

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 THIRD QUARTERLY REPORT

This announcement is published simultaneously in Shenzhen pursuant to the Rules Governing Listing of Stocks on Shenzhen Stock Exchange and in Hong Kong pursuant to the disclosure obligations under Rule 13.09 of the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited.

1. IMPORTANT

- 1.1 The Board of Directors and Supervisory Committee and the Directors, Supervisors and senior management of ZTE Corporation (the "Company") confirm that this report does not contain any false or misleading statements or material omissions, and collectively and individually accept responsibility for the truthfulness, accuracy and completeness of its contents.
- 1.2 This quarterly report has been considered and approved by the nineteenth meeting of the third session of the Board of Directors of the Company. Mr. Zhang Junchao, Director, was unable to attend the meeting due to work reasons, and has authorised in writing Mr. Wang Zongyin, vice chairman, to vote on his behalf. Mr. He Shiyou, Director, was unable to attend the meeting due to work reasons, and has authorised in writing Mr. Yin Yimin, Director, to vote on his behalf.
- 1.3 The financial statements contained in this quarterly report are unaudited. The financial information contained in this report has been prepared in accordance with generally accepted accounting principles in the People's Republic of China ("PRC GAAP"). The Company has also disclosed in this quarterly report a reconciliation of net profits and shareholders' equity of the Group (the "Company and its subsidiaries") from PRC GAAP to Hong Kong accounting standards.
- 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 statements contained in this quarterly report.

2. CORPORATE PROFILE

2.1 Corporate information

Stock Name (A share/H share)	ZTE
Stock code (A share/H share)	000063/763
	Secretary to the Board of Directors
Name	Feng Jianxiong
	Authorised representatives
	Yin Yimin, Feng Jianxiong
	Joint company secretaries
	Feng Jianxiong, Suen Pui Yee, Samantha
	Securities affairs representative
	Li Lihong
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Place of business in Hong Kong	8/F Gloucester Tower, the Landmark, 15 Queen's Road, Central, Hong Kong

2.2 Financial Information

2.2.1 Major Accounting Data and Financial Indicators of the Group

Item	As at	As at	Increase/decrease as at the end of reporting period compared with the end of last year
	30 September 2006	31 December 2005	
Total assets (RMB in thousands)	23,070,124	21,779,131	5.93%
Shareholders' equity (excluding minority interests) (RMB in thousands)	10,318,578	10,125,095	1.91%
Net assets per share (RMB) (excluding minority interests)	10.75	10.55	1.90%
Adjusted net assets per share (RMB) (excluding minority interests)	10.74	10.55	1.80%
	For the three months ended 30 September 2006	For the nine months ended 30 September 2006	Increase/decrease as at the end of reporting period compared with the end of last year
Net cashflow from operating activities (RMB in thousands)	22,040	(2,812,753)	13.88%
Earnings per share (RMB) ^{Note}	0.080	0.469	-46.58%
Return on net assets (%)	0.75	4.36	Decrease by 4.27 percentage points
Return on net assets after extraordinary gains or losses (%)	0.75	4.15	Decrease by 4.00 percentage points

Note: There was no change in share capital of the Company for the period commencing from 1 January 2005 to 30 September 2006, and the share capital of the Company comprised 959,521,650 shares.

Extraordinary gain or loss items	For the three months ended 30 September 2006	For the nine months ended 30 September 2006
	Amount (RMB in thousands)	
Subsidy income (non-recurrent)	4,323	33,993
Non-operating income	2,041	5,818
Less: Non-operating expenses	7,015	13,549
Less: Effect of income tax	(98)	3,939
Total	(553)	22,323

2.2.2 Income Statements (Unaudited)

Please refer to the Part 4.2.

2.2.3 Differences in financial statements prepared in accordance with PRC GAAP and Hong Kong Accounting Standards

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

Item	Net Profit for the nine months ended 30 September 2006	Shareholders' equity (excluding minority interests) as at 30 September 2006
	(Unaudited)	(Unaudited)
	(RMB in thousands)	
Under PRC GAAP	450,359	10,318,578
Add back/(deduct):		
Recognition of government grants (i)	674	(4,252)
Deferred development costs (ii)	(42,734)	139,374
Provision for retirement benefits (iii)	—	(30,459)
Deferred tax (iv)	4,825	(16,481)
Under Hong Kong accounting standards	413,124	10,406,760

(i) Government grants

Government grants for specific research and development projects are accounted for as other long-term liabilities under PRC GAAP, whereas under Hong Kong Accounting Standards, such grants are accounted for as deferred income in the other payable or other long-term payable accounts.

Under PRC GAAP, the research and development costs are recognised as technology research and development costs in inventory to the extent of the granted amounts, and the other long-term liabilities thereof will be transferred to the inventory account to off-set the technology research and development costs upon completion of the projects.

Under Hong Kong Accounting Standards, the 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) Deferred development costs

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

Under Hong Kong Accounting Standards, 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.

(iii) 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 postretirement benefits are expensed as incurred.

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

(iv) Deferred tax

Differences in gains and profit before taxation arise in financial statements of the Group prepared under PRC GAAP and Hong Kong Accounting Standards as a result of differences in accounting estimates and between PRC GAAP and Hong Kong Accounting Standards. Deferred taxation is recognised as the impact of temporary differences in deferred development costs and government grants.

2.3 Total number of shareholders and top ten holders of shares not subject to lock-up as at the end of the reporting period

Total number of shareholders as at the end of the reporting period 24,355 shareholders (of which: 23,890 were holders of A shares and 465 were holders of H shares)

Shareholdings of top ten holders of shares not subject to lock-up

Name of shareholder	Number of shares held that are not subject to lock-up (shares)		Class of shares
HKSCC Nominees Limited	159,544,039		H shares
Deutsche Bank Aktiengesellschaft	18,816,363		A shares
ICBC Credit Suisse Selected Balance Mixed Equity Fund	9,760,514		A shares
E FUND Selected Value Stocks Equity Fund	9,231,554		A shares
Hanxing Equity Fund	8,500,654		A shares
China International Fund Balance in Dual Interests Mixed Equity Fund	7,495,621		A shares
China Life Insurance Company Limited — Dividends — Individual Dividends — 005L-FH002 Shen	7,078,418		A shares
China Life Insurance Group Company — Traditional — General Insurance Products	6,270,169		A shares
Bank of Communication Schroder Sustainable & Mixed Equity Fund	6,000,667		A shares
Pufeng Equity Fund	5,688,492		A shares

3. MANAGEMENT DISCUSSION AND ANALYSIS

3.1 Brief analysis of the overall operating conditions of the Group during the period

According to statistics from the Ministry of Information Industry, the telecommunications sector in China continued to maintain a high level development during the reporting period, underpinned by year-on-year in capital expenditure. However, the level of development and scale of investment varied considerably among different carriers, while the mobile sector significantly outgrew the wireline sector. Investment in PHS and China Unicom's CDMA continued to decline in tandem with the scenario prevailing in the first six months. Meanwhile, moderate development was seen in the global telecommunications market.

Measures implemented in the first half of the year to optimise our organisational structure and improve our management measures have effectively facilitated market development for the Group. For the nine months ended 30 September 2006, revenue from the Group's principal operations increased 5.93% to RMB15.921 billion compared to the same period last year. Net profit dropped 46.54% to RMB450 million. Earnings per share amounted to RMB0.469.

The Group's domestic operations remained stable despite continued decline in revenue contributions from PHS systems and handsets and China Unicom's CDMA. This was attributable to increased sales of GSM, NGN network intelligence products and transmission products that effectively offset the decline in revenue contribution from its traditional leading-edge products such as PHS, as the Group consolidated its leading-edge resources to strengthen customer relations with carriers and adapted its operations to accommodate the diversion of carriers' investments.

Global-wise, the Group made sound progress in international business development on the back of effective allocation of resources resulting from investments made and management initiatives implemented in the previous period. Amid substantial progress in international business development, the Group entered into business partnerships with a number of international and multi-national carriers to enlarge its market share in certain developing countries. There was notable growth in the sales of handset products in certain developed countries, especially 3G handsets, during the reporting period.

On the research and development front, the Group continued to manage research and development on a market-oriented basis, focusing on mainstay products represented in our customers' large-scale development projects, while enhancing the overall competitiveness of our 3G-related products to prepare for the building of China's 3G network. Our TD-SCDMA products continued to lead in various indicators in the TD-SCDMA tests organised by the Ministry of Information Industry.

Looking to the fourth quarter, the Group will further consolidate its leading-edge resources to enhance relations with key customers. Domestically, the Group intends to capitalise on opportunities presented by increased construction of telecommunications projects in rural areas by carriers prior to the commencement of 3G building, with a view to increasing the domestic market share of its major products. Internationally, the Group will continue to identify opportunities to foster closer liaison with international carriers. Meanwhile the Group will further improve its management standard and efficiency, with a special emphasis on rolling out internal control initiatives.

3.1.1 **Principal business or product segments accounting for 10% or more of revenue or profit from principal operations**

Applicable Not applicable

Breakdown of principal operations by industry

By Industry	Revenue from Principal operations (RMB in thousands)	Costs of Principal operations (RMB in thousands)	Profit Margin of Principal operations
Telecommunications equipment	15,921,467	10,224,277	35.33%
Of which: Connected transactions	23,775	15,810	33.50%

Breakdown of principal operations by product

By Product	Revenue from Principal operations (RMB in thousands)	Costs of Principal operations (RMB in thousands)	Profit Margin of Principal operations
Wireless communications products	5,510,754	3,019,383	44.76%
Wireline switch and access products	1,649,932	994,502	39.27%
Optical and data communications products	2,798,815	1,920,826	30.92%
Handsets	3,077,037	2,310,524	24.46%
Telecommunications software systems, services and other products	2,884,929	1,979,042	30.95%
Total	15,921,467	10,224,277	33.50%

Classification of transaction	Member of the Group (party to connected transaction)	Connected party (counterparty to connected transaction)	Subject matter	Pricing basis	Transaction amount for the nine months ended 30 September 2006 (excluding VAT) (RMB in 10,000)	As a percentage of transactions in the same classification	Settlement	Whether Different From Estimated Conditions
	ZTE Kangxun Telecom Company, Limited	Chung Hing (Hong Kong) Development Limited	Printers and other electronic products	Consistent with market prices (as per contract)	25	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)	140	0.01%	banker's acceptance bill	No
	ZTE Kangxun Telecom Company, Limited	Shenzhen Zhongxing Information Technology Company, Limited	Dispatch exchange systems, integrated police alarm command dispatch systems, pre-hospitalisation first-aid command dispatch systems	Consistent with market prices (as per contract)	513	0.05%	banker's acceptance bill	No
Sales of products	The Company	Xi'an Microelectronics Technology Research Institute	Handsets and other products	Consistent with market prices (as per contract)	2	0.00%	banker's acceptance bill	No
	ZTE Kangxun Telecom Company, Limited	Shenzhen Zhongxing WXT Equipment Company, Ltd	IC and other products	Consistent with market prices (as per contract)	481	0.03%	banker's acceptance bill	No
	The Company and ZTE Kangxun Telecom Company, Limited	Shenzhen Zhongxing Information Technology Company, Limited	Optical transmission systems, power supply equipment, data products and conferencing TV	Consistent with market prices (as per contract)	104	0.01%	banker's acceptance bill	No

3.2.3 **Significant litigation during the reporting period**

Applicable Not applicable

During the reporting period, there was no material litigation or arbitration.

Apart from the litigation instituted by Beijing Success Communications and Electronic Engineering Co., Ltd. against the Company's subsidiary Yangzhou Zhongxing Mobile Telecom Equipment Co., Ltd. and the Company, which is currently under trial after first trial proceedings commenced at Jiangsu Provincial Higher People's Court on 13 October 2006, there was no substantial progress during the reporting period in respect of the other litigation and arbitration proceedings disclosed in the 2006 interim report of the Company published on 24 August 2006. The Company will make timely announcements in the event of any substantial progress of such matters.

3.1.2 **Seasonal or cyclical characteristics of the Group's operations**

Applicable Not applicable

3.1.3 **Profit structure for the reporting period (profit from principal operations, profit from other operations, expenses for the period, investment gains, subsidy income and net non-operating items each as a percentage of total profit, and any substantial change compared to the previous reporting period and reasons for such change)**

Applicable Not applicable

Item	As a percentage of total profit for the three months ended 30 September 2006	As a percentage of total profit for the six months ended 30 June 2006	Increase/decrease
Profit from principal operations	1200.15%	749.50%	Increase by 450.65 percentage points ⁽¹⁾
Profit from other operations	1.10%	5.71%	Decrease by 4.61 percentage points
Expenses for the period	1171.37%	698.65%	Increase by 472.72 percentage points ⁽²⁾
Investment gains	0.04%	0.14%	Decrease by 0.10 percentage points
Subsidy income	73.05%	43.87%	Increase by 29.18 percentage points
Non-operating items, net	-2.98%	-0.57%	Decrease by 2.41 percentage points

Note:

- (1) The substantial increase in profit from principal operations as a percentage of total profit was mainly attributable to the increase in expenses for the period and the decrease in total profit for the reporting period.
- (2) The substantial increase in expenses for the period as a percentage of total profit was mainly attributable to the increase in provision for asset impairment for the reporting period.

3.1.4 **Substantial change in principal operations and its structure compared to the previous reporting period and reasons for such change**

Applicable Not applicable

3.1.5 **Substantial change in the profitability (gross profit margin) from principal operations compared to the previous reporting period and reasons for such change**

Applicable Not applicable

3.2 **Analysis of significant events and their effects and proposed solutions**

Applicable Not applicable

3.2.1 **Non-operating use of funds of listed company by connected parties and repayment progress**

Applicable Not applicable

3.2.2 **Ongoing connected transactions during the reporting period**

During the reporting period, ongoing connected transactions (as defined in the Rules Governing Listing of Stocks on Shenzhen Stock Exchange) of the Group included the purchase of raw materials from and sales of products to connected parties by the Company and its subsidiaries. Such connected transactions were conducted after arm's length negotiations on the basis of normal commercial terms. The prices at which the Group made purchases from the connected parties were not higher than the prices at which the connected parties sell similar products to other users in similar quantities. The prices at which the Group sold its products to the connected parties were not lower than the prices at which the Group sells similar products to other users in similar quantities. In addition, such connected transactions would not have any adverse impact on the Group's profit. The Company is not dependent on the connected parties and the connected transactions do not affect the independence of the Company.

Details of the implementation of the Group's ongoing connected transactions during the reporting period are set out in the following table (for basic information on the connected parties, their connected relationships with the Group, basic terms of the connected transaction agreements between the Group and the connected parties, estimated transaction amounts for 2006 under each agreement, impact of the connected transactions on the Group and review of the connected transactions by the general meeting and board of directors of the Company, please refer to the ongoing connected transactions announcement published by the Company on 7 April 2006 in the China Securities Journal, Securities Times, Shanghai Securities News, The Standard and Hong Kong Economic Times).

Classification of transaction	Member of the Group (party to connected transaction)	Connected party (counterparty to connected transaction)	Subject matter	Pricing basis	Transaction amount for the nine months ended 30 September 2006 (excluding VAT) (RMB in 10,000)	As a percentage of transactions in the same classification	Settlement	Whether Different From Estimated Conditions
Purchases of raw materials	ZTE Kangxun Telecom Company, Limited	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)	30,239	2.96%	banker's acceptance bill	No
	ZTE Kangxun Telecom Company, Limited	Xi'an Microelectronics Technology Research Institute	Circuit protectors and other electronic products	Consistent with market prices (as per contract)	499	0.06%	banker's acceptance bill	No
	ZTE Kangxun Telecom Company, Limited	Shenzhen Zhongxing WXT Equipment Company, Ltd and its investee entity, Shenzhen Gaodonghua Communication Technique Co., Ltd	IC, connector assemblies, optical devices, modules and other ancillary equipment	Consistent with market prices (as per contract)	13,546	1.52%	banker's acceptance bill	No

3.3 **Changes in accounting policies, accounting estimates, scope of consolidation and significant accounting errors and reasons therefor**

Applicable Not applicable

3.3.1 **Accounting policies, accounting estimates and significant accounting errors and reasons therefor**

Applicable Not applicable

3.3.2 **Changes in scope of consolidation and reasons therefor**

Applicable Not applicable

Changes in the Group's scope of consolidation during the reporting period were as follows:

Company Name	Change	Reason
Nanjing Zhongxing Ruanchuang Software Company, Limited	Included	New incorporation
Shanghai Zhongxing Software Company, Limited	Included	New incorporation
Nanjing Zhongxing Software Company, Limited	Included	New incorporation
Chengdu Zhongxing Software Company, Limited	Included	New incorporation
Shenzhen Zhongruan Haina Technology Company, Limited	Included	New incorporation
Shenzhen Zhongxing Mobile Telecom Equipment Co., Ltd	Excluded	Liquidation and deregistration

3.4 **Declaration issued by the Board of Directors and Supervisory Committee in relation to any qualified opinion provided for in the auditors' report**

Applicable Not applicable

3.5 **Warning and explanation of possible accumulated net loss projected for the period from the beginning of the year through the end of the next reporting period or significant changes in accumulated net profit as compared to the same period last year and the reasons therefor**

Applicable Not applicable

3.6 **Accumulated adjustments made by the Group against its disclosed annual operational plan or budget**

Applicable Not applicable

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

Applicable Not applicable

Name of shareholder	Special undertaking	Performance of contract	Performance of undertaking
Shenzhen Zhongxingxin Telecommunications Equipment Company, Limited ("Zhongxingxin"), the largest shareholder of the Company	Where Zhongxingxin sells its shares during the period from the 13th month to the 24th month after the non-circulating shares of the Company 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 capitalization 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.	Performance in progress	Strict compliance with undertaking

Note: Other than Zhongxingxin, the remaining eight holders of original non-circulating shares of the Company did not give any special undertaking in respect of the share reform.

3.8 **This quarterly report is published in the Chinese and English languages. In case of any discrepancy between the Chinese and English versions, the Chinese version shall prevail.**

4. APPENDICES

4.1 Balance Sheet (unaudited)

Balance Sheet

Unit: RMB in thousands

Assets	As at 30 September 2006		As at 31 December 2005	
	Consolidated	Company	Consolidated	Company
Current assets:				
Cash in banks and on hand	3,124,279	2,008,693	5,573,132	4,258,936
Bills receivable	1,468,327	1,278,912	1,244,853	1,209,151
Dividends receivable	—	13,385	—	16,465
Trade receivables	5,342,120	6,095,064	3,441,922	4,481,796
Factored trade receivables	154,194	123,537	36,416	5,007
Other receivables	427,618	968,224	279,975	1,230,352
Prepayments	63,464	25,970	151,174	67,305
Inventories	2,562,657	1,855,107	2,519,547	1,557,312
Amount due from customers for contract work	5,879,376	5,750,172	4,689,157	4,440,842
Prepaid expenses	2,457	621	—	—
Total current assets	19,024,492	18,119,685	17,936,176	17,267,166
Long-term investments:				
Long-term equity investments	93,381	4,145,842	85,459	2,833,305
Fixed assets:				
Fixed assets — cost	3,962,260	2,448,633	3,623,940	2,491,000
Less: accumulated depreciation	1,419,449	769,824	1,148,789	712,768
Net fixed assets	2,542,811	1,678,809	2,475,151	1,778,232
Less: fixed asset impairment	94,980	87,002	94,980	87,002
Fixed assets — net	2,447,831	1,591,807	2,380,171	1,691,230
Construction in progress	337,686	268,901	126,741	77,261
Total fixed assets	2,785,517	1,860,708	2,506,912	1,768,491
Intangible and other assets:				
Intangible assets	159,352	83,835	160,264	87,081
Long term trade receivables	202,843	202,843	307,666	327,122
Factored long-term trade receivables	685,002	680,878	687,765	683,598
Long-term deferred assets	36,655	—	13,996	—
Total intangible and other assets	1,083,852	967,556	1,169,691	1,097,801
Deferred taxes:				
Deferred tax assets	82,882	76,419	80,893	76,419
Total assets	23,070,124	25,170,210	21,779,131	23,043,182
Current liabilities:				
Short-term loans	767,331	535,032	99,695	—
Bank advances on factored trade receivables	154,194	123,537	36,416	5,007
Bills payable	3,253,787	3,042,726	1,977,584	1,918,831
Accounts payable	3,114,295	5,950,644	4,292,208	6,538,622
Amount due to customers for contract work	658,077	658,077	733,455	688,876
Advances from customers	838,584	430,977	861,024	493,438
Accrued payroll	279,172	123,193	622,804	367,583
Welfare payable	349,998	243,623	394,216	326,370
Dividends payable	143,466	378	163,008	928
Taxes payable	(684,334)	(640,310)	(670,282)	(844,875)
Sundry payables	5,311	1,895	7,134	2,996
Other payables	595,138	1,166,938	626,066	1,084,091
Accrued expenses	356,031	278,896	346,668	286,561
Provisions	32,226	15,000	20,035	16,000
Long-term loans due within 1 year	500,000	500,000	500,000	500,000
Total current liabilities	10,363,276	12,430,606	10,010,031	11,384,428
Non-current liabilities:				
Long-term loans	680,000	600,000	80,000	—
Bank advances on factored long-term receivables	685,002	680,878	687,765	683,598
Other long-term liabilities	414,661	351,840	405,511	359,220
Total non-current liabilities	1,779,663	1,632,718	1,173,276	1,042,818
Total liabilities	12,142,939	14,063,324	11,183,307	12,427,246
Minority interests:				
Minority interests	608,607	—	470,729	—
Owners' equity:				
Share capital	959,522	959,522	959,522	959,522
Capital reserve	5,507,183	5,533,654	5,506,424	5,532,896
Surplus reserves	1,264,060	769,603	1,264,060	769,603
of which: statutory welfare fund	344,908	242,464	344,908	242,464
Undistributed profits	2,621,549	3,847,162	2,171,190	3,116,070
Exchange differences	(33,736)	(3,055)	(15,981)	(2,035)
Declared cash dividends	—	—	239,880	239,880
Total owner's equity	10,318,578	11,106,886	10,125,095	10,615,936
TOTAL LIABILITIES AND OWNER'S EQUITY	23,070,124	25,170,210	21,779,131	23,043,182

Hou Weigui
Legal representativeWei Zaisheng
Chief Financial OfficerShi Chunmao
Head of Finance Division

4.2 Income Statements (unaudited)

Income Statements and Statements of Income Distribution

Unit: RMB in thousands

Item	Nine months ended 30 September 2006		Nine months ended 30 September 2005	
	Consolidated	Company	Consolidated	Company
I. Revenue from principal operations	15,921,467	14,778,283	15,030,591	14,383,785
Less: Cost of sales	10,224,277	12,583,224	9,310,241	11,479,043
Taxes and surcharges	72,270	29,380	76,851	35,139
II. Profit from principal operations	5,624,920	2,165,679	5,643,499	2,869,603
Add: Profit from other operations	29,401	230,513	4,742	3,061
Less: Selling and distribution expenses	2,392,094	1,563,178	2,426,461	2,026,167
General and administrative expenses	2,813,749	1,256,029	2,249,761	956,785
Finance expense	125,396	140,539	176,937	187,781
III. Operating profit	323,082	(563,554)	795,082	(298,069)
Add: Investment income	763	1,294,363	(507)	588,513
Subsidy income	333,911	27,010	223,384	—
Non-operating income	5,818	5,727	15,868	6,769
Less: Non-operating expenses	13,549	6,454	8,453	2,616
IV. Total profit	650,025	757,092	1,025,374	294,597

Hou Weigui
Legal representativeWei Zaisheng
Chief Financial OfficerShi Chunmao
Head of Finance Division

Item	Nine months ended 30 September 2006		Nine months ended 30 September 2005	
	Consolidated	Company	Consolidated	Company
Less: Income tax	90,760	26,000	74,380	—
Minority interests	108,906	—	108,498	—
V. Net profit	450,359	731,092	842,496	294,597
Add: Undistributed profits at beginning of the year	2,171,190	3,116,070	1,495,431	2,682,269
VI. Distributable profit	2,621,549	3,847,162	2,337,927	2,976,866
Less: Statutory surplus reserves	—	—	—	—
Statutory public welfare fund	—	—	—	—
VII. Profit available for distribution to equity owners	2,621,549	3,847,162	2,337,927	2,976,866
Less: Discretionary common reserve	—	—	—	—
Ordinary shares dividends payable	—	—	—	—
Ordinary shares dividends converted to shares	—	—	—	—
VIII. Undistributed profits	2,621,549	3,847,162	2,337,927	2,976,866

Supplemental Information:

Item	Nine months ended 30 September 2006		Nine months ended 30 September 2005	
	Consolidated	Company	Consolidated	Company
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	—	—	—	—
5. Losses resulting from debt restructuring	—	—	—	—
6. Others	—	—	—	—

Hou Weigui
Legal representativeWei Zaisheng
Chief Financial OfficerShi Chunmao
Head of Finance Division

Income Statements (unaudited)

Unit: RMB in thousands

Item	Three months ended 30 September 2006		Three months ended 30 September 2005	
	Consolidated	Company	Consolidated	Company
I. Revenue from principal operations	5,430,938	5,040,341	4,727,593	4,431,296
Less: Cost of sales	3,397,362	4,614,164	2,886,758	3,369,127
Taxes and surcharges	28,326	10,985	40,408	23,665
II. Profit from principal operations	2,005,250	415,192	1,800,427	1,038,504
Add: Profit from other operations	1,845	1,955	2,007	(1,117)
Less: Selling and distribution expenses	824,098	597,679	979,250	870,021
General and administrative expenses	1,061,728	592,919	661,115	271,137
Finance expense	71,332	67,546	78,231	81,504
III. Operating profit	49,937	(840,997)	83,838	(185,275)
Add: Investment income	69	1,229,522	(218)	332,241
Subsidy income	122,051	2,500	96,856	—
Non-operating income	2,041	4,171	4,185	2,078
Less: Non-operating expenses	7,015	2,820	3,342	1,599
IV. Total profit	167,083	392,376	181,319	147,445
Less: Income tax	35,526	—	—	—
Minority interests	54,666	—	26,486	—
V. Net profit	76,891	392,376	154,833	147,445

Supplemental Information:

Item	Three months ended 30 September 2006		Three months ended 30 September 2005	
	Consolidated	Company	Consolidated	Company
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	—	—	—	—
5. Losses resulting from debt restructuring	—	—	—	—
6. Others	—	—	—	—

Hou Weigui
Legal representativeWei Zaisheng
Chief Financial OfficerShi Chunmao
Head of Finance Division

4.3 Cash Statement (unaudited)

Cash Flow Statement

Unit: RMB in thousands

Item	Nine months ended 30 September 2006	
	Consolidated	Company
I. Cash flow from operating activities		
Cash received from sale of goods or provision of services	13,506,821	12,707,193
Tax refund received	906,387	594,260
Cash received from other operating activities	80,026	44,412
Sub-total of cash inflow	<u>14,493,234</u>	<u>13,345,865</u>
Cash paid for goods and services	12,155,528	13,202,568
Cash paid to and on behalf of employees	2,750,821	1,229,625
Cash paid for all types of taxes	878,425	95,004
Cash paid in other operating activities	1,521,213	1,403,657
Sub-total of cash outflow	<u>17,305,987</u>	<u>15,930,854</u>
Net cash flow from operating activities	<u>(2,812,753)</u>	<u>(2,584,989)</u>
II. Cash flow from investing activities		
Cash received from disinvestment	10,470	9,470
Cash received from investment gains	141	7,896
Net cash received from disposal of fixed assets, intangible assets and other long-term assets	3,848	3,007
Cash received from other investing activities	—	—
Sub-total of cash inflow	<u>14,459</u>	<u>20,373</u>
Cash paid for acquisition of fixed assets, intangible assets and other long-term assets	578,254	518,182
Cash paid for acquisition of equity investments	6,843	—
Cash paid for other investing activities	—	—
Sub-total of cash outflow	<u>585,097</u>	<u>518,182</u>
Net cash flow from investing activities	<u>(570,638)</u>	<u>(497,809)</u>
III. Cash flow from financing activities		
Cash received from shareholders' investments	—	—
Cash received from borrowings	1,446,111	1,235,032
Cash received from other financing activities	—	—
Sub-total of cash inflow	<u>1,446,111</u>	<u>1,235,032</u>
Cash paid for debt repayments	178,475	100,000
Cash paid for dividend distributions or interest expenses	321,968	297,360
Cash paid for other financing activities	—	—
Sub-total of cash outflow	<u>500,443</u>	<u>397,360</u>
Net cash flow from financing activities	<u>945,668</u>	<u>837,672</u>
IV. Effect of foreign exchange rate changes on cash	<u>(11,130)</u>	<u>(5,117)</u>
V. Net decrease in cash and cash equivalents	<u>(2,448,853)</u>	<u>(2,250,243)</u>

Unit: RMB in thousands

Item	Nine months ended 30 September 2006	
	Consolidated	Company
I. Investing and financing activities not involved in cash		
Debt conversion into capital	—	—
Convertible bonds maturing within one year	—	—
Fixed assets under finance lease	—	—
II. Net profit reconciled to cash flow from operating activities		
Net profit	450,359	731,092
Add: Minority interests	108,906	—
Provision for impairment of assets	227,437	95,580
Depreciation of fixed assets	328,405	204,937
Amortisation of intangible assets	37,366	30,960
Amortisation of long-term prepaid expenses	—	—
Increase in prepaid expenses	(2,457)	(621)
Increase/(decrease) in accrued expenses	21,554	(8,665)
Losses on disposal of fixed assets, intangible assets and other long term assets	7,650	6,034
Finance expenses	57,016	61,382
Investment gains	(763)	(1,294,363)
Decrease in inventories	385,992	217,876
Increase in operating receivables	(4,032,132)	(3,022,791)
(Decrease)/increase in operating payables	(400,097)	393,590
Deferred tax assets	(1,989)	—
Net cash flow from operating activities	<u>(2,812,753)</u>	<u>(2,584,989)</u>
III. Net increase in cash and cash equivalents		
Cash at end of period	3,124,279	2,008,693
Less: Cash at beginning of period	5,573,132	4,258,936
Add: Cash equivalents at end of period	—	—
Less: Cash equivalents at beginning of period	—	—
Net increase in cash and cash equivalents	<u>(2,448,853)</u>	<u>(2,250,243)</u>

Hou Weigui
Legal representativeWei Zaisheng
Chief Financial OfficerShi Chunmao
Head of Finance Division

5. DOCUMENTS AVAILABLE FOR INSPECTION

- 5.1 Text of the 2006 third quarterly report signed by the Chairman of the Board of Directors;
- 5.2 Financial statements duly signed and sealed by the Company's legal representative, Chief Financial Officer and Head of Finance Division;
- 5.3 All original copies of the Company's released documents and announcements published in the China Securities Journal, Securities Times, Shanghai Securities News, The Standard and Hong Kong Economic Times during the reporting period.

By order of the Board
Hou Weigui
ChairmanShenzhen, PRC
26 October 2006

As at the date of this announcement, the Board of Directors of the Company comprises three executive directors, Yin Yimin, Shi Lirong and He Shiyong; 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.