

ZTE中兴

ZTE CORPORATION

中興通訊股份有限公司

(a joint stock limited company incorporated in the People's Republic of China with limited liability)

(Stock Code: 763)

2006 ANNUAL REPORT SUMMARY AND RESULTS ANNOUNCEMENT

1. IMPORTANT

1.1 The Board of Directors, Supervisory Committee and the Directors, Supervisors and senior management of ZTE Corporation ("ZTE" or the "Company") confirm that this annual report summary and results announcement do not contain any false information, misleading statements or material omissions, and collectively and individually accept responsibility for the truthfulness, accuracy and completeness of its contents. This annual report summary is extracted from the full text of the annual report, which is simultaneously published in the website of Shenzhen Stock Exchange (<http://www.szse.com.cn>), the Company's designated information disclosure website (<http://www.cninfo.com.cn>) and the ZTE website (<http://www.zte.com.cn>). For more details, investors should refer to the full text of the 2006 annual report.

1.2 The 2006 annual report has been considered and approved at the Second meeting of the fourth session of the Board of Directors of the Company. Mr. Wong Zongyin, Vice Chairman, was unable to attend the meeting due to work reasons and authorised in writing Mr. Hou Weigui, Chairman, to vote on his behalf. Mr. Zhang Junchao and Mr. Shi Lirong, both are Directors, were unable to attend the meeting due to work reasons and authorised in writing Mr. Yin Yimin, Director, to vote on their behalf.

1.3 The financial reports of ZTE and its subsidiaries (the "Group") for the year ended 31 December 2006 were prepared in accordance with generally accepted accounting principles in the People's Republic of China ("PRC GAAP") and Hong Kong Financial Reporting Standards ("HKFRSs"), and had been audited by Ernst & Young Hua Ming and Ernst & Young respectively, and an unqualified auditors' report was issued by each of them.

1.4 Mr. Hou Weigui, Chairman of the Company, Mr. Wei Zaisheng, Chief Financial Officer of the Company and Mr. Shi Chunmao, Head of Finance Division of the Company, hereby declare that they warrant the truthfulness and completeness of the financial reports contained in the 2006 annual report.

2. CORPORATE PROFILE

2.1 Corporate information

Abbreviated Name of Stock	ZTE
Stock code	000063 763
Place of listing	The Shenzhen Stock Exchange The Stock Exchange of Hong Kong Limited
Registered and office address	ZTE Plaza, Keji Road South, Hi-Tech Industrial Park, Nanshan District, Shenzhen, Guangdong Province, People's Republic of China
Principal place of business in Hong Kong	8/F Gloucester Tower, The Landmark, 15 Queen's Road Central, Central, Hong Kong
Postal code	518057
Website	http://www.zte.com.cn
E-mail	fengjianxiong@zte.com.cn

2.2 Contact Persons and Correspondence

Name	Authorised representatives	Secretary to the Board of Directors	Joint company secretaries	Securities affairs representative
	Yin Yimin, Feng Jianxiong	Feng Jianxiong	Feng Jianxiong, Suen Pui Yee, Samantha	Li Liuhong
Address	ZTE Plaza, Keji Road South, Hi-Tech Industrial Park, Nanshan District, Shenzhen, Guangdong Province, People's Republic of China			
Tel	+86 755 26770282			
Fax	+86 755 26770286			
E-mail	fengjianxiong@zte.com.cn			

3. ACCOUNTING AND BUSINESS DATA HIGHLIGHTS

3.1 Major financial data of the group prepared in accordance with PRC GAAP

Unit: RMB in millions

	For the year ended 31 December 2006 (current year)	For the year ended 31 December 2005 (previous year)	Year-on-year change	For the year ended 31 December 2004
Income from principal operations	23,031.7	21,575.9	6.75%	22,698.2
Total profit	1,069.6	1,501.9	-28.78%	1,418.8
Net profit	807.4	1,194.3	-32.40%	1,008.9
Net profit after extraordinary items	753.9	1,212.9	-37.84%	992.4
Net cash flow from operating activities	-1,555.0	177.3	-977.04%	1,644.6

	As at 31 December 2006 (end of current year)	As at 31 December 2005 (end of previous year)	Year-on-year change	As at 31 December 2004
Total assets	25,916.9	21,779.1	19.00%	20,830.0
Shareholders' equity (excluding minority interests)	10,678.9	10,125.1	5.47%	9,174.4

3.2 Principal financial indicators prepared in accordance with PRC GAAP

	For the year ended 31 December 2006 (current year)	For the year ended 31 December 2005 (previous year)	Year-on-year change	For the year ended 31 December 2004
Earnings per share (RMB)	0.84	1.24	-32.26%	1.05
Return on net assets (%)	7.56%	11.80%	Decrease by 4.24 percentage points	11.00%
Return on net assets based on net profit after extraordinary items (%)	7.06%	11.98%	Decrease by 4.92 percentage points	10.82%
Net cash flow per share from operating activities (RMB)	-1.62	0.18	-1,000%	1.71

	As at 31 December 2006 (end of current year)	As at 31 December 2005 (end of previous year)	Year-on-year change (%)	As at 31 December 2004
Net assets per share (RMB)	11.13	10.55	5.50%	9.56
Adjusted net assets per share (RMB)	11.12	10.55	5.40%	9.53

Note: During the period from 1 January 2006 to 31 December 2006, there has been no change in the total share capital of the Company, which is 959,521,650 shares.

Extraordinary profit or loss items

Applicable N/A

Unit: RMB in millions

Extraordinary item	Amount
Subsidy income	65.1
Non-operating income	24.0
Less: Non-operating expenses	(26.2)
Less: effect of income tax	(9.4)
Total	53.5

3.3. Financial information prepared in accordance with HKFRSs

3.3.1 Major financial information of the group prepared in accordance with HKFRSs

Unit: RMB in millions

	2006	2005	2004	2003	2002
Results					
Revenue	23,031.7	21,575.9	21,220.1	17,036.1	10,795.9
Cost of sales	(15,250.5)	(14,101.7)	(13,813.5)	(11,226.1)	(6,924.2)
Gross profit	7,781.2	7,474.2	7,406.6	5,810.0	3,871.7
Other revenue and gains	792.1	681.6	534.1	252.0	312.1
Research and development costs	(2,832.7)	(1,959.5)	(2,265.2)	(1,535.7)	(1,127.9)
Selling and distribution costs	(3,274.6)	(3,186.4)	(2,799.6)	(1,981.5)	(1,277.0)
Administrative expenses	(1,097.6)	(1,095.4)	(981.4)	(869.0)	(542.4)
Other operating expenses	(191.5)	(128.6)	(162.4)	(213.9)	(212.6)
Profit from operating activities	1,176.9	1,785.9	1,732.1	1,461.9	1,023.9
Finance costs	(153.7)	(175.9)	(140.4)	(171.2)	(122.3)
Share of profits and losses of jointly-controlled entities and associates	7.5	(4.2)	3.1	(3.6)	4.2
Profit before tax	1,030.7	1,605.8	1,594.8	1,287.1	905.8
Tax	(127.1)	(179.8)	(115.0)	(198.5)	(159.7)
Profit before minority interests	903.6	1,426.0	1,479.8	1,088.6	746.1
Minority interests	(136.6)	(138.3)	(207.3)	(60.3)	(42.5)
Net profit from ordinary activities attributable to shareholders	767.0	1,287.7	1,272.5	1,028.3	703.6

Unit: RMB in millions

	2006	2005	2004	2003	2002
Assets and liabilities					
Total assets	26,787.2	22,464.0	21,007.8	16,476.4	12,022.8
Total liabilities	15,461.4	11,742.8	11,312.2	11,649.9	8,124.8
Minority interests	561.9	470.7	478.4	226.6	215.4
Shareholders' equity (excluding minority interests)	10,763.9	10,250.5	9,217.2	4,599.9	3,682.6

3.3.2 Major financial indicators of the group prepared in accordance with HKFRSs

	2006	2005	2004	2003	2002
Basic earnings per share (RMB/share)	0.80	1.34	1.57	1.28	0.88
Net assets per share (RMB/share)	11.80	11.17	11.96	6.03	4.87
Return on net assets	6.77%	12.01%	13.12%	21.31%	18.05%

Note: There was no change in share capital of the Company during 2006, and the share capital of the Company comprised 959,521,650 shares.

3.4 Differences between PRC GAAP and HKFRSs

Applicable N/A

Unit: RMB in millions

	PRC GAAP	HKFRSs
Net profit	807.4	767.0
Shareholders' equity	10,678.9	10,763.9
Explanation for difference	See part 10.3.3 for details.	

4 CHANGES IN SHARE CAPITAL AND SHAREHOLDERS

4.1 Changes in share capital during the year

Unit: shares

	At beginning of the year		Increase/decrease as a result of the Change (+, -)				At the end of the year		
	Number of shares	Percentage (%)	Issue of new share	Unlock of Shares subject to lock-up ¹	Concession from capital reserve	Bonus issue	Sub-total	Number of shares	Percentage (%)
I. Shares subject to lock-up	423,084,674	44.09		-110,819,869			-110,819,869	312,264,805	32.54
1. State-owned shares	0	0		0			0	0	0
2. State-owned Legal person shares	392,079,904	40.86		-81,097,163			-81,097,163	310,982,741	32.41
3. Other domestic shareholders	12,713,874	1.32		-11,431,810			-11,431,810	1,282,064	0.13
Comprising: Domestic legal person shares	11,431,810	1.19		-11,431,810			-11,431,810	0	0
Domestic natural person shares (including shares held by senior management of the Company)	1,282,064	0.13		0			0	1,282,064	0.13
4. Foreign shares	18,290,896	1.91		-18,290,896			-18,290,896	0	0
Comprising: Foreign legal person shares	18,290,896	1.91		-18,290,896			-18,290,896	0	0
Foreign natural person shares	0	0		0			0	0	0
II. Shares not subject to lock-up	536,436,976	55.91		+110,819,869			+110,819,869	647,256,845	67.46
1. RMB ordinary shares	376,285,936	39.22		+110,819,869			+110,819,869	487,105,805	50.77
2. Domestic-listed foreign shares	0	0		0			0	0	0
3. Oversea-listed foreign shares (H shares)	160,151,040	16.69		0			0	160,151,040	16.69
4. Others	0	0		0			0	0	0
III. Total numbers of shares	959,521,650	100		0			0	959,521,650	100

Note 1: On 29 December 2006, 110,819,869 shares held by holders of non-circulating shares of the Company were unlocked and made available for listing and circulation. Please refer to the Indicative Announcement on the Unlocking of Shares of ZTE Corporation published by the Company on the designated website for information disclosure on 26 November 2006 for details.

Note 2: At the end of the year, the Company did not have any employee shares.

4.2 Shareholders

4.2.1 Top ten shareholders of the Company and top ten holders of the shares of the Company that are not subject to lock-up.

Total numbers of shareholders Number of shareholders: the Company had 37,729 shareholders in total (of which 37,324 were holders of A shares and 405 were holders of H shares).

Top ten shareholders

Name of shareholders	Nature of shareholders	Percentage shareholding (%)	Total no. of shares held (shares)	Number of shares held that are subject to lock-up (shares)	Number of shares pledged or locked up
1. Zhongxingxin	State-owned shareholders	37.41	358,958,824	310,982,741	None
2. HKSCC Nominees Limited	Foreign shareholders	16.64	159,643,439	—	Unknown
3. JADE DRAGON (MAURITIUS) LIMITED	Foreign shareholders	1.91	18,290,896	—	Unknown
4. ICBC Credit Suisse Stable Growth Stock Securities Investment Fund	Others	1.45	13,875,942	—	Unknown
5. DEUTSCHE BANK AKTIENGESELLSCHAFT	Foreign shareholders	1.32	12,699,431	—	Unknown
6. ICBC Credit Suisse Selected and Balanced Hybrid Fund	Others	1.26	12,096,825	—	Unknown
7. Hunan Nantian (Group) Co., Ltd	Others	1.19	11,431,810	—	Unknown
8. E Fund Selective Value	Others	0.92	8,860,354	—	Unknown
9. China Life Insurance Company Limited — Dividends — Individual Dividends — 005L-FH002 Shen	Others	0.86	8,208,418	—	Unknown
10. ICBC Credit Suisse Core Value Stock Securities Investment Fund	Others	0.73	7,009,592	—	Unknown

Top ten holders of shares not subject to lock-up

Name of shareholder	Number of shares held that were not subject to lock-up	Class of shares
1. HKSCC Nominees Limited	159,643,439	H shares
2. JADE DRAGON (MAURITIUS) LIMITED	18,290,896	A shares
3. ICBC Credit Suisse Stable Growth Stock Securities Investment Fund	13,875,942	A shares
4. DEUTSCHE BANK AKTIENGESELLSCHAFT	12,699,431	A shares
5. ICBC Credit Suisse Selected and Balanced Hybrid Fund	12,096,825	A shares
6. Hunan Nantian (Group) Co., Ltd	11,431,810	A shares
7. E Fund Selective Value	8,860,354	A shares
8. China Life Insurance Company Limited — Dividends — Individual Dividends — 005L-FH002 Shen	8,208,418	A shares
9. ICBC Credit Suisse Core Value Stock Securities Investment Fund	7,009,592	A shares
10. Harvest Sustained Open Fund (嘉實穩健開放式證券投資基金)	6,263,819	A shares

Descriptions of any connected party relationships or concerted party relationships among the above shareholders

- Among the Company's top ten holders of shares not subject to lock-up, ICBC Credit Suisse Stable Growth Stock Securities Investment Fund (4th), ICBC Credit Suisse Selected and Balanced Hybrid Fund (6th) and ICBC Credit Suisse Core Value Stock Securities Investment Fund (10th) are managed by the same fund manager, ICBC Credit Suisse Fund Management Co., Ltd.
- There were no connected party relationships or concerted party relationships between Zhongxingxin and other top ten shareholders and top holders of shares not subject to lock-up.
- Save for the above, the Company is not aware of any connected party relationships or concerted party relationships among the top ten shareholders and the top ten holders of shares that are not subject to lock-up.

Agreed period of shareholding for strategic investors or legal persons participating in the placing of new shares	Name of shareholder	Agreed period of shareholding
	N/A	N/A

4.2.2 Listing and trading dates for shares subject to lock-up

Time for listing and trading	Number of additional shares to be listed and traded upon expiry of lock-up (shares)	Balance of shares subject to lock-up (shares)	Balance of shares not subject to lock-up (shares)
29 December 2006	110,819,869	310,982,741	110,819,869
29 December 2007	47,976,083	263,006,658	158,795,952
29 December 2008	263,006,658	—	421,802,610

4.2.3 There were nine shareholders of the Company subject to lock-up, the shareholding and lock-up conditions of which are set out as follows:

Name of shareholders subject to lock-up	Shares (A shares) held subject to lock-up (share)	Time for listing and trading	Number of additional shares to be listed and traded upon expiry of lock-up (shares)	Lock-up terms
Shenzhen Zhongxingxin Telecommunications Equipment Company, Limited ("Zhongxingxin")	358,958,824	29 December 2006	47,976,083	Note 1 & 2 & 3
Jade Dragon(Mauritius) Limited	18,290,896	29 December 2006	47,976,083	Note 2 & 3
Hunan Nantian (Group) Co., Ltd	11,431,810	29 December 2006	263,006,658	Note 2 & 3
Lishan Microelectronics Corporation	5,520,180	29 December 2006	18,290,896	Note 2 & 3
CASIC Shenzhen (Group) Company, Limited	5,520,180	29 December 2006	11,431,810	Note 2 & 3
China Mobile Telecommunications No. 7 Research Institute	5,520,180	29 December 2006	5,520,180	Note 2 & 3
Shaanxi Telecommunications Industrial Company	5,520,180	29 December 2006	5,520,180	Note 2 & 3
Jilin Posts and Telecommunications Equipment Company	5,520,180	29 December 2006	5,520,180	Note 2 & 3
Hebei Telecommunications Equipment Company, Limited	5,520,180	29 December 2006	5,520,180	Note 2 & 3

Note 1: The following undertakings relating to the Share Reform Plan were made by Zhongxingxin, the largest shareholder of the Company in the Revised Share Reform Plan of ZTE Corporation announced on the designated website for information disclosure on 23 November 2005:

Statutory undertakings: to comply with the laws, regulations and rules and perform its statutory obligations, namely not to transfer or trade the listed shares, which are converted from the Non-circulating Shares, held by it within 12 months from the first trading day after implementation of the Share Reform Plan; and not to sell its original Non-circulating Shares amounting to more than five per cent (5%) of the total share capital of the Company by way of trading subsequent to their listing on the Shenzhen Stock Exchange within 12 months and not to sell more than ten per cent (10%) within 24 months after the above lock-up period.

Special undertakings: Where Zhongxingxin sells its shares during the period from the 13th month to the 24th month after such shares have been granted the right of listing and circulation on the Shenzhen Stock Exchange, the price at which the shares are sold shall not be less than RMB30.76 per share, which is 115% of the mathematical average of the closing prices of its A shares for the 60 trading days prior to the initial announcement made by the directors of the Company regarding the Share Reform Plan, that is, RMB26.75 per share (such price to be calculated on an ex-rights basis and net of any dividends, bonus issues and capitalisation of capital reserve during the period from the implementation date of the Share Reform Plan to the date of sale). The proceeds from any sale by Zhongxingxin in breach of such undertaking shall be reverted to the Company's account for the benefit of all shareholders of the Company.

The price of "30.76" specified in the special undertaking by Zhongxingxin set out above has been adjusted to "30.51" following the implementation of the 2005 profit distribution plan of the Company on 14 July 2006.

Note 2: To comply with the laws, regulations and rules and perform its statutory obligations, namely not to transfer or trade the listed shares, which are converted from the Non-circulating Shares, held by it within 12 months after completion of the Share Reform Plan.

Note 3: Please refer to the Indicative Announcement on the Unlocking of Shares of ZTE Corporation published by the Company on the designated website for information disclosure on 26 November 2006 for details.

4.3 Controlling shareholder and de facto controller

4.3.1 Changes in controlling shareholder and de facto controller

Applicable N/A

4.3.2 Details of controlling shareholder and de facto controller

4.3.2.1 Name of controlling shareholder of the Company: Shenzhen Zhongxing Xin Telecommunications Equipment Company, Limited ("Zhongxingxin")

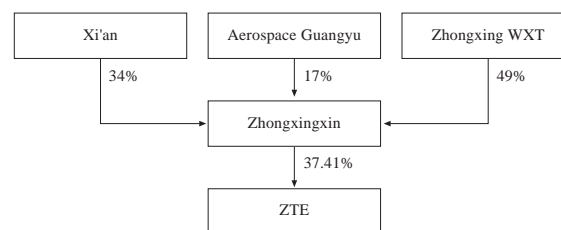
Legal representative:	Zhang Taifeng
Date of incorporation:	29 April 1993
Registered capital:	RMB100,000,000
Scope of business:	production of programmed switchboard cabinets, telephones and related components, electronic products; import and export operations; treatment of toxic fumes, waste water and noise and related technical services, research and technical development of environmental protection equipment; production of continuous monitoring smoke systems.

4.3.2.2. The controlling shareholders (or de facto controller) of the Company's controlling shareholder

The controlling shareholder of the Company, Zhongxingxin was jointly formed by Xi'an Microelectronics, Shenzhen Aerospace Guangyu Industrial Group Company ("Aerospace Guangyu") and Zhongxing WXT, each holding a 34%, 17% and 49% stake in Zhongxingxin respectively. Zhongxingxin currently has 9 directors, of which 3 have been nominated by Xi'an Microelectronics, 2 by Aerospace Guangyu and 4 by Zhongxing WXT, representing 33.33%, 22.22% and 44.45% of the board of directors of Zhongxingxin respectively. Therefore, no shareholder of Zhongxingxin shall have the right to control the financial and operating decisions of the Company whether in terms of shareholding or corporate governance structure and no party has effective control over the Company. Details of these three shareholders are as follows:

- Xi'an Microelectronics, a subsidiary of China Aerospace Times Electronics Corporation, is a large state-owned research institute, which was established in 1965 with its establishment expenses amounting to RMB198,530,000. The legal representative of the institute is Mr. Zhang Junchao. It is the only specialized research institute in China which integrates and complements the research, development and production of semiconductor integrated circuits, mixed integrated circuits and computers.
- Aerospace Guangyu, a subsidiary of CASIC, is a wholly state-owned enterprise established on 20 March 1984. The legal representative is Mr. Xie Weiliang and the registered capital amounts to RMB17,950,000. The scope of business includes aerospace technical products, mechanical products, electrical appliance products, apparatuses and instruments; electronic products, plastic products, chemical products, hoisting and transportation products, hardware and furniture, construction materials, magnetic materials, powder metallurgy, Chinese-manufactured automobiles (except sedans), warehousing and import and export operations.
- Zhongxing WXT is a private high-technology enterprise incorporated on 23 October 1992. Its legal representative is Mr. Hou Weigui and its registered capital amounts to RMB10,000,000. The scope of business includes the development and production of telecommunications and transmission equipment, associated equipment, computer and peripheral equipment.

The following diagram shows the shareholding relationships between the above units and the Company as at 31 December 2006:



5 DIRECTORS, SUPERVISORS AND SENIOR MANAGEMENT

5.1 Changes in the shareholdings and annual remuneration of Directors, Supervisors and senior management

Name	Gender	Age	Title	Term of Office	No. of A shares held at beginning of the reporting period (shares)	Change in the no. of shares held during the reporting period (shares)	No. of A shares held at end of the reporting period (shares)	Total annual remuneration received from the Company (RMB10,000) (before tax and excluding share incentive scheme cost)	Whether remuneration is received from shareholder entities or other connected entities
Hou Weigui	Male	65	Chairman	2/2004-2/2007	219,600	0	219,600	73.72	No
Wang Zongyin	Male	62	Vice Chairman	2/2004-2/2007	0	0	0	6.00	Yes
Xie Weiliang	Male	51	Vice Chairman	2/2004-2/2007	0	0	0	6.00	Yes
Zhang Junchao	Male	53	Director	2/2004-2/2007	0	0	0	6.00	Yes
Li Juping	Male	51	Director	2/2004-2/2007	0	0	0	6.00	Yes
Dong Lianbo	Male	50	Director	2/2004-2/2007	0	0	0	6.00	Yes
Yin Yimin	Male	43	Director and President	2/2004-2/2007	121,680	0	121,680	157.22	No
Shi Lirong	Male	43	Director and Senior Vice President	2/2004-2/2007	95,760	0	95,760	78.34	No
He Shiyou	Male	40	Director and Senior Vice President	2/2004-2/2007	91,007	0	91,007	82.61	No
Zhu Wuxiang	Male	41	Independent Director	2/2004-2/2007	0	0	0	6.00	No
Chen Shaohua	Male	45	Independent Director	2/2004-2/2007	0	0	0	6.00	No
Qiao Wenjun	Male	36	Independent Director	2/2004-2/2007	0	0	0	6.00	No
Mi Zhengkun	Male	61	Independent Director	2/2004-2/2007	0	0	0	6.00	No
Li Jim	Male	39	Independent Director	6/2004-2/2007	0	0	0	6.00	No
Zhang Taifeng	Male	65	Chairman of the Supervisory Committee	2/2004-2/2007	121,680	0	121,680	73.43	No
Wang Wangxi	Male	40	Independent Director	2/2004-2/2007	0	0	0	50.68	No
He Xuemei	Female	36	Independent Director	2/2004-2/2007	0	0	0	25.88	No
Qu Deqian	Male	45	Independent Director	5/2005-2/2007	10,020	0	10,020	0	Yes
Wang Yan	Female	42	Independent Director	5/2005-2/2007	0	0	0	0	Yes
Wei Zansheng	Male	44	Senior Vice President and Chief Financial Officer	2/2004-2/2007	95,760	0	95,760	76.06	No
Xie Daxiong	Male	43	Senior Vice President	2/2004-2/2007	44,839	0	44,839	89.65	No
Zhou Susu	Female	52	Senior Vice President	2/2004-2/2007	95,760	0	95,760	71.01	No
Tian Wenguo	Male	38	Senior Vice President	2/2004-2/2007	24,300	0	24,300	75.61	No
Fang Kong	Female	42	Vice President	2/2004-2/2007	41,385	0	41,385	75.43	No
Chen Jie	Female	48	Vice President	2/2004-2/2007	94,500	0	94,500	75.12	No
Ding Mingfeng	Male	37	Vice President	2/2004-2/2007	61,756	0	61,756	64.87	No
Zhang Chuanghai	Male	41	Vice President	2/2004-2/2007	9,900	0	9,900	75.27	No
Ye Weimin	Male	40	Vice President	2/2004-2/2007	33,804	0	33,804	58.57	No
Qiu Weizhao	Male	43	Vice President	2/2004-2/2007	0	0	0	71.01	No
Ni Qin	Male	47	Vice President	2/2004-2/2007	78,840	0	78,840	71.28	No
Zhao Xianming	Male	40	Vice President	2/2004-2/2007	0	0	0	102.17	No
Yu Huijun	Male	33	Vice President	2/2004-2/2007	0	0	0	79.39	No
Pang Shengguang	Male	38	Vice President	4/2006-2/2007	0	0	0	79.71	No
Zhong Hong	Male	37	Vice President	4/2006-2/2007	0	0	0	61.01	No
Fan Qingfeng	Male	38	Vice President	4/2006-2/2007	0	0	0	72.06	No
Yu Yong	Male	40	Vice President	4/2006-2/2007	0	0	0	60.57	No
Zeng Xuezhong	Male	33	Vice President	8/2006-2/2007	0	0	0	89.87	No
Feng Jianxiang	Male	33	Secretary to the Board	2/2004-2/2007	0	0	0	35.70	No
Total					1,240,591	0	1,240,591	1,986.24	—

5.2 Directors', Supervisors' and President's interests in shares or debentures

The interests in shares of the Company held by Directors, Supervisors and the President of the Company as at 31 December 2006 are set out in Section 5.1.

Save as disclosed above, as at 31 December 2006, none of the Directors, Supervisors and the President had any interest or short position in the shares, underlying shares and debentures of the Company and its associated corporations (within the meaning of Part XV of the Securities and Futures Ordinance) that is required to be recorded in the register to be kept by the Company under Section 352 of the Securities and Futures Ordinance, or otherwise notified to the Company and The Stock Exchange of Hong Kong Limited ("Hong Kong Stock Exchange") pursuant to the Model Code for Securities Transactions by Directors of Listed Companies ("Model Code") as set out in Appendix 10 to the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited ("Hong Kong Stock Exchange Listing Rules").

As at 31 December 2006, none of the Directors, Supervisors or the President of the Company, or their respective spouses or children under the age of 18 had been granted or had exercised any rights to subscribe for the share capital or debentures of the Company or its associated corporations.

6 REPORT OF THE BOARD OF DIRECTORS

6.1 Discussion and analysis of overall operations during the reporting period

6.1.1 Review of Results

Business of the Group

The Group is principally engaged in the design, development, production, distribution and installation of a broad range of advanced telecommunications equipment, including wireless communications systems, wireline switch and access equipment, optical and data communications equipment, handsets, and telecommunications software systems and services.

Financial Results

Please refer to the financial statements appended to this annual report summary for the results of the Group for the year ended 31 December 2006 prepared in accordance with PRC GAAP and HKFRSs.

Business Review

Overview of the PRC telecommunications industry in 2006

China's telecommunications industry maintained sustainable growth during 2006. According to the statistics from the Ministry of Information Industry, revenue for the telecommunications sector in China grew by 11.7% to RMB648.4 billion and capital expenditure grew by 7.5% to RMB218.7 billion, as compared to the same period last year. Driven by the mobile and data businesses, the telecommunications sector enjoyed sound overall growth. Carriers increased their investments in transmission setup to enable speedy network rollouts as would be required in the coming 3G era. On the other hand, expenditure on CDMA and PHS, the Group's traditional leading products in the domestic market, continued to decline significantly. TD-SCDMA assumed growing importance in China's telecommunications industry as the government enhanced policy directives over proprietary intellectual property rights, although tangible investments in TD-SCDMA had yet to occur in large scale.

Overview of the global telecommunications industry in 2006

Growth in the global telecommunications sector slowed down to begin a period of adjustment in 2006 following significant gains in 2004 and 2005. According to the statistics from Gartner, revenue of the global telecommunications market was worth US\$1,663.3 billion in 2006, in which the telecommunications equipment market accounted for US\$334.2 billion. In 2007, the revenue of the telecommunications equipment market is expected to increase slightly to US\$353.7 billion. An overview of the regional markets indicates that while Western Europe, North America and the Asia Pacific account for over three quarters of the telecommunications market, the momentum for future growth lies with emerging markets like the Middle East and Africa.

Operating results of the Group for 2006

Revenue from the Group's principal operations based on the financial statements prepared in accordance with PRC GAAP amounted to RMB23.032 billion, representing a year-on-year growth of 6.7%. Net profit amounted to 807 million, representing a year-on-year decrease of 32.4%.

Revenue from the Group's principal operations based on the financial statements prepared in accordance with HKFRSs amounted to RMB23.032 billion, representing a year-on-year growth of 6.7%. Net profit amounted to 767 million, representing a year-on-year decrease of 40.4%.

By market:

The domestic market

In 2006, the Group registered RMB12.802 billion in revenue from its domestic principal operations, declined by 7.7% compared to the previous year. In the PRC market, there were opportunities as well as challenges for the Group in 2006. The Group countered the significant decline of investment in its traditional CDMA and PHS products and stabilised sales in the domestic market by expanding its market share in GSM and other products. Meanwhile, the Group vigorously implemented the State policy of proprietary innovation and positioned itself favourably for the future 3G market in China in close cooperation with the carriers.

The international market

In 2006, the Group's revenue from its international principal operations grew 32.8% to RMB10.230 billion and accounted for 44.4% of its total revenue from principal operations, which was 8.7 percentage points higher compared the previous year, as it continued full-scale execution of its strategy of internationalization. Regionally, major breakthroughs were achieved in the market for multinational carriers in the Asia Pacific region, as a result of our strategy to focus on mainstream multinational carriers. Strong sales growth was registered in North Africa while groundbreaking sales were being made in Europe and North America.

By product:

Wireless communications products

The Group was capable of mass production of 3G products in all three standards, namely TD-SCDMA, WCDMA and CDMA2000, for commercial application. In 2006, the Group engaged in TD-SCDMA trial network tests in Xiamen and Qingdao, in collaboration with China Mobile and China Netcom, respectively. The results have been encouraging and positive relationships have been built with the carriers. Research and development efforts relating to the serialization of WCDMA base stations progressed smoothly. Breakthroughs were achieved in for high-efficiency power amplifier and core technologies of baseband in 2006. While maintaining our low-cost advantage, we have surpassed some of our competitors in terms of the performance and speed of our products, which delivered outstanding results in the HSDPA tests conducted by China Mobile and China Telecom Research Institute.

Our GSM products enjoyed strong growth in 2006, having been short-listed by multinational carrier projects in South Asia and Eastern Europe while gaining access to the Indian market. The international sales of our CDMA products also were also underpinned by substantial growth as inroads were being made in North America.

Switch and access products

Carriers' investments in traditional switch and access products continued to decline in 2006. The Group responded by increasing its market share in traditional products and driving its fixed line intelligence solutions in tandem with changing approaches of the carriers.

Data and optical communications and products

The Group provides a variety of data communications equipment such as NGN, DSL systems, routers, routing switches and wireless access data products. The DC1 IDD network built by the Group on behalf of China Telecom passed the final phase of inspection and acceptance. In the optical communications sector, multi-purpose transmission equipment adaptable to backbone networks, convergence levels and access level were launched. We also started research and development on the ASON version during the year. All in all, there was significant progress over the previous year in term of regional coverage and network levels.

Handsets

The Group made inroads towards market diversification for its handset products with balanced development between the global and the domestic markets, in contrast to being confined to sale of PHS and CDMA handsets in the domestic market prior to 2005.

On the domestic front, our A12 GSM handset model was selected as one of China Mobile's customised handsets, laying solid foundations for further collaborations with China Mobile. Our CDMA handsets maintained a strong share of the PRC market. Our U310 TD handset received the first approval for trial network access by TD handsets, while U350 was introduced to the market as the first TD+GSM dual mode handset in the world. Internationally, the growth in the sales of CDMA handsets was most notable.

Miscellaneous

In 2006, the Group completed the first mass production of its IPTV products. With increasing carrier investment in value-added services and the growth of the network management business, prospects look promising for this type of products and its related services.

6.1.2 Future changes in the accounting policies and accounting estimates of the Company following the implementation of new accounting standards and its impact on the financial conditions and operating results of the Company

Applicable N/A

In accordance with Order No. 33 of the Ministry of Finance and requirements of the document Cai Kuai [2006] No. 3 (財會[2006]3), the Company resolved to carry out full implementation of the revised "Enterprise Accounting Standards — Basic Standards" and 38 implementation rules, including "Enterprise Accounting Standard No. 1 — Inventory" and others, with effect from 1 January 2007, whereupon the "Enterprise Accounting System" and original "Enterprise Accounting Standards" shall cease to be implemented.

In accordance with "Enterprise Accounting Standard No. 38 — Initial Implementation of the Enterprise Accounting Standards," the Company shall classify, recognise and measure anew all assets, liabilities and shareholders' equity in accordance with the provisions of the Enterprise Accounting Standards on the date of initial implementation. The effect of the adjustment on the date of initial implementation on the shareholders' equity at the beginning of 2007 was a decrease of RMB21,955,000 in shareholders' equity. Please refer to part 10.7 "Statement of reconciliation of differences in combined shareholders' equity under old and new accounting standards" for details.

The impact of the implementation of new Enterprise Accounting Standards on the Company's financial report mainly included the following:

- Research and development expenses incurred by the Company during the development stage may, subject to certain conditions, be recognised as intangible assets and amortised over the benefit period;
- For sales contracts that effectively embody a financing nature with deferred receipt of sales amounts, operating income shall be recognised at the fair value of the goods sold and finance gains arising from the contracts shall be recognised on a deferred basis;
- Staff welfare expenses shall be recognised as remuneration payable to staff (staff welfare) based on the actual staff welfare expenses and the welfare schemes;
- Share-based payments settled in equity (such as the Phase 1 Share Incentive Scheme of the Company) shall be recognised as current expenses at the fair value of the equity tools based of the number of options exercised;
- Government subsidies shall be recognised when the conditions of grant are being fulfilled and such subsidies become receivable, rather than upon actual receipt. Expenses or asset depreciation related to government subsidies shall be directly charged to the current profit and loss when incurred; government subsidies used as compensation shall be concurrently recognised as non-operating income;
- Changes in the fair value of financial assets or liabilities that are measured at fair value and whose changes are dealt with in profit and loss shall be directly to the current income statement and balance sheet.
- Derivative financial tools, hedging tools and their profit or loss shall be separately recognised in the financial report;
- Real estate properties held for investment purposes shall be separately recognised in the financial report using cost model measurement, if such costs can be reliably measured;
- Investments in subsidiaries shall be accounted for using the cost method and dividends payable by the subsidiaries to the parent shall not be recognised as investment gains until being declared, with no impact on the consolidated statement.

The implementation of the new Enterprise Accounting Standards, will further standardise the Company's accounting recognition, measurement and reporting, improve the quality of its financial information and narrow the differences between financial reports prepared under PRC accountings standards and Hong Kong financial reporting standards.

6.2 Principal operations analysed by industry and product segments (under PRC GAAP)

Major industries and products accounting for more than 10% of revenue from principal operations or profit from principal operations (under PRC GAAP)

	Revenue from principal operations (RMB in millions)	Cost of principal operations (RMB in millions)	Profit margin of principal operations (%)	Year-on-year increase/decrease in revenue from principal operations	Year-on-year increase/decrease in cost of principal operations	Year-on-year increase/decrease in profit margin of principal operations (basis point)
By industry						
Manufacturing of communications systems	23,031.7	15,171.8	33.6%	6.7%	8.8%	-1.3
By product						
Wireless communications systems	9,186.9	5,225.0	42.6%	2.9%	6.0%	-1.7
Wireline switch and access systems	2,279.4	1,356.2	40.0%	-17.2%	9.3%	-14.5
Optical and data communications systems	3,874.7	2,944.6	23.5%	15.6%	10.5%	3.5
Handset	4,519.5	3,375.2	24.8%	4.3%	-5.6%	7.8
Telecommunication software systems, services and other products	3,171.2	2,270.8	27.9%	43.7%	48.0%	-2.1

6.3 Breakdown of principal operations by geographic region (under PRC GAAP)

Region	Revenue from principal operations (RMB in millions)	Year-on-year increase/decrease in revenue from principal operations (%)
The PRC	12,801.8	-7.7%
Asia (excluding the PRC)	5,753.7	25.9%
Africa	2,563.2	-9.6%
Other regions	1,913.0	543.0%
Total	23,031.7	6.7%

Purchases from and sales to customers

Purchases from top five suppliers

Total amount (RMB in millions)	As a percentage of total purchases
2,762.0	19.5%

Sales to top five customers

Total amount (RMB in millions)	As a percentage of total sales
9,171.4	39.8%

6.4 Management discussion and analysis on financial data of the Group prepared in accordance with HKFRSs

The financial data below are extracted from the Group's audited financial statements prepared in accordance with HKFRSs. The following discussion and analysis should be read in conjunction with the Group's financial statements audited by Ernst & Young and the accompanying notes as set out in this annual report.

Financial Data

Unit: RMB in millions

	2006	2005
Revenue		
Wireless communications	9,186.9	8,930.8
Wireline switch and access	2,279.4	2,752.6
Optical and data communications	3,874.7	3,353.0
Handset	4,519.5	4,333.1
Telecommunications software systems, services and other products	3,171.2	2,206.4
Total revenue	23,031.7	21,575.9
Cost of sales	(15,250.5)	(14,101.7)
Gross profit	7,781.2	7,474.2
Other revenue and gains	792.1	681.6
Research and development costs	(2,832.7)	(1,959.5)
Selling and distribution costs	(3,274.6)	(3,186.4)
Administrative expenses	(1,097.6)	(1,095.4)
Other expenses	(191.5)	(128.6)
PROFIT FROM OPERATING ACTIVITIES	1,176.9	1,785.9
Finance costs	(153.7)	(175.9)
Share of profits and losses of jointly-controlled entities and associates	7.5	(4.2)
PROFIT BEFORE TAX	1,030.7	1,605.8
Tax	(127.1)	(179.8)
PROFIT BEFORE MINORITY INTERESTS	903.6	1,426.0
Attributable to:		
Minority interests	(136.6)	(138.3)
Equity holders of the parent	767.0	1,287.7
Dividends	143.9	239.9
Earnings per share — basic	RMB0.80	RMB1.34
diluted	RMB0.80	N/A

Revenue analysed by product and geographic region

The following table sets out the revenue and the corresponding percentage of the total revenue attributable to the major product segments of the Group for the periods indicated:

Unit: RMB in millions

Product segment	2006		2005	
	Revenue	Percentage of total revenue	Revenue	Percentage of total revenue
Wireless communications	9,186.9	39.9%	8,930.8	41.4%
Wireline switch and access	2,279.4	9.9%	2,752.6	12.8%
Optical and data communications	3,874.7	16.8%	3,353.0	15.5%
Handset	4,519.5	19.6%	4,333.1	20.1%
Telecommunications software systems, services and other products	3,171.2	13.8%	2,206.4	10.2%
Total	23,031.7	100.0%	21,575.9	100.0%

The following table sets out the Group's revenue generated from sales in the PRC, Asia (excluding the PRC), Africa and other regions and the corresponding percentage of total revenue for the periods indicated:

Unit: RMB in millions

Region	2006		2005	
	Revenue	Percentage of total revenue	Revenue	Percentage of total revenue
The PRC	12,801.8	55.6%	13,874.3	64.3%
Asia (excluding the PRC)	5,753.7	25.0%	4,568.7	21.2%
Africa	2,563.2	11.1%	2,835.4	13.1%
Other regions	1,913.0	8.3%	297.5	1.4%
Total	23,031.7	100.0%	21,575.9	100.0%

The Group's revenue in 2006 increased 6.7% to RMB23,031.7 million, as compared to RMB21,575.9 million in 2005. The increase was mainly attributable to growth in revenue from the wireless communications segment, the optical and data communications segment, the handset segment, the telecommunications software systems, and the services and other products segment, which was partially offset by the decrease in revenue from sales of wireline switch and access products. The Group's international business maintained rapid growth in 2006 with sales revenue rising 32.8% to RMB10,229.9 million as compared to RMB7,701.6 million in 2005, although the growth was partially offset by the decline in domestic sales revenue due to a decrease in capital expenditure of domestic carriers who were in the process of adjusting their investment structure.

The Group's revenue from the wireless communications business slightly increased 2.9% to RMB9,186.9 in 2006, as compared to RMB8,930.8 million in 2005. The increase was mainly attributable to solid increases in the international sales of GSM systems, partially offset by the declining PHS revenue resulting from declining investments in PHS network construction by domestic carrier.

The Group's revenue from the wireline switch and access segment decreased 17.2% to RMB2,279.4 million in 2006, as compared to RMB2,752.6 million in 2005. The setback was mainly attributable to the decline in sales revenue from both overseas and domestic markets.

The Group's revenue from the optical and data communications segment increased 15.6% to RMB3,874.7 million in 2006, as compared to RMB3,353.0 million in 2005, reflecting mainly the growth of domestic sales revenue for the segment, partially offset by the decline in international sales revenue.

The Group's revenue from the handsets business amounted RMB4,519.5 million in 2006, up 4.3% from RMB4,333.1 million in 2005. The increase was mainly attributable to the growth in revenue generated from the sales of 3G and CDMA handsets, although this was partially offset by reduced sales of the Group's GSM and PHS handsets.

The Group's revenue from the telecommunications software systems, services and other products segment increased 43.7% to RMB3,171.2 million in 2006, as compared to RMB2,206.4 million in 2005, benefiting mainly from stronger sales in video communication products, terminal products and overseas telecommunications services.

Cost of sales and gross profit analysed by product

The following tables set out (1) the cost of sales and cost of sales as a percentage of total revenue and (2) the Group's gross profit and gross profit margin for the periods indicated:

Unit: RMB in millions

Product segment	2006		2005	
	Cost of Sales	Percentage of product segment revenue	Cost of Sales	Percentage of product segment revenue
Wireless communications	5,276.6	57.4%	5,021.6	56.2%
Wireline switch and access	1,361.5	59.7%	1,260.9	45.8%
Optical and data communications	2,959.8	76.4%	2,697.7	80.5%
Handset	3,364.5	74.4%	3,575.0	82.5%
Telecommunications software systems, services and other products	2,288.1	72.2%	1,546.5	70.1%
Total	15,250.5	66.2%	14,101.7	65.4%

Unit: RMB in millions

Product segment	2006		2005	
	Gross profit	Gross profit margin	Gross profit	Gross profit margin
Wireless communications	3,910.3	42.6%	3,909.2	43.8%
Wireline switch and access	917.9	40.3%	1,491.7	54.2%
Optical and data communications	914.9	23.6%	655.3	19.5%
Handset	1,155.0	25.6%	758.1	17.5%
Telecommunications software systems, services and other products	883.1	27.8%	659.9	29.9%
Total	7,781.2	33.8%	7,474.2	34.6%

The Group's gross profit rose to RMB7,781.2 million in 2006 from RMB7,474.2 million in 2005, although its gross profit margin for 2006 dropped slightly to 33.8% from 34.6% in 2005 due primarily to the decrease in the gross profit margin of wireless communication products, wireline switch and access products and telecommunications software systems, services and other products, which was more than offset by improved gross profit margin for handsets and optical and data communications products.

Gross profit margin of the Group's wireless communications business dropped to 42.6% in 2006 from 43.8% in 2005 mainly as a result of declined gross profit margin for CDMA systems, partially offset by improved gross profit margin for PHS systems and GSM systems.

Gross profit margin in the Group's wireline switch and access segment dropped to 40.3% in 2006 from 54.2% in 2005 as a result of lower prices for the segment in line with shrinking market demand.

Gross profit margin in the Group's optical and data communications business rose to 23.6% in 2006 from 19.5% in 2005, mainly reflecting improved gross profit margin for DSL products, routers, router switches and other data communications products.

Gross profit margin in the Group's handsets segment rose to 25.6% in 2006 from 17.5% in 2005 in tandem with rising gross profit margin for 3G and PHS handsets. International sales of 3G handsets increased further as the Group made further inroads in the international market. Gross profit margin for PHS handsets improved despite decreased sales in 2006 as compared to 2005 owing to reduced investments by carriers, due to effective cost reductions resulting from ongoing upgrades in technology and production processes. In addition, the gross profit margin of CDMA handsets and GSM handsets also enjoyed slight improvement in tandem with reduced production costs.

Gross profit margin in the Group's telecommunications software systems, services and other products segment decreased to 27.8% in 2006 from 29.9% in 2005. The decrease was mainly attributable to increased sales of low-margin items such as video communication products and network terminal products resulting in lower gross profit margin for the segment.

Other Revenue and Gains

Other revenue and gains of the Group increased 16.2% to RMB792.1 million in 2006 from RMB681.6 million in 2005. The increase was mainly attributable to the increase in VAT rebate income.

Research and Development costs

The Group's research and development costs increased 44.6% to RMB2,832.7 million in 2006 from RMB1,959.5 million in 2005, mainly as a result of increased investment in customised products for overseas strategic markets and advanced technologies such as 3G, WIMAX and IMS. It was also owing to the capitalisation of certain development expenses in 2005. Research and development costs accounted for 12.3% of revenue from principal operations in 2006, as compared to 9.1% in 2005.

Selling and Distribution Costs

The Group's selling and distribution costs in 2006 amounted to RMB3,274.6 million, representing a 2.8% increase comparing to RMB3,186.4 million in 2005. Selling and distribution costs accounted for 14.2% of revenue from principal operations in 2006, as compared to 14.8% in 2005.

Administrative Expenses

The Group's administrative expenses in 2006 amounted to RMB1,097.6 million, 0.2% up from RMB1,095.4 million in 2005, although administrative expenses accounted for 4.8% of revenue from principal operations in 2006, as compared to 5.1% in 2005.

Other Expenses

Other expenses of the Group increased 48.9% to RMB191.5 million in 2006 from RMB128.6 million in 2005. The increase mainly reflected increased bad debt provision which was partially offset by the decrease in exchange losses and goodwill impairment.

Profit from Operating Activities

The Group's profit from operating activities decreased 34.1% from RMB1,785.9 million in 2005 to RMB1,176.9 million in 2006, while the profit margin from operating activities dropped to 5.1% in 2006 from 8.3% in 2005, which was mainly attributable to the increase in research and development costs, selling and distribution costs and other expenses.

Finance Costs

The Group's finance costs decreased 12.6% to RMB153.7 million in 2006 from RMB175.9 million in 2005, mainly as a result of reduced expenses in line with decreased factoring of accounts receivable of the Group. The decrease was partially offset by higher financing costs accompanying increased interest-bearing bank loans.

Tax

The Group's tax expenses decreased 29.3% to RMB127.1 million in 2006 from RMB179.8 million in 2005 and its effective tax rate increased to 12.3% in 2006 from 11.2% in 2005, reflecting mainly the increase in effective tax liabilities of certain subsidiaries of the Group.

Minority Interests

The Group's minority interests in 2006 decreased 1.2% to RMB136.6 million from RMB138.3 million in 2005. Minority interests as a percentage of profit before minority interests increased to 15.1% in 2006 from 9.7% in 2005, mainly as a result of increased contribution to the Group's profit from subsidiaries in which minority shareholders of the Group had larger shareholdings.

Gearing Ratio and the Basis of Calculation

The Group's gearing ratio for 2006 was 18.8%, up 12.8 percentage points from 6.0% in 2005, mainly attributable to the increase in interest-bearing loans. The gearing ratio represented total interest-bearing loans as a percentage of total capital.

Liquidity and Capital Resources

In 2006, the Group's development funds were financed mainly by the proceeds from cash generated from its operations and bank loans. The Group's cash requirements related primarily to production and operating activities, repayment of due liabilities, capital expenditure, interest and dividend payments and other unforeseeable cash requirements.

Cash and cash equivalents of the Group as of 31 December 2006 amounted to RMB4,142.1 million.

Cash Flow Data

Unit: RMB in millions

	2006	2005
Net cash outflow from operating activities	(2,106.3)	(285.9)
Net cash outflow from investing activities	(1,115.2)	(1,067.3)
Net cash inflow/(outflow) from financing activities	1,975.6	(735.0)
Net decrease in cash and cash equivalents	(1,245.9)	(2,088.2)
Cash and cash equivalents at the end of the year	4,142.1	5,397.2

Operating Activities

Net cash outflow from the Group's operating activities amounted to RMB2,106.3 million in 2006 compared to net cash outflow of RMB285.9 million in 2005, consisting mainly of an increase of RMB2,412.9 million in trade and bills receivables (including approximately RMB2,273.4 million due in less than six months) and an increase in contract work amounts receivable of RMB1,144.3 million as telecommunications system construction project works were completed ahead of progress bill payments as a result of more favourable business terms offered by the Group to customers. Operating profit before working capital changes decreased from RMB2,222.9 million in 2005 to RMB1,863.1 million in 2006 because of increased research and development expenses and selling and distribution costs during the year. The aforesaid reduction in cash was partially offset by an increase in trade and bills payables due to delay in payment resulting from higher credit limit granted to the Group by its suppliers. Prepayments and other receivables increased by RMB309.5 million owing to an external loan granted by the Group in 2006. In 2006, the Group's receivables turnover rate was 3.7 compared to 4.0 in 2005. Inventory turnover rate was 6.5 compared to 7.1 in 2005. Payables turnover rate was 2.3 compared to 2.7 in 2005.

Investing Activities

Net cash outflow from the Group's investing activities in 2006 amounted to RMB1,115.2 million, as compared to net cash outflow of RMB1,067.3 million in 2005. The cash outlay in 2006 was mainly used in business and production expansion, comprising RMB1,135.7 million for the purchase of machinery and equipment, testing instruments, computers and replacements of and additions to office equipment and RMB43.9 million for the purchase of software and other intangible assets.

Financing Activities

Net cash inflow from the Group's financing activities in 2006 amounted to RMB1,975.6 million, as compared to net cash outflow of RMB735 million in 2005, representing mainly new loans amounting to RMB1,945.3 million.

Capital Expenditure

The following table sets out the Group's capital expenditure for the periods indicated. The following capital expenditure was funded out of the proceeds of the Company's initial public offering of H shares, long-term bank loans, cash generated from operating activities and government grants.

Unit: RMB in millions

Capital expenditure	2006	2005
Purchases of fixed assets and additions to construction in progress	1,135.7	803.8

The Group's capital expenditure in 2006 amounting to RMB1,135.7 million was mainly used to complete the construction of the ZTE research and development center in Shenzhen and purchase other equipment and facilities.

Indebtedness

Unit: RMB in millions

	At 31 December 2006	2005
Secured bank loans	394.7	47.7
Unsecured bank loans	2,230.3	632.0

Unit: RMB in millions

	At 31 December 2006	2005
Short-term bank loans	945.7	599.7
Long-term bank loans	1,679.3	80.0

Credit facilities available to the Group included long-term and short-term bank loans, which were mainly used as working capital. Within the Group's long-term loans, RMB loans were subject to fixed interest rates while USD loans were subject to floating interest rates. To control the risk associated with RMB appreciation, the Group's borrowings were mainly denominated in US dollars, apart from certain RMB loans.

The Group's bank loans in 2006 increased as a result of reduced factoring of accounts receivable and the borrowing of bank loans to provide additional working capital.

Contractual obligations

Unit: RMB in millions

	Total	As at 31 December 2006 Less than one year	Two to five years	More than five years
Bank loans	2,625.0	945.7	1,409.5	269.8
Operating lease obligations	201.4	118.3	81.5	1.6

Contingent liabilities

Unit: RMB in millions

	As at 31 December 2006	2005
Factored trade receivables	107.2	438.5
Guarantees given to banks in respect of performance bonds	5,200.6	2,823.8
Total	5,307.8	3,262.3

Capital Commitments

The Group had the following capital commitments as of the dates indicated:

Unit: RMB in millions

	As at 31 December 2006	2005
Land and buildings		
Contracted, but not provided for	796.0	231.6
Investment in an associate		
Contracted, but not provided for	80.3	21.1

Details of the Subsidiaries, Jointly-controlled Entities and Associates of the Group

Details of the subsidiaries, jointly-controlled entities and associates of the Group as at 31 December 2006 are set out in notes 18, 19 and 20 to the financial statements prepared in accordance with HKFRSs.

Prospects for New Business

Details of the prospects for new business of the Group are set out in the section headed "Chairman's Statement" in the Annual Report.

Employees

Details of the number of employees, remuneration, remuneration policy, bonus and training programs of the Group as at 31 December 2006 are set out in the sections headed "Directors, Supervisors, Senior Management and Employees" and "Corporate Governance Structure" in the Annual Report.

Charges on Assets

Details of charges on the Group's assets as at 31 December 2006 are set out in note 32 to the financial statements prepared under HKFRSs.

Plans for Material Investments or Acquisition of Capital Assets

Details of the Group's material investments and their performance and prospects as at 31 December 2006 are set out section headed "Report of the Board of Directors" in the Annual Report.

Details of plans for material investments or acquisition of capital assets are set out section headed "Report of the Board of Directors" in the Annual Report.

Market Risks

Interest rate risks:

The interest rate risk of the Group was mainly associated with the Company's interest bearing long-term liabilities. The Group controlled its interest rate risk mainly by rescheduling the maturity period of its debts.

Foreign Exchange risks:

The foreign exchange risk of the Group arose mainly from exchange differences in the conversion to RMB (the functional currency of the Group) of sales and purchases settled in currencies other than RMB. The Group attempts to include terms relating to exchange risk avoidance or allocation when entering into purchase and sales contracts. The Group endeavoured to enhance its internal management standards and actively managed its foreign exchange position. Matching of currencies and amounts received or incurred was conducted. Whereas matching was not practicable, derivative products such as foreign exchange forward contracts were employed to lock up exchange rates in varying proportions based on the maturity periods of the outstanding foreign exchange positions, so as to minimise the impact of exchange rate fluctuations on the principal business of the Group. With a strong emphasis on the research of exchange risk management policies, models and strategies, the Group has formulated a foreign exchange risk management policy that takes into account the business characteristics of the Company and international standards in risk management with ongoing improvements, and has gained considerable experience in exercising exchange risk management through the extensive use of exchange-related derivative products.

6.5 Use of proceeds

Applicable N/A

6.5.1 As at the end of the reporting period, utilisation of the proceeds from the H share global offering by the Company was as follows:

Unit: in RMB10,000

Gross amount of proceeds	354,217.8	Gross amount of proceeds utilised during the year	24,481.1
		Gross amount of proceeds utilised on an accumulated basis	354,217.8

Projects committed	Proposed amount of application of proceeds	Any changes to project	Actual amount of application of proceeds	Earnings generated	Whether project schedule has been met	Whether expected earnings has been attained
IP switching platforms for mobile communications	24,039	No	24,039	See below	Yes	Yes
Integrated mobile broadband service systems	22,525	No	22,525	See below	Yes	Yes
High speed packet mobile communication base station systems	23,820	No	23,820	See below	Yes	Yes
Intelligent wireless integrated access systems	12,890.1	No	12,890.1	See below	Yes	Yes
Core router	20,838	No	20,838	See below	Yes	Yes
NGN systems	20,118	No	20,118	See below	Yes	Yes
Automated optical switching network systems	17,457	No	17,457	See below	Yes	Yes
Sub-total	141,687.1	—	141,687.1	—	—	—
Overseas operations	212,530.7	—	212,530.7	See below	Yes	Yes
Total	354,217.8	—	354,217.8	—	—	—

Note As at 31 December 2006, proceeds from the global issue of H shares of the Company in 2004 had been utilised in full.

Progress of projects utilising H share issue proceeds and revenue from these projects are set out as follows:

IP switching platforms for mobile communications

The IP switching platforms for mobile communications for NGN network, base station controllers and the IP switching platform supporting a variety of core networks based on 3G wireless standards were completed as scheduled, putting the Company in a leading position in the industry. Mass production of IP switching platforms has commenced, generating sound earnings following commercial application by domestic mobile networks and in numerous countries around the world.

Integrated mobile broadband service system

Research and development of the integrated service platform for this project was completed and products in connection with services including network paging, network conferences, one-touch dialing, caller tunes, soft terminal communications, SMS and WAP were being extensively used in the networks of domestic carriers. Moreover, such products were also employed to provide value-added services to telecommunications carriers in countries including Columbia, Malaysia, the Philippines and Pakistan. In future, the integrated platform will be able to support services on PSTN, PHS, GSM, CDMA, 3G and NGN networks simultaneously. Given its competitive edge in technology, this project promises sound prospects.

High-speed packet mobile communications base station systems

Riding on the mass commercial application of CDMA2000 EV-DO Rev.0, the project saw completion of development of various advanced functions and the pre-emptive launch of the CDMA2000 EV-DO Rev.A system which promises superior performance. ZTE has now opened over 50 CDMA2000 1xEV-DO commercial or trial stations in more than 40 countries and regions, including the Philippines, Vietnam, Norway, Sri Lanka and Mongolia. ZTE became the focus of the industry after it had been officially awarded the world's first EVDO Rev.A commercial contract in May 2006. The world's first commercial application of "Ap connector" was conducted in Sri Lanka in June 2006 as the CDMA2000 ALLIP integrated solution was introduced with over 400,000 users. ZTE's EV-DO broke into Norway, the U.S. and other high-end markets in mid-2006.

Intelligent wireless integrated access systems

This project has been successfully launched following completion of product research and development. Meanwhile, research and development of next generation intelligent wireless integrated access system products equipped with expansion connectors to access 3G networks has also been completed. These intelligent wireless integrated access systems have the capacity to meet the demands of the international market and are compatible with the development of next generation networks. As a result, there will be bright prospects for such products.

Core routers

Product research and development has been completed for the project, which has passed the stringent testing procedures of China Telecom Research Institute with outstanding performance. The high-end routers have been put to commercial application. Contracts have been awarded to construct core connections in the next-generation CNGI backbone networks for numerous carriers, including China Mobile and China Unicom, as well as to undertake trial projects of urban networks in various provinces for China Telecom's CN2. The IPV6 trial station with 10G connections set up in Kunming has passed the initial inspection and acceptance test of China Unicom to facilitate ZTE's growth in the data product market.

NGN systems

Following the launch of bulk-volume media gateway equipment and softswitch control equipment in 2005, the V2.0 version was completed and put to mass application in 2006, while the launch of TG and AG had significantly enhanced the stability of the system. The NGN system is currently being applied in the long-distance softswitch commercial trial network of China Telecom and the Shanghai International Station project. The DC1 IDD network built by ZTE on behalf of China Telecom officially passed the final inspection and acceptance of China Telecom Group Company on 21 November 2006.

There were also extensive commercial applications of ZTE's soft switch products in the intelligence upgrade projects for fixed line convergence stations or NGN projects in Guangdong, Shanghai, Wuhan, Chongqing, Sichuan, Liaoning and Inner Mongolia. Market prospects look good for the proprietary NGN systems of ZTE, which are fully capable of providing a rich variety of functions in massive scale too meet increasing demand from users.

Automated optical switching network systems

Research and development of automated optical switching network systems for commercial application has been completed and commercial trial stations have been set up in Inner Mongolia with marketing and functional enhancement initiatives underway. Automated optical switching network technologies prepare operators for future requirements in telecommunications as they facilitate the introduction of new businesses with ease, as well as enhancing operational management of optical networks. Prospects are promising as carriers are expected to deploy automated optical switching systems in the coming years, first in the backbone networks and then gradually extending to urban and regional networks.

Proceeds from the offering of shares applied in overseas operations contributed to the continuous growth of the Group's overseas revenue in recent years.

Changes to projects committed

Applicable N/A

6.5.2 Relevant Scheme Participants of the Phase I Share Incentive Scheme of the Company paid subscription amounts for their Subject Shares between 14 March 2007 and 18 March 2007, which will be used as additional working capital for the Company. For details regarding the terms, progress and accounting treatment of the Phase I Share Incentive Scheme of the Company, please refer to the section headed "Material Matters" in the 2006 Annual Report.

6.6 Major investments using funds other than the share issue proceeds

Applicable N/A

In May 2006, ZTE (H.K.) Limited ("ZTE HK"), a wholly-owned subsidiary of the Company, and ZTE Software, a subsidiary of the Company, established Xi'an Zhongxing Software Company, Limited with a registered capital of RMB30 million. The principal scope of business of this company is: development, production and sale of telecommunications equipment, value-added services, network planning, terminal equipment, network management system, telecommunications system drivers, development, production and sales of hardware and software for service-based telecommunications businesses, development of other software, provision of related technical consultancy services and import/export businesses.

In June 2006, ZTE Energy (Cayman) Co., Limited ("ZTE Energy") was incorporated in the Cayman Islands with a registered capital of US\$10 million and ZTE HK had a 100% shareholding in ZTE Energy. The company was principally engaged in research and development, production, sales and investment in the energy sector.

In July 2006, ZTE HK and ZTE Software established Shanghai Zhongxing Software Company, Limited, Nanjing Zhongxing Software Company, Limited and Chengdu Zhongxing Software Company, Limited, respectively, each with a registered capital of RMB50 million. The three new subsidiaries are principally engaged in the development, production and sale of telecommunications equipment, value-added services, network planning, terminal equipment, network management system, telecommunications system drivers, development, production and sales of hardware and software for service-based telecommunications businesses, development of other software and provision of related technical consultancy services. The Company held a 98% interest in each of the three new subsidiaries mentioned above through ZTE HK and ZTE Software.

In December 2006, China Communications Services Company Limited launched a global offering of H shares for listing on the main board of the Stock Exchange of Hong Kong, in which the Company subscribed for 17,674,000 H shares through ZTE HK at the global offer price of HK\$2.2 per share for a total subscription amount of HK\$38,883,000.

6.7 Explanatory statement by the Board of Directors in respect of qualified opinion from accountants

Applicable N/A

6.8 Board of Directors' proposal for profit distribution or capitalisation from capital reserve for the current year

Applicable N/A

The net profit of the Company for the year 2006 calculated in accordance with PRC GAAP amounted to RMB650.356 million. Profit available for distribution amounted to RMB3,766.426 million after adding the undistributed profit of RMB3,116.07 million carried forward at the beginning of the year.

The net profit of the Company for the year 2006 calculated in accordance with HKFRSs amounted to RMB831.13 million. Profit available for distribution amounted to RMB1,786.512 million after adding the undistributed profit of RMB955.382 million carried forward at the beginning of the year.

In accordance with the requirements of the Ministry of Finance of the People's Republic of China and the Articles of Association, profit available for distribution shall be the lower of profit available for distribution as calculated in accordance with PRC GAAP and that calculated in accordance with HKFRSs. Therefore the amount of profit available for distribution is RMB1,786.512 million. The 2006 profit distribution proposal recommended by the Board of Directors of the Company is as follows: RMB1.50 (including tax) for every 10 shares or a total of RMB143,928,000 in cash on the basis of the Company's total share capital of 959,521,650 shares as at 31 December 2006.

The Company recorded profit for the reporting period but did not put forth any proposal of cash distribution of profit

Applicable N/A

6.9 Purchase, sale or redemption of shares

Neither the Company nor any of its subsidiaries has purchased, sold or redeemed any listed securities of the Company during the year.

6.10 Business outlook and risk exposure of the Company

6.10.1 Business outlook for 2007

Modest growth is expected for the global telecommunications industry in 2007. The Group is set to capture sound business opportunities as the picture for future 3G investment becomes clearer. On the other hand, competition will become more intense than ever as industry consolidation extends its reach. With the implementation of corporate strategies on differentiation, human resources and cost priority, the management is confident that the Group would be able to capture market opportunities amid escalating competition. Major objectives set for 2007 are as follows:

- (1) to cope with market conditions and customer requirements by conducting market-driven research and development, realigning our organizational structure, enhancing overall capabilities of solutions and building customer-oriented capabilities and organization underpinned by integrated marketing and integrated commercial technologies;
- (2) To adopt further customer differentiation, optimise the allocation of resources, improve the functional positioning of the overseas regional platforms and representative offices at various levels and to enhance global execution capabilities for leading strategies;
- (3) To enhance training of crucial staff;
- (4) To resolve issues arising from customer dissatisfaction with deliveries and compartmentalized logistics management by developing logistics capabilities and organization oriented towards customers and driven by uniform sources of information;
- (5) To better define the nature of engineering and after-sales services by developing a customer-oriented engineering and after-sales service team capable of uniform dispatching and speedy response to the ends that engineering and after-sales services will grow into a core business and a profit centre.

To achieve the above development objectives, the Group will strive to implement major capital expenditure plans by improving its operating efficiency and speeding up the turnover of funds. Meanwhile, we will meet additional funding requirements by resorting to various financing tools, including bank loans, in a reasonable and effective manner. To maintain its competitive edge and sustainable development, the Group intends to commit funds to the development of ZTE Industrial Park and the second phase of the R&D buildings in Shanghai and Nanjing. We will also carry out upgrades and replacements of fixed assets, IT equipment and software as an when necessary.

6.10.2 Risk exposure

Policy risks

Investments in system equipment, especially in the case of China, are subject to macro-economic factors such as government policies.

International market risks

The Group has now established business presence in over 100 countries and regions. Such geographic coverage demands a high level of skills in business operation to cope with issues arising from differences in political and legal systems, taxation, market profiles and cultural traditions.

Foreign exchange risks

The Group will continue to experience imbalances in foreign exchange payments with the growth of its international business. Meanwhile, there are long-term risks relating to competitiveness and foreign currency transaction as a result of the appreciation of RMB.

7 MATERIAL MATTERS

7.1 Acquisition of assets

Applicable N/A

7.2 Disposal of assets

Applicable N/A

7.3 Material guarantees

Applicable N/A

Third party guarantees provided by the Company (excluding guarantees in favour of subsidiaries)

Guaranteed party	Date of incurrence (date of execution of relevant agreements)	Amounts guaranteed	Type of guarantee	Term	Whether fully performed	Whether provided in favour of connected parties (Yes/No)
Djibouti Telecom S.A	8 September 2006	RMB50 million	Joint liability	12 years	No	No
Total amount guaranteed during the reporting period						RMB50 million
Total balance of amount guaranteed at the end of the reporting period (A)						RMB50 million
Guarantees provided in favour of subsidiaries						
Total amount guaranteed in favour of subsidiaries during the reporting period (Note 1)						US\$3 million
Total amount guaranteed among subsidiaries during the reporting period						RMB47,015,000
Total balance of amount guaranteed in favour of subsidiaries at the end of the reporting period (B)						US\$117,600
Total amount guaranteed by the Company (including guarantees in favour of subsidiaries)						RMB47,015,000
Total guaranteed amount (A+B) (Note 2)						US\$3,117,600
Total guaranteed amount as a percentage of net assets of the Company at the end of the reporting period						1.14%
of which:						
Amounts of guarantees provided in favour of shareholders, de facto controllers and their connected parties (C)						0
Amount of debt guarantee provided directly or indirectly in favour of parties with a gearing ratio exceeding 70% (D)						0
Amount of total guarantee exceeding 50% of net assets (E)						0
Aggregated amount of the three guarantee amounts stated above (C+D+E)						0

Note 1: Provided by the Company in favour of its wholly-owned subsidiary ZTE (H.K.) Limited.

Note 2: Guaranteed amounts denominated in US dollars are translated at the exchange rate of US\$1 to RMB7.8087 (being the exchange rate published by the People's Bank of China on 29 December 2006).

Note 3: All external guarantees of the Company shall be submitted to the Board of Directors for its review and shall require the approval of two-thirds of the members of the Board. If such external guarantees are otherwise subject to review and approval at the general meeting, then they shall be tabled at the general meeting following approval by the Board of Directors.

7.4 Significant connected transactions

7.4.1 Connected transactions in the ordinary course of business (in accordance with the PRC regulation)

Applicable N/A

Classification of transaction	Member of the Group (party to connected transaction)	Connected person (counterparty to connected transaction)	Subject matter	Pricing basis	Amounts for connected transactions for January to December 2006 (excluding VAT) (RMB in 10,000)	As a percentage of transactions in the same classification	Settlement	Whether different from estimated conditions
Purchase of raw materials	ZTE Kangsun Telecom Co., Ltd.	Shenzhen Zhongxingxin Telecommunications Equipment Company, Limited and its subsidiaries Shenzhen Zhongxing Xindi Telecommunications Equipment Company, Limited and Shenzhen Zhongxing Xinyu FPC Company, Limited	Various telecommunications products such as cabinets, cases, distribution frames, soft circuit boards and other raw materials	Consistent with market prices (as per contract)	45,081	3.28%	banker's acceptance bill	No
	ZTE Kangsun Telecom Co., Ltd.	Xi'an Microelectronics Technology Research Institute	Circuit protectors and other electronic products	Consistent with market prices (as per contract)	552	0.04%	banker's acceptance bill	No
	ZTE Kangsun Telecom Co., Ltd.	Shenzhen Zhongxing WXT Equipment Company, Ltd. and its subsidiary Shenzhen Gaodonghua Communication Technology Co., Ltd.	IC, connector assemblies, optical devices, modules and other ancillary equipment	Consistent with market prices (as per contract)	12,714	0.93%	banker's acceptance bill	No
	ZTE Kangsun Telecom Co., Ltd.	Chung Hing (Hong Kong) Development Limited	Printers and other electronic products	Consistent with market prices (as per contract)	22	0.00%	banker's acceptance bill	No
	Shenzhen Lead Communications Company, Limited	Shenzhen Zhongxing Xinyu FPC Company, Limited	Soft circuit boards and other products	Consistent with market prices (as per contract)	141	0.01%	banker's acceptance bill	No
Product sales	ZTE Kangsun Telecom Co., Ltd.	Shenzhen Zhongxing Information Technology Co., Ltd.	Dispatch exchange systems, integrated police alarm command dispatch systems, pre-hospitalisation first aid command dispatch systems	Consistent with market prices (as per contract)	682	0.05%	banker's acceptance bill	No
	The Company	Xi'an Microelectronics Technology Research Institute	Handsets and other products	Consistent with market prices (as per contract)	13	0.00%	banker's acceptance bill	No
	ZTE Kangsun Telecom Co., Ltd.	Shenzhen Zhongxing WXT Equipment Company, Ltd	IC and other products	Consistent with market prices (as per contract)	563	0.02%	banker's acceptance bill	No
	The Company and ZTE Kangsun Telecom Co., Ltd.	Shenzhen Zhongxing Information Technology Co., Ltd.	Optical transmission systems, power supply equipment, data products and conferencing TV	Consistent with market prices (as per contract)	144	0.01%	banker's acceptance bill	No

Connected transactions involving sales of products or provision of labour services to the controlling shareholder and its subsidiaries by Company during the reporting period amounted to RMB6,948,000.

7.4.2 Current connected creditor's rights and debts

Applicable N/A

7.4.3 Progress of repayment of fund appropriations as at the end of 2006

Applicable N/A

Additional fund appropriation in 2006

Applicable N/A

Failure of listed companies to repay fund appropriations for non-business purposes, reasons for such failure, repayment measures adopted and responsibility investigation plans

Applicable N/A

7.5 Entrusted fund management

Applicable N/A

7.6 Performance of undertakings

Applicable N/A

7.6.1 Special undertaking given by original holders of non-circulating shares in respect of the share reform and its performance

Applicable N/A

Name of shareholder	Undertaking	Performance of undertaking	Remarks
Shenzhen Zhongxingxin Telecommunication Equipment Company Limited ("Zhongxingxin")	Zhongxingxin has made a special undertaking as follows: Where Zhongxingxin sells its shares during the period from the 13th month to the 24th month after such shares have been granted the right of listing and circulation on the Shenzhen Stock Exchange, the price at which the shares are sold shall not be less than RMB30.76 per share, which is 115% of the mathematical average of the closing prices of its A shares for the 60 trading days prior to the initial announcement made by the directors of the Company regarding the Share Reform Plan, that is, RMB26.75 per share (such price to be calculated on an ex-rights basis and net of any dividends, bonus issues and capitalisation of capital reserve during the period from the implementation date of the Share Reform Plan to the date of sale). The proceeds from any sale by Zhongxingxin in breach of such undertaking shall be reverted to the Company's account for the benefit of all shareholders of the Company. The price of "30.76" specified in the special undertaking by Zhongxingxin set out above has been adjusted to "30.51" following the implementation of the 2005 profit distribution plan of the Company on 14 July 2006.	Under normal Performance	Save for Zhongxingxin, other original holders of non-circulating shares of the Company have not made any undertakings other than the statutory undertaking.

7.6.2 Number of circulating shares not subject to lock-up held by original holders of non-circulating shares interested in 5% or above of the shares at the end of the reporting period

Name of shareholder	Circulating shares not subject to lock-up held on the date of listing (29 December 2006) of shares subject to lock-up (shares)	Increase/decrease during the year (shares)	Reasons for change	Circulating shares not subject to lock-up held at the end of the reporting period (shares)
Zhongxingxin	47,976,083	—	—	47,976,083

Note: As at the close of 22 January 2007, Zhongxingxin had disposed of 11,489,083 A shares of the Company, representing 1.20% of the total share capital of the Company, through the Shenzhen Stock Exchange.

7.7 Material litigation or arbitration

Applicable N/A

During the year, the Group had no material litigation or arbitration. Please refer to Section headed "Material Matters" set out in 2006 annual report for progress during the year of litigation and arbitration proceedings occurring prior to the reporting period and other litigation and arbitration during the year in details.

8 REPORT OF THE SUPERVISORY COMMITTEE

The Supervisory Committee is of the view that the Company was operating in accordance with the law and that there were no irregularities in the financial position, use of proceeds, acquisitions and disposals of assets and connected transactions of the Company.

9 CORPORATION GOVERNANCE REPORT

The Group complied with all the code provisions of the Code on Corporate Governance Practices set out as Appendix 14 to the Hong Kong Stock Exchange Listing Rules throughout 2006.

The Company has adopted code provisions relating to the dealing in the Company's shares by Directors contained in the Model Code for Securities Transactions by Directors of Listed Issuers ("Model Code") set out in Appendix 10 to the Listing Rules. After making specific enquiry with the Directors, the Company confirms that all Directors of the Company were in full compliance with the Model Code throughout 2006.

10 FINANCIAL REPORTS

10.1 The Audit Committee of the Company has reviewed, in association with the management, the accounting principles and standards adopted by the Group, and has investigated issues relating to auditing, internal control and financial reporting, including the review of the consolidated and company balance sheets at 31 December 2006, the consolidated and company income statements as at 31 December 2006, statements of income distribution and cash flow statements for 2006 prepared by the Group in accordance with PRC GAAP and with HKFRSs.

10.2 Audit Opinion

The consolidated and company balance sheets as at 31 December 2006, the consolidated and company income statements, statements of income distribution and cash flow statements for 2006 prepared by the Group in accordance with PRC GAAP have been audited by Ernst & Young Hua Ming, who has issued a standard auditors' report without any qualified opinion (Ernst & Young Hua Ming (2007) SHENZHI NO. 60438556_H01).

Ernst & Young issued an unqualified auditors' report following auditing in connection with the consolidated and company balance sheets as at 31 December 2006, the consolidated income statement, the consolidated statement of changes in equity and the consolidated cash flow statement for 2006 prepared by the Group in accordance with HKFRSs.

10.3 Comparative consolidated balance sheets, income statements, statements of income distribution and cash flow statements of the parent.

10.3.1 Accounting statements prepared in accordance with PRC GAAP and notes thereto

Please see Appendix I.

10.3.2 Accounting statements prepared in accordance with HKFRSs

Please see Appendix II.

10.3.3 Differences between the Group's net profit for 2006 and shareholders' equity at the end of 2006 prepared under PRC GAAP and those prepared under HKFRSs

The effects on the net profit and the shareholders' equity arising from material differences between the consolidated financial statements prepared under PRC GAAP and those under HKFRSs are summarised as follows:

	2006	2005
Notes	RMB'000	RMB'000
Net profit		
Net profit from ordinary activities attributable to shareholders under PRC GAAP	807,353	1,194,343
Add back/(deduct):		
Accounting standards differences		
Recognition of government grants	(i) 2,123	(8,881)
Provision for retirement benefits	(ii) (1,599)	(1,536)
Deferred development costs	(iii) (52,357)	115,621
Recognition of excess over the cost of business combinations	(iv) —	9,460
Deferred tax	(v) (1,454)	(21,306)
Fair value gains on equity investment at fair value through profit or loss	(vi) 16,595	—
Recognition of financial guarantee contracts	(vii) (3,689)	—
Profit attributable to equity holders of the parent under HKFRSs	766,972	1,287,701

Notes RMB'000 RMB'000

Shareholders' equity

Shareholders' equity under PRC GAAP 10,678,911 10,125,095

Add back/(deduct):

	2006	2005
Notes	RMB'000	RMB'000
Accounting standards differences		
Recognition of government grants	(i) (2,805)	(4,926)
Provision for retirement benefits	(ii) (32,058)	(30,459)
Deferred development costs	(iii) 129,751	182,108
Deferred tax	(v) (22,760)	(21,306)
Fair value gains on equity investment at fair value through profit or loss	(vi) 16,595	—
Recognition of financial guarantee contracts	(vii) (3,689)	—
Equity attributable to equity holders of the parent under HKFRSs	10,763,945	10,250,512

(i) Government grants

Government grants for specific research and development projects are accounted for as specific payables under PRC GAAP. Whereas under HKFRSs, such grants are accounted for as deferred income in the other payable or other long-term payable accounts.

Under PRC GAAP, research and development costs are recognised as technology development costs in inventory to the extent of the granted amounts, and the specific payables thereof will be transferred to the inventory account to offset the technology development costs upon completion of the projects.

Under HKFRSs, deferred income is recognised as income over the periods necessary to match the grants on a systematic basis to the costs that they are intended to compensate.

(ii) Provision for retirement benefits

Under PRC GAAP, there is no specific standard, regulation or rule for the recognition of post-retirement benefits under defined retirement benefits plan. The costs of post-retirement benefits are expensed as incurred.

Under HKFRSs, the costs of providing these benefits under the defined retirement benefits plan are actuarially determined and recognised over the employees' service period.

(iii) Deferred development costs

Under PRC GAAP, all research and development costs are charged to the income statement as incurred.

Under HKFRSs, expenditures incurred on projects to develop new products is capitalised and deferred only when the projects are clearly defined; the expenditure is separately identifiable and can be measured reliably; there is reasonable certainty that the projects are technically feasible; and the products have commercial value. Product development expenditure which does not meet these criteria is expensed when incurred.

(iv) Excess over the cost of business combinations

Under PRC GAAP, excess over the cost of business combination is credited to capital reserves.

Under HKFRSs, any excess of the Group's interest in the net fair value of the acquirees' identifiable assets and liabilities over the cost of acquisition of such acquirees (previously referred to as negative goodwill), after reassessment, is recognised immediately in the income statement.

(v) *Income tax and deferred tax*

Deferred tax is recognised to account for the effect of any temporary differences arising from the accounting differences between PRC GAAP and HKFRSs in the preparation of the Group's financial statements under PRC GAAP and HKFRSs.

(vi) *Fair value gains on equity investment at fair value through profit or loss*

Under PRC GAAP, equity investment held for trading is measured at cost.

Under HKFRSs, equity investment held for trading is classified as financial assets at fair value through profit or loss, any gains or losses are recognised in the income statement.

(vii) *Financial guarantee contracts*

Under PRC GAAP, there is no specific standard, regulation or rule for the recognition of financial guarantee contracts. The financial guarantee contracts are disclosed as contingent liability.

Under HKFRSs, financial guarantee contract is accounted for as financial liability which is recognised initially at its fair value. Subsequent to initial recognition, the Group measures the financial guarantee contract at the higher of: (i) the amount determined in accordance with HKAS 37 *Provision, Contingent Liabilities and Contingent Assets*; and (ii) the amount initially recognised less, when appropriate, cumulative amortization recognised in accordance with HKAS 18 *Revenue*.

10.4 Changes in accounting policies, accounting estimates and auditing methods compared to the 2005 annual report

Applicable N/A

10.5 Details, corrected amounts, reasons and effect of significant accounting errors

Applicable N/A

10.6 Changes in the scope of consolidation compared to the 2005 annual report are set out in the following table:

Name of Company	Change	Reasons
南京中興軟創軟件有限公司	Addition	New incorporation
ZTE SINGAPORE PTE. LTD.	Addition	New incorporation
ZTE Korea Limited	Addition	New incorporation
ZTE CZECH s.r.o.	Addition	New incorporation
ZTE India R&D Center Private Limited	Addition	New incorporation
ZTE INVESTMENT	Addition	New incorporation
ZTE Norway AS	Addition	New incorporation
Xi'an Zhongxing Software Company, Limited	Addition	New incorporation
Nanjing Zhongxing Software Company, Limited	Addition	New incorporation
Shanghai Software Company, Limited	Addition	New incorporation
Chengdu Zhongxing Software Company, Limited	Addition	New incorporation
深圳市中興海納技術有限公司	Addition	New incorporation
Shenzhen Zhongxing Mobile Telecom Equipment Co., Ltd.	Reduction	Liquidation and deregistration
Shanghai Xingfei Science and Technology Company, Limited	Reduction	Liquidation and deregistration
ZHONGXING CORPORATION EL SALVADOR, S.A. DE C.V.	Addition	New incorporation
ZTE (Mauritius) Ltd.	Addition	New incorporation
ZTE Energy (Cayman) Co., Limited	Addition	New incorporation
中興能源技術(武漢)有限公司	Addition	New incorporation
中興能源(湖北)有限公司	Addition	New incorporation
深圳市中興力維軟件有限公司	Addition	New incorporation
WANAAG Communications Limited	Reduction	Reduced shareholding

10.7 Statement of reconciliation of differences in combined shareholders' equity under old and new accounting standards

Type	Name	RMB'000
1	Consolidated shareholders' equity as at 31 December 2006 (Under Current Accounting Standards)	10,678,911
2	Provision for retirement benefits	(32,058)
3	Fair value gains on an equity investment at fair value through profit or loss	16,595
4	Other financial liabilities	(3,689)
5	Recognition of government grants	(2,803)
	Company shareholders' equity as at 1 January 2007 (Under New Accounting Standards)	10,656,956
6	Changes in minority interests	561,892
	Consolidated shareholders' equity as at 1 January 2007 (Under New Accounting Standards)	11,218,848

Hou Weigui Wei Zaisheng Shi Chunmao
Legal representative *Chief Financial Officer* *Head of Finance Division*

ZTE Corporation**Review report on reconciliation of differences between shareholders' equity prepared in accordance with the current and the new PRC Accounting Standards**

Ernst & Young Hua Ming (2007) Zhuan Zi No.60438556_H01

To: all shareholders of ZTE Corporation

We have reviewed the accompanying statement of reconciliation of differences between shareholders' equity prepared in accordance with the current and the new PRC Accounting Standards (the "Reconciliation Statement") of ZTE Corporation (the "Company") as at 31 December 2006 and 1 January 2007 which has been prepared in accordance with the basis of preparation set out in note II of the Reconciliation Statement. In accordance with the "Accounting Standards for Business Enterprises No.38 — First time adoption of Accounting Standards for Business Enterprises" and the "Pronouncement on proper disclosure of financial information in accordance with the New Accounting Standards" ("CSRC" (2006) No.136, the "Pronouncement") and other relevant regulations, preparation of the Reconciliation Statement is the responsibility of management of the Company. Our responsibility is to issue a review report on the Reconciliation Statement based on our review work.

As required by the relevant regulations of the Pronouncement, we performed our review in accordance with "the Independent Reviewing Standards for the Chinese Certified Public Accountants No.2101 — review of financial statements". Those standards require us to plan and perform the review so as to obtain moderate assurance about whether the Reconciliation Statement is free of material misstatement. The review is limited primarily to making enquiries to the responsible personnel on the relevant accounting policies and all material assertions, understanding the calculation process of adjustments included in the Reconciliation Statement, reviewing the Reconciliation Statement to assess whether it is prepared in accordance with the basis of preparation and performing analytical review if required. A review provides less assurance than an audit. We did not perform an audit, thus we do not express an audit opinion.

Based on our review, nothing has come to our attention that causes us to believe that the Reconciliation Statement is not prepared in accordance with the "Accounting Standards for Business Enterprises No.38- First time adoption of Accounting Standards for Business Enterprises" and the Pronouncement and other relevant regulations in all material respects.

On behalf of Ernst & Young Hua Ming

PRC Registered Accountant: Xie Feng

PRC Registered Accountant: Li Di

Beijing, the People's Republic of China
 18 April 2007

The annual report has been prepared in Chinese and English respectively. In case of discrepancy, the Chinese version of the annual report shall prevail, except for the financial statements prepared in accordance with HKFRSs, of which the English version shall prevail.

By order of the Board
Hou Weigui
Chairman

19 April 2007

As at the date of this announcement, the Board of Directors of the Company comprises three executive directors, Yin Yimin, Shi Lirong and He Shiyou; six non-executive directors, Hou Weigui, Wang Zongyin, Xie Weiliang, Zhang Junchao, Li Juping and Dong Lianbo; and five independent non-executive directors, Zhu Wuxiang, Chen Shaohua, Qiao Wenjun, Mi Zhengkun and Li Jin.

APPENDIX I ACCOUNTING STATEMENTS PREPARED IN ACCORDANCE WITH PRC GAAP**CONSOLIDATED BALANCE SHEET
(Prepared under PRC GAAP)**

	As at 31 December 2006	2005
	RMB'000	RMB'000
Current assets		
Cash in banks and on hands	4,311,060	5,573,132
Short-term investment	16,693	—
Notes receivable	1,658,406	1,244,853
Dividend receivable	1,136	—
Trade receivables	5,329,628	3,441,922
Factored trade receivables	152,848	36,416
Other receivables	439,904	279,975
Accounts prepaid	51,757	151,174
Inventories	2,760,995	2,519,547
Amount due from customers for contract work	5,833,480	4,689,157
Total current assets	20,555,907	17,936,176
Long-term investment		
Long-term equity investments	100,681	85,459
Total long-term investments	100,681	85,459
Fixed assets		
Fixed assets-cost	4,234,574	3,623,940
Less: accumulated depreciation	1,555,714	1,148,789
Net fixed assets	2,678,860	2,475,151
Less: fixed assets impairment provision	87,002	94,980
Fixed assets-net book value	2,591,858	2,380,171
Construction in progress	469,636	126,741
Total fixed assets	3,061,494	2,506,912
Intangible and other assets		
Intangible and other assets	152,859	160,264
Long-term trade receivables	372,703	307,666
Factored long-term trade receivables	1,399,206	687,765
Long-term deferred assets	40,416	13,996
Total intangible and other assets	1,965,184	1,169,691
Deferred taxes		
Deferred taxes assets	233,683	80,893
TOTAL ASSETS	25,916,949	21,779,131

**CONSOLIDATED BALANCE SHEET
(Prepared under PRC GAAP)**

	As at 31 December 2006	2005
	RMB'000	RMB'000
Current liabilities		
Short-term loans	945,726	99,695
Bank advances on factored trade receivables	152,848	36,416
Notes payable	2,242,566	1,977,584
Accounts payable	4,749,099	4,292,208
Amount due to customers for contract work	996,275	733,455
Advances from customers	635,875	861,024
Accrued payroll	668,307	622,804
Welfare payable	298,430	394,216
Dividend payables	83,941	163,008
Taxes payable	(699,658)	(670,282)
Other levies	8,891	7,134
Other payables	666,430	626,066
Accrued expenses	387,619	346,668
Provision	35,680	20,035
Long-term loans due within 1 year	—	500,000
Total current liabilities	11,172,029	10,010,031
Non-current liabilities		
Long-term loans	1,679,242	80,000
Bank advances on factored long-term trade receivables	1,399,206	687,765
Specific payables	425,669	405,511
Total non-current liabilities	3,504,117	1,173,276
Total liabilities	14,676,146	11,183,307
Minority interests	561,892	470,729
Owner's equity:		
Share capital	959,522	959,522
Capital surplus	5,509,666	5,506,424
Surplus reserves	1,331,059	1,264,060
Undistributed profits	2,767,616	2,171,190
Exchange differences	(32,880)	(15,981)
Proposed final dividend	143,928	239,880
Total owner's equity	10,678,911	10,125,095
TOTAL LIABILITIES AND OWNER'S EQUITY	25,916,949	21,779,131

Legal representative
Hou Weigui

Chief Financial Officer:
Wei Zaisheng

Head of Finance Division
Shi Chunmao

**CONSOLIDATED INCOME STATEMENTS & STATEMENTS OF INCOME DISTRIBUTION
(Prepared under PRC GAAP)**

	As at 31 December 2006	2005
	RMB'000	RMB'000
Revenue from principal operations	23,031,684	21,575,920
Less: Cost of sales	15,171,797	13,944,797
Taxes and surcharges	111,360	105,660
Profit from principal operations	7,748,527	7,525,463
Add: Profit from other operations	69,152	15,779
Less: Operating expenses	3,140,108	3,023,126
General and administrative expenses	4,010,206	3,137,066
Finance expenses	239,617	288,751
Operating profit	427,748	1,092,299
Add: Investment income	31,849	(59,354)
Subsidy income	612,163	458,014
Non-operating income	24,008	27,627
Less: Non-operating expenses	26,151	16,722
Total profit	1,069,617	1,501,864
Less: Income tax	125,624	158,545
Minority interests	136,640	148,976
Net profit	807,353	1,194,343
Add: Undistributed profits at beginning of year	2,171,190	1,495,431
Distributable profit	2,978,543	2,689,774
Less: Statutory reserves	66,999	278,704
Profit available for distribution to owners	2,911,544	2,411,070
Less: Proposed ordinary shares dividends	143,928	239,880
Undistributed profits at year-end	2,767,616	2,171,190

Supplemental Information Item	2006	2005
1. Gains received from sale or disposal of business departments or investee units	—	—
2. Losses resulting from natural disaster	—	—
3. Increase (or decrease) in total profit as a result of changes in accounting policies	—	—
4. Increase (or decrease) in total profit as a result of changes in accounting estimates	—	145,920
5. Losses resulting from debt restructuring	—	—
6. Others	—	—

CONSOLIDATED CASH FLOW STATEMENT (Prepared under PRC GAAP)

	As at 31 December	
	2006	2005
	RMB'000	RMB'000
1. Cash flows from operating activities		
Cash received from sale of goods or rendering services	21,600,437	21,315,221
Cash received from taxes returned	1,404,449	458,014
Cash received relating to other operating activities	131,464	119,215
Sub-total of cash inflow	23,136,350	21,892,450
Cash paid for goods and services	17,685,647	13,915,822
Cash paid to and on behalf of employees	3,514,280	2,793,854
Payments of taxes and levies	1,265,754	1,679,312
Cash paid relating to other operating activities	2,225,655	3,326,157
Sub-total of cash outflow	24,691,336	21,715,145
Net cash flows from operating activities	(1,554,986)	177,305
2. Cash flows from investing activities		
Cash received from sale of investments	22,766	331
Net cash received from the disposal of subsidiaries	—	(31,555)
Cash received from gains of investment	23,265	—
Net cash received from disposal of fixed asset, intangible assets and other long-term assets	20,851	41,372
Sub-total of cash inflow	66,882	10,148
Cash paid to acquire fixed asset, intangible assets and other long-term assets	1,181,162	921,463
Cash paid for acquisition of equity investments	48,889	72,955
Cash paid relating to other investing activities	394	—
Sub-total of cash outflow	1,230,445	994,418
Net cash flows from investing activities	(1,163,563)	(984,270)
3. Cash flows from financing activities		
Cash received from investment	30,366	25,227
Cash received from borrowings	3,093,148	108,695
Sub-total of cash inflow	3,123,514	133,922
Cash paid for debt repayments	1,147,875	869,867
Cash payments for distribution of dividends and interest expenses	509,886	459,553
Sub-total of cash outflow	1,657,761	1,329,420
Net cash flow from financing activities	1,465,753	(1,195,498)
4. Effect of foreign exchange rate changes on cash	(9,276)	(22,628)
5. Net decrease in cash	(1,262,072)	(2,025,091)

CONSOLIDATED CASH FLOW STATEMENT (Prepared under PRC GAAP)

	As at 31 December	
	2006	2005
	RMB'000	RMB'000
1. Reconciliation of net profit to cash flows from operating activities		
Net profit	807,353	1,194,343
Add: Minority interests	136,640	148,976
Provision for impairment of assets	199,116	362,300
Depreciation of fixed assets	503,301	394,984
Amortisation of intangible assets	49,564	51,009
Amortisation of long-term prepaid expenses	—	1,616
Decrease in prepaid expenses	—	478
Increase in accrued expenses (less: decrease)	56,596	78,134
Losses on disposal of fixed assets, intangible assets and other long-term assets (less: gains)	(2,660)	(909)
Losses on retirement of fixed assets and intangible assets	17,545	7,072
Finance expense	173,840	175,884
Losses (gain) on investment	(31,849)	59,354
Deferred tax credit (less: debit)	(152,790)	23,732
Decrease in inventories (less: increase)	(381,185)	(866,316)
Staff cost on share incentive scheme	2,480	—
Increase in operating receivable items	(3,612,469)	(2,015,438)
Increase in operating payable items	679,532	562,086
Net cash flows from operating activities	(1,554,986)	177,305
2. Net decrease in cash		
Cash at end of year	4,311,060	5,573,132
Less: Cash at beginning of year	5,573,132	7,598,223
Net decrease in cash	(1,262,072)	(2,025,091)

BALANCE SHEET (Prepared under PRC GAAP)

	As at 31 December	
	2006	2005
	RMB'000	RMB'000
ASSETS		
Current assets		
Cash in banks and on hands	2,957,920	4,258,936
Notes receivable	1,617,133	1,209,151
Dividend receivable	817,631	16,465
Trade receivables	5,753,208	4,481,796
Factored trade receivables	275,830	5,007
Other receivables	1,220,098	1,230,352
Accounts prepaid	20,619	67,305
Inventories	1,458,946	1,557,312
Amount due from customers for contract work	5,809,647	4,440,842
Total current assets	19,931,032	17,267,166
Long-term investment		
Long-term equity investments	2,632,569	2,833,305
Total long-term investments	2,632,569	2,833,305

	As at 31 December	
	2006	2005
	RMB'000	RMB'000
Fixed assets		
Fixed assets-cost	2,510,628	2,491,000
Less: accumulated depreciation	811,658	712,768
Net fixed assets	1,698,970	1,778,232
Less: fixed assets impairment provision	87,002	87,002
Fixed assets-net book value	1,611,968	1,691,230
Construction in progress	402,430	77,261
Total fixed assets	2,014,398	1,768,491
Intangible and other assets		
Intangible assets	78,456	87,081
Long-term trade receivables	328,166	327,122
Factored long-term trade receivables	1,394,970	683,598
Total intangible and other assets	1,801,592	1,097,801
Deferred taxes		
Deferred taxes assets	217,307	76,419
TOTAL ASSETS	26,596,898	23,043,182

BALANCE SHEET (Prepared under PRC GAAP)

	As at 31 December	
	2006	2005
	RMB'000	RMB'000
LIABILITIES AND OWNER'S EQUITY		
Current liabilities		
Short-term loans	741,827	—
Bank advances on factored trade receivables	275,830	5,007
Notes payable	2,187,595	1,918,831
Accounts payable	6,704,325	6,538,622
Amount due to customers for contract work	991,612	688,876
Advances from customers	513,954	493,438
Accrued payroll	396,952	367,583
Welfare payable	238,962	326,370
Dividends payable	378	928
Taxes payable	(618,142)	(844,875)
Other levies	2,401	2,996
Other payables	767,107	1,084,091
Accrued expenses	254,739	286,561
Provision	13,000	16,000
Long-term loans due within 1 year	—	500,000
Total current liabilities	12,470,540	11,384,428
Non-current liabilities		
Long-term loans	1,329,478	—
Bank advances on factored long-term trade receivables	1,394,970	683,598
Other long-term liabilities	373,800	359,220
Total non-current liabilities	3,098,248	1,042,818
Total liabilities	15,568,788	12,427,246
Owner's equity:		
Share capital	959,522	959,522
Capital surplus	5,536,137	5,532,896
Surplus reserves	769,603	769,603
Undistributed profits	3,622,498	3,116,070
Exchange differences	(3,578)	(2,035)
Proposed final dividend	143,928	239,880
Total owner's equity	11,028,110	10,615,936
TOTAL LIABILITIES AND OWNER'S EQUITY	26,596,898	23,043,182

Legal representative
Hou Weigui

Chief Financial Officer:
Wei Zaisheng

Head of Finance Division
Shi Chunmao

INCOME STATEMENTS & STATEMENTS OF INCOME DISTRIBUTION (Prepared under PRC GAAP)

	As at 31 December	
	2006	2005
	RMB'000	RMB'000
Revenue from principal operations	21,215,583	20,565,052
Less: Cost of sales	18,846,594	16,671,822
Taxes and surcharges	44,080	56,009
Profit from principal operations	2,324,909	3,837,221
Add: Profit from other operations	684,036	149,282
Less: Operating expenses	2,291,774	2,360,822
General and administrative expenses	1,929,543	1,451,749
Finance expenses	285,112	294,898
Operating loss	(1,497,484)	(120,966)
Add: Investment income	2,106,953	919,713
Subsidy income	44,223	8,259
Non-operating income	10,011	19,834
Less: Non-operating expenses	13,095	6,321
Total profit	650,608	820,519
Less: Income tax	252	27,953
Net profit	650,356	792,566
Add: Undistributed profits at beginning of year	3,116,070	2,682,269
Distributable profit	3,766,426	3,474,835
Less: Statutory reserves	—	118,885
Profit available for distribution to owners	3,766,426	3,355,950
Less: Proposed ordinary shares dividends	143,928	239,880
Undistributed profits at year-end	3,622,498	3,116,070

CASH FLOW STATEMENT (Prepared under PRC GAAP)

	As at 31 December	
	2006	2005
	RMB'000	RMB'000
1. Cash flows from operating activities		
Cash received from sale of goods or rendering services	20,378,716	22,269,031
Cash received from taxes returned	810,891	8,259
Cash received relating to other operating activities	91,495	205,278
Sub-total of cash inflow	21,281,102	22,482,568
Cash paid for goods and services	19,211,544	18,549,739
Cash paid to and on behalf of employees	1,503,266	1,788,552
Payments of taxes and levies	161,113	724,097
Cash paid relating to other operating activities	2,145,255	1,756,749
Sub-total of cash outflow	23,021,178	22,819,137
Net cash flows from operating activities	(1,740,076)	(336,569)

	As at 31 December	
	2006 RMB'000	2005 RMB'000
2. Cash flows from investing activities		
Cash received from sale of investments	9,430	331
Cash received from gains of investment	9,196	2,621
Net cash received from disposal of fixed assets, intangible assets and other long-term assets	3,942	172,186
Sub-total of cash inflow	22,568	175,138
Cash paid to acquire fixed assets, intangible assets and other long-term assets	778,177	796,746
Cash paid for equity investment	6,340	43,552
Sub-total of cash outflow	784,517	840,298
Net cash flows from investing activities	(761,949)	(665,160)
3. Cash flows from financing activities		
Cash received from borrowings	2,626,523	—
Sub-total of cash inflow	2,626,523	—
Cash paid for debt repayments	1,055,218	790,344
Cash payments for distribution of dividends and interest expenses	363,718	407,651
Sub-total of cash outflow	1,418,936	1,197,995
Net cash flows from financing activities	1,207,587	(1,197,995)
4. Effect of foreign exchange rate changes on cash	(6,578)	(4,505)
5. Net decrease in cash	(1,301,016)	(2,204,229)

CASH FLOW STATEMENT (Prepared under PRC GAAP)

Items	As at 31 December	
	2006 RMB'000	2005 RMB'000
1. Reconciliation of net profit to cash flows from operating activities		
Net profit	650,356	792,566
Add: Provision for impairment of assets	147,489	236,168
Depreciation of fixed assets	267,920	392,118
Amortisation of intangible assets	42,062	16,004
Increase in accrued expenses (less: decrease)	(34,822)	38,075
Losses on retirement of fixed assets	11,366	3,558
Finance expense	128,322	167,779
Gain on investment	(2,106,953)	(919,713)
Deferred tax debit	(140,888)	—
Decrease (increase) in inventories	98,366	(335,921)
Staff cost on share incentive scheme	2,480	—
Increase in operating receivable items	(3,079,468)	(2,171,944)
Increase in operating payable items	2,273,694	1,444,741
Net cash flows from operating activities	(1,740,076)	(336,569)
2. Net decrease in cash		
Cash at end of year	2,957,920	4,258,936
Less: Cash at beginning of year	4,258,936	6,463,165
Net decrease in cash	(1,301,016)	(2,204,229)

APPENDIX II ACCOUNTING STATEMENTS PREPARED IN ACCORDANCE WITH HKFRSs

CONSOLIDATED INCOME STATEMENT (Prepared under Hong Kong financial reporting standards)

	Notes	Year ended 31 December	
		2006 RMB'000	2005 RMB'000
REVENUE	5	23,031,684	21,575,920
Cost of sales		(15,250,453)	(14,101,720)
Gross profit		7,781,231	7,474,200
Other income and gains		792,124	681,646
Research and development costs		(2,832,685)	(1,959,543)
Selling and distribution costs		(3,274,699)	(3,186,442)
Administrative expenses		(1,097,615)	(1,095,400)
Other expenses		(191,495)	(128,605)
Finance costs	7	(153,694)	(175,884)
Share of profits and losses of: Jointly-controlled entities		(652)	(1,198)
Associates		8,175	(2,969)
PROFIT BEFORE TAX	6	1,030,690	1,605,805
Tax	8	(127,078)	(179,851)
PROFIT FOR THE YEAR		903,612	1,425,954
Attributable to:			
Equity holders of the parent		766,972	1,287,701
Minority interests		136,640	138,253
		903,612	1,425,954
DIVIDEND			
Proposed final	9	143,928	239,880
EARNINGS PER SHARE ATTRIBUTABLE TO ORDINARY EQUITY HOLDERS OF THE PARENT			
Basic	10	RMB0.8	RMB1.34
Diluted		RMB0.8	N/A

CONSOLIDATED BALANCE SHEET (Prepared under Hong Kong financial reporting standards)

	Notes	As at 31 December	
		2006 RMB'000	2005 RMB'000
NON-CURRENT ASSETS			
Property, plant and equipment		3,053,019	2,470,965
Prepaid land premiums/land lease payments		55,146	55,062
Intangible assets		274,905	335,835
Investments in jointly-controlled entities		5,936	6,588
Investments in associates		51,257	35,583
Available-for-sale investments		43,488	43,288
Long-term trade receivables	11	372,703	307,666
Factored long-term trade receivables		1,399,206	687,765
Deferred tax assets		210,923	59,587
Total non-current assets		5,466,583	4,002,339

	Notes	Year ended 31 December	
		2006 RMB'000	2005 RMB'000
CURRENT ASSETS			
Prepaid land premiums/land lease payments		1,449	1,418
Inventories		2,481,155	2,240,327
Amount due from customers for contract work		5,833,480	4,689,157
Trade and bills receivables	11	6,988,034	4,686,775
Factored trade receivables		152,848	36,416
Prepayments, deposits and other receivables		1,497,323	1,188,313
Loan receivables		22,026	46,165
Equity investments at fair value through profit or loss		33,288	—
Pledged bank deposits		168,997	175,899
Cash and cash equivalents		4,142,063	5,397,233
Total current assets		21,320,663	18,461,703

	Notes	Year ended 31 December	
		2006 RMB'000	2005 RMB'000
CURRENT LIABILITIES			
Trade and bills payables	12	6,991,665	6,269,792
Amount due to customers for contract work		996,275	733,455
Other payables and accruals		2,732,572	2,900,137
Interest-bearing bank borrowings		945,726	599,695
Bank advances on factored trade receivables		152,848	36,416
Tax payable		297,913	114,672
Dividend payables		83,941	163,008
Total current liabilities		12,200,940	10,817,175

NET CURRENT ASSETS **9,119,723** 7,644,528

TOTAL ASSETS LESS CURRENT LIABILITIES **14,586,306** 11,646,867

	As at 31 December	
	2006 RMB'000	2005 RMB'000

NON-CURRENT LIABILITIES		
Interest-bearing bank borrowings	1,679,242	80,000
Bank advances on factored long-term trade receivables	1,399,206	687,765
Financial guarantee contracts	3,689	—
Provision for retirement benefits	32,058	30,459
Other long-term payables	146,274	127,402
Total non-current liabilities	3,260,469	925,626

Net assets **11,325,837** 10,721,241

EQUITY		
Equity attributable to equity holders of the parent		
Issued capital	959,522	959,522
Reserves	9,660,495	9,051,110
Proposed final dividend	143,928	239,880
	10,763,945	10,250,512

Minority interests **561,892** 470,729

Total equity **11,325,837** 10,721,241

Hou Weigui
Director

Yin Yimin
Director

1. BASIS OF PREPARATION

These financial statements have been prepared in accordance with Hong Kong Financial Reporting Standards ("HKFRSs") (which also include Hong Kong Accounting Standards ("HKASs") and Interpretations) issued by the Hong Kong Institute of Certified Public Accountants, accounting principles generally accepted in Hong Kong and the disclosure requirements of the Hong Kong Companies Ordinance. They have been prepared under the historical cost convention except for equity investments, which have been measured at fair value. These financial statements are presented in Renminbi ("RMB") and all values are rounded to the nearest thousand except when otherwise indicated.

Basis of consolidation

The consolidated financial statements include the financial statements of the Company and its subsidiaries for the year ended 31 December 2006. The results of subsidiaries are consolidated from the date of acquisition, being the date on which the Group obtains control, and continue to be consolidated until the date that such control ceases. All significant intercompany transactions and balances within the Group are eliminated on consolidation.

The acquisition of subsidiaries during the year has been accounted for using the purchase method of accounting. This method involves allocating the cost of the business combinations to the fair value of the identifiable assets acquired, and liabilities and contingent liabilities assumed at the date of acquisition. The cost of the acquisition is measured at the aggregate of the fair value of the assets given, equity instruments issued and liabilities incurred or assumed at the date of exchange, plus costs directly attributable to the acquisition.

Minority interests represent the interests of outside shareholders not held by the Group in the results and net assets of the Company's subsidiaries. Acquisitions of minority interests are accounted for using the parent entity extension method whereby the difference between the consideration and the book value of the share of the net assets acquired is recognised as goodwill.

2. IMPACT OF NEW AND REVISED HONG KONG FINANCIAL REPORTING STANDARDS

The Group has adopted the following new and revised HKFRSs for the first time for the current year's financial statements. Except for in certain cases, giving rise to new and revised accounting policies and additional disclosures, the adoption of these new and revised standards and interpretation has had no material effect on these financial statements.

HKAS 21 Amendment	Net Investment in a Foreign Operation
HKAS 39 & HKFRS 4	Financial Guarantee Contracts Amendments
HKAS 39 Amendment	The Fair Value Option
HK(IFRIC)-Int 4	Determining whether an Arrangement contains a Lease

The principal changes in accounting policies are as follows:

(a) HKAS 21 The Effects of Changes in Foreign Exchange Rates

Upon the adoption of the HKAS 21 Amendment regarding a net investment in a foreign operation, all exchange differences arising from a monetary item that forms part of the Group's net investment in a foreign operation are recognised in a separate component of equity in the consolidated financial statements irrespective of the currency in which the monetary item is denominated. This change has had no material impact on these financial statements as at 31 December 2006 or 31 December 2005.

(b) HKAS 39 Financial Instruments: Recognition and Measurement

(i) Amendment for financial guarantee contracts

This amendment has revised the scope of HKAS 39 to require financial guarantee contracts issued that are not considered insurance contracts, to be recognised initially at fair value and to be remeasured at the higher of the amount determined in accordance with HKAS 37 Provisions, Contingent Liabilities and Contingent Assets and the amount initially recognised less, when appropriate, cumulative amortisation recognised in accordance with HKAS 18 Revenue. Approximately RMB4 million has been recognised upon the adoption of this amendment at 31 December 2006 and disclosed in note 42(g) to the financial statements and has had no impact on these financial statements as at 31 December 2005.

(ii) Amendment for the fair value option

This amendment has changed the definition of a financial instrument classified as fair value through profit or loss and has restricted the use of the option to designate any financial asset or any financial liability to be measured at fair value through the income statement. The Group had not previously used this option, and hence the amendment has had no effect on the financial statements.

(c) HK(IFRIC)-Int 4 Determining whether an Arrangement contains a Lease

The Group has adopted this interpretation as of 1 January 2006, which provides guidance in determining whether arrangements contain a lease to which lease accounting must be applied. This interpretation has had no material impact on these financial statements.

3. IMPACT OF ISSUED BUT NOT YET EFFECTIVE HONG KONG FINANCIAL REPORTING STANDARDS

The Group has not applied the following new and revised HKFRSs, that have been issued but are not yet effective, in these financial statements.

HKAS 1 Amendment	Capital Disclosures
HKFRS 7	Financial Instruments: Disclosures
HKFRS 8	Operating Segments
HK(IFRIC)-Int 7	Applying the Restatement Approach under HKAS 29 Financial Reporting in Hyperinflationary Economies
HK(IFRIC)-Int 8	Scope of HKFRS 2
HK(IFRIC)-Int 9	Reassessment of Embedded Derivatives
HK(IFRIC)-Int 10	Interim Financial Reporting and Impairment
HK(IFRIC)-Int 11	Group and Treasury Share Transactions
HK(IFRIC)-Int 12	Services Concession Arrangements

The HKAS 1 Amendment shall be applied for annual periods beginning on or after 1 January 2007. The revised standard will affect the disclosures about qualitative information about the Group's objective, policies and processes for managing capital; quantitative data about what the Company regards as capital; and compliance with any capital requirements and the consequences of any non-compliance.

HKFRS 7 shall be applied for annual periods beginning on or after 1 January 2007. The standard requires disclosures that enable users of the financial statements to evaluate the significance of the Group's financial instruments and the nature and extent of risks arising from those financial instruments and also incorporates many of the disclosure requirements of HKAS 32.

HKFRS 8 shall be applied for annual periods beginning on or after 1 January 2009. The standard requires disclosures of information about the operating segments of the Group, the products and services provided by the segments, the geographical areas in which the Group operates, and revenues from the Group's major customers. This standard will supercede HKAS 14 Segment Report.

HK(IFRIC)-Int 7, HK(IFRIC)-Int 8, HK(IFRIC)-Int 9, HK(IFRIC)-Int 10, HK(IFRIC)-Int 11 and HK(IFRIC)-Int 12 shall be applied for annual periods beginning on or after 1 March 2006, 1 May 2006, 1 June 2006, 1 November 2006, 1 March 2007 and 1 January 2008, respectively.

The Group is in the process of making an assessment of the impact of these new and revised HKFRSs upon initial application. So far, it has concluded that while the adoption of the HKAS 1 Amendment, HKFRS 7 and HKFRS 8 may result in new or amended disclosures, these new and revised HKFRSs are unlikely to have a significant impact on the Group's results of operations and financial position.

4. SEGMENT INFORMATION

(a) Business segments

The following tables present revenue, profit and certain asset, liability and expenditure information for the Group's business segments for the years ended 31 December 2006 and 2005.

Group

	Wireless communications		Wireline switch and access		Optical and data communications		Handsets		Telecommunications software systems, services and other products		Consolidated	
	2006	2005	2006	2005	2006	2005	2006	2005	2006	2005	2006	2005
	RMB'000	RMB'000	RMB'000	RMB'000	RMB'000	RMB'000	RMB'000	RMB'000	RMB'000	RMB'000	RMB'000	RMB'000
Segment revenue:												
Contract revenue from external customers	9,186,920	8,930,836	2,279,424	2,752,570	3,874,634	3,352,980	—	—	1,912,160	1,943,428	17,253,138	16,979,814
Sale of goods and services	—	—	—	—	—	—	4,519,492	4,333,082	1,259,054	263,024	5,778,546	4,596,106
Total	9,186,920	8,930,836	2,279,424	2,752,570	3,874,634	3,352,980	4,519,492	4,333,082	3,171,214	2,206,452	23,031,684	21,575,920
Segment results	2,604,063	2,590,240	593,821	1,085,112	364,028	160,110	512,429	118,165	432,191	334,131	4,506,532	4,287,758
Interest and unallocated gains											792,124	681,646
Unallocated expenses											(4,121,795)	(3,183,548)
Finance costs											(153,694)	(175,884)
Share of profits and losses of:												
Jointly-controlled entities											(652)	(1,198)
Associates											8,175	(2,969)
Profit before tax											1,030,690	1,605,805
Tax											(127,078)	(179,851)
Profit for the year											903,612	1,425,954
Assets and Liabilities												
Segment assets	7,928,525	5,292,995	1,979,726	2,196,473	3,352,383	2,778,123	2,368,637	2,162,194	1,124,605	810,136	16,753,876	13,239,921
Investments in jointly-controlled entities	—	—	—	—	—	—	—	—	—	—	5,936	6,588
Investments in associates	—	—	—	—	—	—	—	—	—	—	51,257	35,583
Unallocated assets	—	—	—	—	—	—	—	—	—	—	9,976,177	9,181,950
Total assets											26,787,246	22,464,042
Segment liabilities	491,760	860,005	56,382	91,578	560,098	204,755	254,266	344,933	269,644	93,207	1,632,150	1,594,478
Unallocated liabilities	—	—	—	—	—	—	—	—	—	—	13,829,259	10,148,323
Total liabilities											15,461,409	11,742,801
Other segment information:												
Depreciation and amortisation	218,625	123,367	61,374	37,519	140,369	82,886	137,870	105,251	53,653	45,421	611,891	478,496
Capital expenditure	422,669	371,525	118,655	112,990	271,375	249,611	266,542	316,966	103,729	136,787	1,182,970	1,187,879

(b) Geographical segments

The following table presents revenue information for the Group's geographical segments. Over 90% of the Group's assets are located in the PRC. Accordingly, no analysis of the assets and capital expenditure by geographical segment is presented.

Group

	The PRC		Asia (excluding the PRC)		Africa		Others		Consolidated	
	2006	2005	2006	2005	2006	2005	2006	2005	2006	2005
	RMB'000	RMB'000	RMB'000	RMB'000	RMB'000	RMB'000	RMB'000	RMB'000	RMB'000	RMB'000
Segment revenue:										
Contract revenue from external customers	9,879,161	10,838,079	3,918,344	3,428,396	2,392,356	2,576,744	1,063,277	136,595	17,253,138	16,979,814
Sale of goods and services	2,922,604	3,036,230	1,835,323	1,140,259	170,874	258,667	849,745	160,950	5,778,546	4,596,106
Total	12,801,765	13,874,309	5,753,667	4,568,655	2,563,230	2,835,411	1,913,022	297,545	23,031,684	21,575,920

5. REVENUE

	2006	2005
	RMB'000	RMB'000
Revenue		
Telecommunications systems contracts	17,253,138	16,979,814
Sale of goods and services	5,778,546	4,596,106
Total	23,031,684	21,575,920

6. PROFIT BEFORE TAX

The Group's profit before tax is arrived at after charging:

	2006	2005
	RMB'000	RMB'000
Cost of inventories sold	14,295,410	13,373,519
Depreciation	510,333	394,444
Less: Amount capitalised as deferred development costs	—	(7,585)
Total	510,333	386,859
Amortisation of intangible assets other than deferred development costs	49,201	50,355
Amortisation of deferred development costs	52,357	32,380
Total	101,558	82,735

	2006	2005
	RMB'000	RMB'000
Impairment of goodwill	—	56,267
Impairment of trade receivables	111,611	15,642
Provision for warranties	114,724	225,790
Write-down of inventories to net realisable value	52,781	96,185
Minimum lease payments under operating leases on land and buildings	206,054	188,905
Staff costs (including directors' and supervisors' remuneration):		
Wages, salaries, bonuses, allowances and welfare	3,103,539	2,601,779
Equity settled share expense	2,480	—
Pension scheme contributions:		
Defined benefits pension scheme	2,787	2,224
Defined contribution pension scheme	208,596	187,081
Total	3,317,402	2,791,084
Foreign exchange differences, net	29,422	48,390
Loss on disposal of items of property, plant and equipment	13,933	6,163
Loss on disposal of intangible assets	952	70
Financial guarantee contracts	3,689	—
Loss on disposal of interests in subsidiaries	—	2,057

7. FINANCE COSTS

	Group	2005
	2006	RMB'000
	RMB'000	RMB'000
Interest on bank loans wholly repayable within five years	58,817	36,042
Finance costs on trade receivables factored and bills discounted	94,877	139,842
Total	153,694	175,884

8. TAX

	2006	2005
	RMB'000	RMB'000
Group:		
Current — Hong Kong	6,951	5,726
Current — Mainland China	106,449	34,700
Current — Overseas	165,014	94,331
Deferred	(151,336)	45,094

Total tax charge for the year

127,078 179,851

Hong Kong profits tax has been provided at the rate of 17.5% (2005: 17.5%) on the estimated assessable profits arising in Hong Kong during the year. Taxes on profits assessable elsewhere have been calculated at the rates of tax prevailing in the countries in which the Group operates, based on existing legislation, interpretations and practices in respect thereof.

Under the relevant PRC income tax law, except for certain preferential treatment available to the Company and its subsidiaries, the Group's entities established in the PRC are subject to corporate income tax at a rate of 33% on their taxable income.

The Company and its subsidiaries that are registered and operating in the Shenzhen Special Economic Zone of the PRC are entitled to a preferential income tax rate of 15%.

9. DIVIDEND

	2006	2005
	RMB'000	RMB'000
Proposed final — RMB0.15 (2005: RMB0.25) per ordinary share	143,928	239,880

The proposed final dividend for the year is subject to the approval of the Company's shareholders at the forthcoming annual general meeting.

10. EARNINGS PER SHARE ATTRIBUTABLE TO ORDINARY EQUITY HOLDERS OF THE PARENT

The calculation of basic earnings per share is based on the profit for the year attributable to ordinary equity holders of the parent of RMB766,972,000 (2005: RMB1,287,701,000) and the weighted average number of 959,521,650 (2005: 959,521,650) ordinary shares in issue during the year.

The calculation of diluted earnings per share amounts is based on the profit for the year attributable to ordinary equity holders of the parent of RMB766,972,000 (2005: RMB1,287,701,000) and the weighted average number of 959,521,650 (2005: 959,521,650) shares in issue during the year, as used in the basic earnings per share calculation, and the weighted average number of 525,808 shares assumed to have been issued at no consideration on the deemed exercise of all dilutive potential shares into shares.

Diluted earnings per share amounts for the years ended 31 December 2005 have not been presented as the Company did not have any potentially dilutive ordinary shares during that year.

11. TRADE AND BILLS RECEIVABLES/LONG-TERM TRADE RECEIVABLES

Progress payment for telecommunications systems contracts is normally made in accordance with the agreed payment schedule. The Group's trading terms with its major customers are mainly on credit, except for new customers, where payment in advance is normally required. The credit period is generally 90 days and is extendable up to two years depending on customer's credit worthiness. The credit terms for major customers are reviewed regularly by senior management. The Group seeks to maintain strict control over its outstanding receivables and has a credit control department to minimise credit risk. Overdue balances are reviewed regularly by senior management. In view of the aforementioned, there is no significant concentration of credit risk. Trade receivables are non-interest-bearing.

An aged analysis of the trade and bills receivables as at the balance sheet date, based on the invoice date and net of provision, is as follows:

	Group	2005
	2006	RMB'000
	RMB'000	RMB'000
Within 6 months	6,242,121	3,968,731
7 to 12 months	650,526	701,656
1 to 2 years	448,583	313,288
2 to 3 years	13,124	10,551
Over 3 years	6,383	215
Total	7,360,737	4,994,441
Current portion of trade and bills receivables	(6,988,034)	(4,686,775)
Long-term portion	372,703	307,666

12. TRADE AND BILLS PAYABLES

An aged analysis of the trade and bills payables as at the balance sheet date, based on the invoice date, is as follows:

	Group	2005
	2006	RMB'000
	RMB'000	RMB'000
Within 6 months	6,816,521	6,049,126
7 to 12 months	81,489	142,100
1 to 2 years	47,855	45,968
2 to 3 years	14,612	5,506
Over 3 years	31,188	27,092
Total	6,991,665	6,269,792

13. POST BALANCE SHEET EVENTS

During the 5th Session of the 10th National People's Congress, which was concluded on 16 March 2007, the PRC Corporate Income Tax Law ("the New Corporate Income Tax Law") was approved and will become effective on 1 January 2008. The New Corporate Income Tax Law introduces a wide range of changes which include, but are not limited to, the unification of the income tax rate for domestic-invested and foreign-invested enterprises at 25%. Since the detailed implementation and administrative rules and regulations have not yet been announced, the financial impact of the New Corporate Income Tax Law to the Group cannot be reasonably estimated at this stage.