers, based on the integrated service capacity of CDMA 1X network technology, we actively pursued integrated services marketing to promote our CDMA 1X services.

We also continued to expand the subscriber base for our GSM voice and value-added services. Our marketing strategies for GSM services focused on the continued development of the voice and SMS services and the rapid expansion of the Cool Ringtone service. We also plan to leverage our newly upgraded GSM networks in selected cities to promote GPRS services.

Recognizing the importance and the needs of our institutional customers and utilizing our advantages of being an integrated telecommunications operator, we formulated marketing strategies for our cellular services that were tailored to our institutional customers. In 2005, we continued to emphasize the development of advanced and customized industrial applications for our institutional customers. By offering industrial solutions, our business extended from the provision of basic telecommunications services to comprehensive value-added information services. For example, we added several applications based on the CDMA 1X network, including Traffic Horizon that provide wireless traffic direction services to CDMA subscribers. We launched in Sichuan province Tianfu Agriculture Information Net , an integrated agriculture information platform supported by our cellular, data and Internet network resources and information resources, which was named the best e-commerce website at the United Nations Summit on Information Society in November 2005.

*Long distance, data and Internet services:* In 2005, we continued to focus on institutional customers, including financial institutions, large corporations, multi-national corporations, government entities and Internet service providers and Internet content providers, in order to provide them customized one-stop solutions. We launched Unicom Commerce to offer integrated telecommunication services specifically designed to cater to institutional customers' needs. Our marketing efforts with respect to retail customers included the marketing of co-branded long distance telephony cards. Under these arrangements, our institutional partners purchased such cards from us and distributed the cards to their employees or customers, thereby facilitating the sale of our long distance telephony services.

*Service Bundling and Cross-Marketing:* A key element of our sales and distribution strategy is to promote our strengths as a provider of a comprehensive range of integrated services. This strategy is implemented by our service centers, independent sales agents and direct sales forces, which distribute and support our various product offerings. For example, we cross-sell our long distance, data and Internet services to our cellular subscribers. In addition, based on the specific demands of our industry and institution clients, we provide customized communications solutions by bundling VPN, IP telephony, Uni-Video broadband video-telephony and U-Net services under the brand Unicom Commerce .

### ***Distribution***

We have a diversified distribution network comprising self-owned sales outlets, agent/distributor sales outlets and direct sales forces. We distribute our services to our individual customers through our self-owned sales outlets as well as other retail outlets. We distribute our services to large customers through our direct sales forces and agents. We have developed a nationwide distribution network of service centers and sales outlets, of which only a small portion are owned by us and the others are owned by independent agents or distributors. As of December 31, 2005, we had a total of approximately 120,000 sales outlets, of which over 6,000 were self-owned. These service centers and retail outlets distribute our cellular, long distance, data and Internet services and provide post-sales services such as service inquiry, customer complaint and collections.

We generally aim to maintain a flat distribution structure, but utilize a multi-level distribution system in some service areas, in which our top-level distributors further distribute to lower level distributors and sales agents. In 2005, we have reduced the levels of such distribution system to control distribution costs. We are also in the process of setting up direct distribution centers to further flatten the distribution structure in some areas. We have also established direct sales and customer service teams to conduct one-on-one sales to high-usage institutional customers. These direct sales and customer service teams focus is to promote our cellular, domestic and international long distance, data and Internet services as integrated telecommunications services in order to provide differentiated and comprehensive solutions for our customers. In 2005, we also expanded the use of new distribution channels such as Internet and telephone marketing.

Our controlling shareholder, Unicom Group, entered into a strategic cooperation arrangement with China Post in 2001. This arrangement allows us to supplement our existing distribution network with China Post's extensive nationwide network. China Post also provides billing, collection and other services to our customers. The arrangement uses a revenue-based commission structure for most services. We and China Post have also agreed to use each other's services and offer each other preferential treatment. We have entered into provincial-level cooperation agreements with China Post in our service areas.

### **Customer Service**

We provide specialized, differentiated and one-stop services to our customers, based on the customer service resources of Unicom Group. In 2006, we launched a uniform service brand of Unicom 10010 to consolidate all customer service resources. Our customer care and service centers in each service area can be accessed by our customers by dialing a nationwide hotline number 10010. Our customer service system is a unified platform providing customer services for all of our businesses. This system is based on the paging centers, and also relies on other systems, including operations, billing, account management and network management. This integrated system allows us to provide personalized and diversified services through customer service representatives or automated systems, including service inquiry, billing inquiry, response to customer complaints and suggestions, service initiation and termination, payment reminder services and emergency services, to different types of customers on a 24-hour basis. Our customers can access our customer services through various means, including telephone calls, faxes, e-mails and SMSs. To better serve our customers, we provide such value-added services as 10011 bill inquiry hotline, 10018 club member service hotline, 13010199999 international roaming service hotline, bill payment through commercial banks, free copies of detailed statements, Internet account inquiry, a single rechargeable card for all of our services and mobile service centers in remote areas of China. To better meet market demand, we continue to seek innovation in our customer services, in order to provide more pro-active, comprehensive and targeted customer services. We also continue to promote customer loyalty through our nationwide club member reward program.

In addition, we also analyze our customer segments in detail, and tailor our services to the requirements of different customer segments. While we are focused on retention of our individual customers, we pay regular visits and provide one-on-one personalized services to our institutional customers and VIP customers and, through customer clubs, provide high-quality and differentiated services for high-net-worth individual customers and important institutional customers. For mass-market customers, we offer standardized services that aim at enhancing customer experience.

We emphasize customer service and customer relations management and have taken various measures to improve customer satisfaction. Such measures include establishing and improving the customer service network, standardizing the content, manner and criteria of service and improving training of customer service representatives. We established our customer service workflow using a consistent set of standards in order to timely resolve problems for our customers. We have also strengthened our analysis and research of customer consumption behavior, consumption cycle and satisfaction levels in order to understand their consumption pattern and influence their consumption trend.



**Billing and Collection**

We are able to leverage our strengths as an integrated service provider to offer integrated billing and collection services to our institutional and individual customers. We also integrate the billing systems for different services and distribute unified recharge cards that can be used to recharge various pre-paid services, including pre-paid cellular services, long distance telephony services and Internet dial-up services. Our billing system can distinguish between customers based on the marketing method and service package plans applicable to each customer. These additional functions would allow us to analyze customer data in more detail, thereby improving our ability to analyze the age of our accounts and control bad debts. The following table sets forth our billing and collection methods for each of our business segments:

<b>Business Segment</b>	<b>Billing</b>	<b>Collection</b>
Post-paid GSM and CDMA services	Centralized at the provincial level and generally by monthly billing.	Subscribers may pre-deposit their service charges with us or commercial banks or China Post that collect payment for us, make payment in person at our service centers or branches of China Post, or through commercial banks.
Pre-paid GSM and CDMA services	Centralized on our nationwide intelligent network	Subscribers can purchase and/or re-charge pre-paid cards through various channels. They can also re-charge cards by telephone.
PSTN long distance telephony services	Through nationwide long distance telephony settlement center and regional billing centers located in Beijing, Shanghai and Guangzhou, which coordinates billing with local settlement centers	Subscribers mainly go to our service centers, commercial banks and branches of China Post for payment.
IP telephony services	Through our nationwide data settlement center and various provincial-level settlement systems	Subscribers mainly go to our service centers, commercial banks and branches of China Post for payment.
Uni-Video services	For each corporate customer, billing is either through the local service centers in the locations of the branches of the customer or centralized at one local service center chosen by the corporate customer. Retail customers purchase pre-paid re-chargeable cards for our services.	Our corporate customers can pay either at the local service centers in the locations of the branches of such customer or at one local service center designated by the customer.
Internet services	Centralized at the provincial level. Billing methods include monthly billing, volume-based billing and billing according to contractual provisions.	Subscribers may go to our service centers, commercial banks, and branches of China Post or use the Internet for payment.
Unicom's Internet Plaza	Customers of the Internet cafes either pay by membership or pay hourly rates.	N/A
Leased lines	Monthly billing in accordance with contractual provisions	Customers mainly pay at our service centers or at commercial banks.



### ***Bad Debt Controls***

*Cellular Services.* Post-paid subscribers must register with us before they can begin using our cellular services. Customer registration allows us to better manage customer credit. If subscribers do not pay their bills on time, we charge a late fee and will either call or send SMSs to the delinquent subscribers to remind them to pay. We generally suspend a post-paid subscriber's account if the account is more than 30 days overdue and terminate the account if it is overdue for more than three months after that. When an account is terminated, we will seek other remedies to collect the overdue payment, including personal visits to the subscriber to collect payments or taking legal actions. At the same time, we encourage our subscribers to pre-deposit service charges with us, to be deducted against charges incurred in the future, or use our pre-paid services. Since 2004, we have developed a customer's credit management system at the provincial branch level to enhance verification of the personal information of new subscribers and tighten credit control for new subscribers. We believe these measures will improve our bad debt control.

*Domestic and International Long Distance Services.* We actively encourage customers to use our pre-paid services. In addition, we perform credit checks on potential customers. For high-volume users, we open telephone banking accounts at commercial banks, set credit limits on such accounts and settle with such customers on a monthly basis.

*Internet services.* We send e-mails to delinquent customers and use other methods to collect payment from delinquent customers. Accounts for individual customers which are delinquent for 20 days are suspended, and such accounts will be terminated if they are delinquent for more than 40 days. For corporate customers, our actions are based on the credit history of each delinquent customer.

### **Research and Development**

We focus on technology innovation in coordination with the various business departments, in order to provide technical support to the development of our various businesses. In 2005, we were granted seven patents from the State Intellectual Properties Bureau of the PRC, including three technology invention patents, one practical patent and three product design patents. We also successfully developed new technology applications such as Tianfu Agriculture Information Online. Major projects of our research and development efforts in 2005 include:

- the tracking and research of the latest technology trends in light of the gradual transition to 3G cellular communications technology and next-generation networks and our position as a provider of integrated services, including participation in the Chinese Next Generation Internet (CNGI) network construction project (led by the National Development and Reform Commission) and the 3G cellular technology testing project (led by the MII);
- the investigation into coordinated development of the GSM and CDMA networks and the transition to next-generation networks, including the development and testing of GSM and CDMA dual-mode handset, the testing of the enhanced CDMA 1X network technology and evolution data optimized technology, the testing of GRPS commercial networks and other research and development of new technologies; and
- the development of new value-added services based on GSM and CDMA networks and new applications for institutional customers.

**Competition**

*The Chinese telecommunications market has six basic telecommunications service providers - China Telecom, Unicom Group, China Mobile, China Netcom, China Satcom and China Railcom - and thousands of value-added service providers. As a relatively new entrant into this highly competitive landscape, we believe the following strengths have contributed to the development and growth of our business in recent years:*

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- *Integrated service offerings and a uniform and advanced telecommunications network* We offer integrated cellular, domestic and international long distance, data and Internet services, and have a nationwide, uniform communications network that support voice, data and Internet communications and allow us to provide integrated services to our customers and utilize our network resources in a cost-effective manner.

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