

CHINA UNICOM (HONG KONG) Ltd

Form 20-F/A

February 18, 2011

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**SECURITIES AND EXCHANGE COMMISSION**

**Washington, D.C. 20549**

**FORM 20-F/A**

**Amendment No. 1**

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

**OR**

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

**For the fiscal year ended December 31, 2009**

**OR**

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

**For the transition period from \_\_\_\_\_ to \_\_\_\_\_**

**OR**

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

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

**Commission file number 1-15028**

**CHINA UNICOM (HONG KONG) LIMITED**

**(Exact Name of Registrant as Specified in Its Charter)**

N/A

Hong Kong

(Translation of Registrant's Name Into English)

(Jurisdiction of Incorporation or Organization)

75<sup>th</sup> Floor, The Center

99 Queen's Road Central

Hong Kong

(Address of Principal Executive Offices)

Chu Ka Yee

Telephone: +852 2121 3220

Facsimile: +852 2121 3232

75<sup>th</sup> Floor, The Center

99 Queen's Road Central

Hong Kong

(Name, Telephone, E-mail and/or Facsimile Number and Address of Company Contact person)

Securities registered or to be registered pursuant to Section 12(b) of the Act:

Title of Each Class

Name of Each Exchange On Which Registered

Ordinary shares, par value HK\$0.10 per share

The New York Stock Exchange, Inc.\*

\* Not for trading, but only in connection with the listing on The New York Stock Exchange, Inc. of American depositary shares, or ADSs, each representing 10 ordinary shares.

Securities registered or to be registered pursuant to Section 12(g) of the Act:

None

(Title of class)

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

None

(Title of Class)

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

As of December 31, 2009, 23,562,092,511 ordinary shares were issued and outstanding.

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

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

Note Checking the box above will not relieve any registrant required to file reports pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 from their obligations under those Sections.

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  No

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

Large Accelerated Filer  Accelerated Filer  Non-Accelerated Filer

Indicate by check mark which basis of accounting the registrant has used to prepare the financial statements included in this filing.

U.S. GAAP

International Financial Reporting Standards as issued by the International Accounting Standards Board  Other

If "Other" has been checked in response to the previous question, indicate by check mark which financial statement item the registrant has elected to follow.

Item 17  Item 18

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

**Table of Contents****EXPLANATORY NOTE**

This Amendment No. 1 on Form 20-F/A ( **Amendment No. 1** ) is being filed to our annual report on Form 20-F for the year ended December 31, 2009, filed with the Securities and Exchange Commission (the **SEC** ) on June 18, 2010 (the **Original Form 20-F** ), to address comments that we received from the SEC in its comment letters from September to December 2010 (collectively, the **SEC Comments** ), relating to the accounting treatment of our acquisition (the **Acquisition** ) of the fixed-line business in 21 provinces in southern China (the **Acquired Business** ) from our parent companies, China United Network Communications Group Company Limited (the **Unicom Group** ) and China Network Communications Group Corporation (which was later merged with Unicom Group in January 2009) on January 31, 2009.

In the Acquisition, we did not purchase the underlying telecommunication networks in southern China ( **Network Assets** ) but leased such assets from Unicom New Horizon, a wholly-owned subsidiary of Unicom Group, to operate the Acquired Business. In determining the accounting policy for the Acquisition, we noted that there is no guidance under the International Financial Reporting Standards ( **IFRS** ) on common control transactions, especially when it involves an acquisition of a business but not the underlying assets. In light of this, we followed the principles under International Accounting Standard (IAS) 8 Accounting policies, changes in accounting estimates and errors paragraph 10, 11 and 12 to exercise our judgment in developing and applying an accounting policy that we believed appropriate for the Acquisition. We accounted for the Acquisition using the predecessor values method in our consolidated financial statements for the years ended December 31, 2007, 2008 and 2009 (the **Financial Statements** ), prepared in accordance with IFRS. We recognized the Acquired Business in the Financial Statements at historical cost or predecessor values as if such business had always been part of our company during all the periods presented, and (i) included all the assets, liabilities, revenues and charges directly related to the Acquired Business, except for the Network Assets and other associated assets and liabilities that were not acquired ( **Excluded Assets and Liabilities** ) and the related charges, and (ii) supplemented such information with comprehensive disclosure of the Excluded Assets and Liabilities and the related charges. We also provided disclosure on the details of the lease payments that were made following the completion of the Acquisition in Note 4.2(b) to the Financial Statements. The Financial Statements were audited by PricewaterhouseCoopers, independent registered public accounting firm, as indicated their audit report dated June 18, 2010.

As part of its periodic review of our Original Form 20-F, the SEC staff (the **Staff** ) raised questions on this accounting treatment. In response to these comments, we have had a number of discussions with the Staff, with the participation of our auditor. At the conclusion, we determined to include all Excluded Assets and Liabilities and the related charges in the Financial Statements for the historical periods prior to the completion of the Acquisition, instead of disclosing such information in the notes to the Financial Statements. Accordingly, we have amended and restated the Financial Statements (the **Restatement** ). With the Restatement, upon completion of the Acquisition, the Excluded Assets and Liabilities were treated as a deemed disposal in January 2009 and recorded as a distribution from our reserves to Unicom Group. As a result, the Restatement only affects our historical financial statements prior to the completion of the Acquisition in January 2009, and has no material impact on our financial statements for the year ended December 31, 2009 and no impact on the financial statements for the year ended December 31, 2010 and thereafter.

The Restatement would have an impact on the following financial statements accounts:

|  |                    | <b>For the year ended December 31,</b> |                 |                    |                    |
|--|--------------------|--|-----------------|--------------------|--------------------|
|  |                    | <b>2007</b>                            |                 | <b>2008</b>        |                    |
| <b>As</b>                                |                    | <b>As</b>                              |                 | <b>As</b>          |                    |
| <b>previously</b>                        |                    | <b>previously</b>                      |                 | <b>previously</b>  |                    |
| <b>reported</b>                          | <b>Adjustments</b> | <b>As restated</b>                     | <b>reported</b> | <b>Adjustments</b> | <b>As restated</b> |
| (in RMB millions, except per share data) |                    |  |                 |                    |                    |

**CONSOLIDATED  
INCOME  
STATEMENT DATA**

**Continuing operations**

|  |          |         |          |          |         |          |
|--|----------|---------|----------|----------|---------|----------|
| Depreciation and amortization                    | (47,625) | (3,650) | (51,275) | (47,961) | (3,886) | (51,847) |
| Other operating expenses                         | (36,353) | (171)   | (36,524) | (37,748) | (249)   | (37,997) |
| Finance costs                                    | (3,241)  | (499)   | (3,740)  | (2,423)  | (846)   | (3,269)  |
| Impairment loss on property, plant and equipment |          | (323)   | (323)    | (11,837) | (657)   | (12,494) |
| Other income net                                 | 5,100    | 2       | 5,102    | 2,097    | 44      | 2,141    |

**Total costs, expenses and others**

|  |                  |                |                  |                  |                |                  |
|--|------------------|----------------|------------------|------------------|----------------|------------------|
|  | <b>(131,856)</b> | <b>(4,641)</b> | <b>(136,497)</b> | <b>(150,139)</b> | <b>(5,594)</b> | <b>(155,733)</b> |
|--|------------------|----------------|------------------|------------------|----------------|------------------|

**Income from****continuing operations**

|                   |               |                |               |              |                |              |
|-------------------|---------------|----------------|---------------|--------------|----------------|--------------|
| <b>before tax</b> | <b>28,084</b> | <b>(4,641)</b> | <b>23,443</b> | <b>9,653</b> | <b>(5,594)</b> | <b>4,059</b> |
|-------------------|---------------|----------------|---------------|--------------|----------------|--------------|

**Income from****continuing operations**

|                   |               |                |               |               |                |               |
|-------------------|---------------|----------------|---------------|---------------|----------------|---------------|
| <b>Net income</b> | <b>21,565</b> | <b>(4,641)</b> | <b>16,924</b> | <b>35,398</b> | <b>(5,594)</b> | <b>29,804</b> |
|-------------------|---------------|----------------|---------------|---------------|----------------|---------------|

**Earnings per share for income attributable to the equity holders of the Company during the year**

|                                   |      |        |      |       |        |       |
|-----------------------------------|------|--------|------|-------|--------|-------|
| -Basic earnings per share (RMB)   | 0.93 | (0.20) | 0.73 | 1.49  | (0.24) | 1.25  |
| -Diluted earnings per share (RMB) | 0.92 | (0.19) | 0.73 | 1.48  | (0.24) | 1.24  |
| -Basic earnings per ADS (RMB)     | 9.35 | (2.02) | 7.33 | 14.90 | (2.35) | 12.55 |
| -Diluted earnings per ADS (RMB)   | 9.25 | (1.99) | 7.26 | 14.79 | (2.34) | 12.45 |

**Earnings per share for income from continuing operations attributable to the equity holders of the Company during the year**

|                                   |      |        |      |      |        |      |
|-----------------------------------|------|--------|------|------|--------|------|
| -Basic earnings per share (RMB)   | 0.90 | (0.20) | 0.70 | 0.33 | (0.24) | 0.09 |
| -Diluted earnings per share (RMB) | 0.89 | (0.19) | 0.70 | 0.33 | (0.24) | 0.09 |
| -Basic earnings per ADS (RMB)     | 9.06 | (2.02) | 7.04 | 3.29 | (2.35) | 0.94 |
| -Diluted earnings per ADS (RMB)   | 8.97 | (1.99) | 6.98 | 3.27 | (2.34) | 0.93 |

**Earnings per share for income from discontinued operations**

**attributable to the  
equity holders of the  
Company during the  
year**

|                                      |      |      |       |       |
|--------------------------------------|------|------|-------|-------|
| -Basic earnings per share<br>(RMB)   | 0.03 | 0.03 | 1.16  | 1.16  |
| -Diluted earnings per<br>share (RMB) | 0.03 | 0.03 | 1.15  | 1.15  |
| -Basic earnings per ADS<br>(RMB)     | 0.29 | 0.29 | 11.61 | 11.61 |
| -Diluted earnings per<br>ADS (RMB)   | 0.28 | 0.28 | 11.52 | 11.52 |

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The Acquisition was completed on January 31, 2009 and therefore the consolidated statement of income for the year ended December 31, 2009 would have included the related charges of approximately RMB334 million for the period from January 1, 2009 to January 31, 2009. However, considering the amounts were not material, we did not restate the consolidated statement of income for the year ended December 31, 2009.

|   | As of January 1, 2008 <sup>(1)</sup> |                            |                   | As of December 31, 2008 |               |                                  |
|---|--------------------------------------|----------------------------|-------------------|-------------------------|---------------|----------------------------------|
|   | Before adjustments                   | Adjustments <sup>(2)</sup> | After adjustments | As previously reported  | Adjustments   | As restated<br>(in RMB millions) |
| <b>CONSOLIDATED BALANCE SHEET DATA</b>          |                                      |                            |                   |                         |               |                                  |
| Property, plant and equipment                   | 276,110                              | 30,310                     | 306,420           | 285,469                 | 30,077        | 315,546                          |
| Lease prepayments                               | 8,063                                | 744                        | 8,807             | 7,863                   | 875           | 8,738                            |
| Other assets                                    | 12,081                               | 659                        | 12,740            | 9,087                   | 398           | 9,485                            |
| Inventories and consumables                     | 2,815                                | 1                          | 2,816             | 1,092                   | 55            | 1,147                            |
| Prepayments and other current assets            | 4,314                                | 867                        | 5,181             | 2,715                   | 161           | 2,876                            |
| <b>Total assets</b>                             | <b>334,087</b>                       | <b>34,348</b>              | <b>368,435</b>    | <b>348,752</b>          | <b>31,566</b> | <b>380,318</b>                   |
| Reserves  | 76,275                               | 1,106                      | 77,381            | (15,464)                | (10,494)      | (25,958)                         |
| Long-term loans due to ultimate holding company |                                      | 27,213                     | 27,213            |                         | 35,652        | 35,652                           |
| Accounts payable and accrued liabilities        | 49,312                               | 12,019                     | 61,331            | 67,509                  | 6,345         | 73,854                           |
| Taxes payable                                   | 4,990                                | 101                        | 5,091             | 11,307                  | 63            | 11,370                           |
| <b>Total liabilities</b>                        | <b>155,571</b>                       | <b>39,575</b>              | <b>195,146</b>    | <b>141,025</b>          | <b>42,060</b> | <b>183,085</b>                   |

Note:

- (1) The opening balance sheet data as of January 1, 2008 is included in accordance with IAS 1/HKAS 1 Presentation of financial statements, which requires an entity to present the financial position as at the beginning of the earliest comparative period when an entity makes a retrospective restatement of items in its financial statements.
- (2) The adjustments on consolidated balance sheet data as of January 1, 2008 reflect the effects of (i) our acquisition of the Acquired Business, as well as local access telephone business in Tianjin Municipality and three subsidiaries from Unicom Group in January 2009 using the predecessor values method and (ii) the effect of the Restatement. For detailed information of our acquisition of the Acquired Business, as well as local access telephone business in Tianjin Municipality and three subsidiaries from Unicom Group, see A. History and Development of the Company Acquisitions of Fixed-Line Business in 21 Provinces in Southern China and Other Assets from Parent Companies and Lease of Telecommunications Networks in 21 Provinces in Southern China under Item 4 of our Original 20-F (such information is not amended by this Amendment).

**For the year ended December 31,**

| OTHER FINANCIAL DATA  | 2007   |             |                                     | 2008                         |             |                 |
|---|--|-------------|-------------------------------------|------------------------------|-------------|-----------------|
|   | As<br>previously<br>reported                                       | Adjustments | As<br>restated<br>(in RMB millions) | As<br>previously<br>reported | Adjustments | As<br>restated  |
|   | Net cash inflow from operating activities of continuing operations | 68,854      |                                     | 68,854                       | 57,241      |                 |
| Net cash outflow from investing activities of continuing operations | (47,770)   | (6,975)     | (54,745)                            | (54,742)                     | (6,284)     | (61,026)        |
| Net cash outflow from financing activities of continuing operations | (29,805)   | 6,975       | (22,830)                            | (35,070)                     | 6,284       | (28,786)        |
| <b>Net cash outflow from continuing operations</b>                  | <b>(8,721)</b>   |             | <b>(8,721)</b>                      | <b>(32,571)</b>              |             | <b>(32,571)</b> |
| <b>Net decrease in cash and cash equivalents</b>                    | <b>(7,909)</b>   |             | <b>(7,909)</b>                      | <b>(2,426)</b>               |             | <b>(2,426)</b>  |

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The following items in the Original Form 20-F have been amended in this Amendment No. 1 as a result of the Restatement or the SEC Comments:

Part I Item 3A Selected Financial Data

Part I Item 5 Operating and Financial Review and Prospects

Part III Item 18 Financial Statements

Part III Item 19 Exhibits

We have considered the effect of the Restatement on our assessment of disclosure controls and procedures and internal control over financial reporting. We believe that we have adequately designed procedures to account for the Acquisition and has therefore concluded that our company does not have a material weakness in the internal control over financial reporting in this respect and that our internal control over financial reporting is effective as of December 31, 2009.

Other than as set forth herein, this Amendment No. 1 does not, and does not purport to, amend, update or restate any other information or disclosure included in the Original Form 20-F or reflect any events that have occurred after the filing date of the Original Form 20-F. Items included in the Original Form 20-F that are not included herein are not amended and remain in effect as of the date of the filing of the Original Form 20-F. Among other things, forward-looking statements contained in the Original Form 20-F have not been revised to reflect events, results or developments that occurred or facts that became known to us after the original filing date, and such forward-looking statements should be read in their historical context. This Amendment No. 1 should be read in conjunction with the Original Form 20-F and our filings made subsequent thereto, including any amendments to those filings. The filing of this Amendment No. 1 shall not be deemed an admission that the Original Form 20-F when made included any untrue statement of material fact or omitted to state a material fact necessary to make a statement not misleading. In addition, this Amendment No. 1 includes currently dated Section 302 and Section 906 certifications of our Chief Executive Officer and Chief Financial Officer that are attached hereto as exhibits, as pursuant to Rule 13a-13(a) and Rule 13a-14(b) under the Securities Exchange Act of 1934, as amended.

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**Table of Contents****PART I****Item 3. Key Information*****A. Selected Financial Data***

The following tables present selected historical financial data of our company as of and for each of the years in the three-year period ended December 31, 2009. Except for amounts presented in U.S. dollars, the selected historical consolidated income statement data for the years ended December 31, 2007, 2008 and 2009 and the selected historical consolidated balance sheet data as of December 31, 2008 and 2009 set forth below are derived from, should be read in conjunction with, and are qualified in their entirety by reference to, our audited consolidated financial statements, including the related notes, included elsewhere in this Amendment No. 1 to our annual report on Form 20-F, or Amendment No. 1. The selected historical consolidated balance sheet data as of January 1, 2008 set forth below is derived from our internal records and management accounts that are not included in this Amendment No. 1. As disclosed under Special Note on Our Financial Information and Certain Statistical Information Presented in This Annual Report in our annual report on Form 20-F, our consolidated statements of income for the years ended December 31, 2007, 2008 and 2009 and consolidated balance sheets as of December 31, 2008 and 2009 have been prepared and presented in accordance with IFRS/HKFRS.

We completed (i) acquisitions of fixed-line business in 21 provinces in southern China, the local access telephone business in Tianjin Municipality, three subsidiaries (together referred to as the Target Business ) and certain other telecommunication assets from Unicom Group and Netcom Group (which was later merged with Unicom Group in January 2009) in January 2009, and (ii) a merger with China Netcom in October 2008. See A. History and Development of the Company Acquisitions of Fixed-Line Business in 21 Provinces in Southern China and Other Assets from Parent Companies and Lease of Telecommunications Networks in 21 Provinces in Southern China and A. History and Development of the Company Sale of CDMA Business, Merger with China Netcom and Related Transactions Merger with China Netcom and Related Transactions under Item 4, respectively. Because we and the Target Business were under common control of Unicom Group, both prior to and after the acquisitions, and we and China Netcom were under the common control of the PRC Government both prior to and after the merger, each of the acquisitions and the merger is considered as a business combination of entities and businesses under common control, and has been accounted for using merger accounting in accordance with Accounting Guideline 5 Merger accounting for common control combinations , or AG 5, issued by the HKICPA in November 2005. In addition, we completed an acquisition of assets and business of the Guizhou Province branch of Unicom Group, or Unicom Guizhou, from Unicom Group in December 2007 and prior to its merger with us, China Netcom completed an acquisition of the entire equity interest of Beijing Planning and Design Institute, or Design Institute, a wholly-owned subsidiary of Netcom Group, in December 2007. Because we and Unicom Guizhou were under the common control of Unicom Group both prior to and after our acquisition of Unicom Guizhou and China Netcom and Design Institute were under the common control of Netcom Group (which merged with, and was absorbed by, Unicom Group in January 2009) both prior to and after China Netcom s acquisition of Design Institute, both acquisitions have been accounted for using merger accounting in accordance with AG5 issued by the HKICPA. Upon our adoption of IFRS, we adopted the accounting policy to account for business combination of entities and businesses under common control using the predecessor values method, which is consistent with HKFRS. The acquired assets and liabilities mentioned above in this paragraph are stated at historical cost, and are included in the consolidated financial statements included in this Amendment No. 1 as if these entities and their businesses acquired had always been part of our company during all the periods presented. Accordingly, the 2007 and 2008 comparative figures in the consolidated financial information included in this Form 20-F have been restated to reflect the financial position, results of operations and cash flows of these acquired businesses.

We completed the disposal of our CDMA business in October 2008. See A. History and Development of the Company Sale of CDMA Business, Merger with China Netcom and Related Transactions Disposal of CDMA Business and Related Transactions under Item 4. In accordance with IFRS/HKFRS 5, Non-Current Assets Held for Sale and Discontinued Operations , we recognized the CDMA business as discontinued operations and the CDMA business was presented separately as discontinued operations in our audited consolidated statements of income and statements of cash flows for the years ended December 31, 2007 and 2008.

Prior to our merger with China Netcom, China Netcom completed the disposal of the fixed-line

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telecommunications and related services in its Guangdong and Shanghai branches in February 2007. See A. History and Development of the Company History and Corporate Development of China Netcom under Item 4. After considering that we reacquired the fixed-line business in Guangdong and Shanghai branches in January 2009, we did not present the fixed-line business in Guangdong and Shanghai branches as discontinued operations and derecognized the gain on disposal previously recorded in our 2007 consolidated financial statements.

|   | 2007<br>As restated<br>RMB | For the year ended December 31, |                  | 2009<br>US\$( <sup>1</sup> ) |
|---|----------------------------|---------------------------------|------------------|------------------------------|
|   |                            | 2008<br>As restated<br>RMB      | 2009<br>RMB      |                              |
| (in millions, except for per share data)                        |                            |                                 |                  |                              |
| <b>Consolidated Income Statement Data:</b>                      |                            |                                 |                  |                              |
| <b>CONTINUING OPERATIONS</b>                                    |                            |                                 |                  |                              |
| <b>Revenue<sup>(2)</sup></b>                                    |                            |                                 |                  |                              |
| <b>Mobile business</b>  |                            |                                 |                  |                              |
| Telecommunication service revenue                               | 62,236                     | 64,240                          | 69,769           | 10,221                       |
| Information communication technology services and other revenue | 187                        | 359                             | 252              | 37                           |
| Sales of mobile telecommunications products                     | 14                         | 532                             | 1,970            | 289                          |
| <b>Total mobile telecommunications revenue</b>                  | <b>62,437</b>              | <b>65,131</b>                   | <b>71,991</b>    | <b>10,547</b>                |
| <b>Fixed-line business</b>                                      |                            |                                 |                  |                              |
| Telecommunication service revenue <sup>(2)</sup>                | 91,093                     | 88,254                          | 79,549           | 11,654                       |
| Information communication technology services and other revenue | 4,782                      | 4,339                           | 1,611            | 236                          |
| Sales of fixed-line telecommunications products                 | 980                        | 1,362                           | 193              | 28                           |
| <b>Total fixed-line telecommunications revenue</b>              | <b>96,855</b>              | <b>93,955</b>                   | <b>81,353</b>    | <b>11,918</b>                |
| <b>Unallocated amounts</b>                                      |                            |                                 |                  |                              |
| Telecommunication service revenue <sup>(2)</sup>                | 420                        | 337                             | 275              | 40                           |
| Information communication technology services and other         | 228                        | 364                             | 326              | 48                           |
| Sales of other telecommunications products                      |                            | 5                               |                  |                              |
|   | 648                        | 706                             | 601              | 88                           |
| <b>Total revenue</b>  | <b>159,940</b>             | <b>159,792</b>                  | <b>153,945</b>   | <b>22,553</b>                |
| <b>Total costs, expenses and others</b>                         | <b>(136,497)</b>           | <b>(155,733)</b>                | <b>(141,668)</b> | <b>(20,754)</b>              |
| <b>Income from continuing operations before income tax</b>      | <b>23,443</b>              | <b>4,059</b>                    | <b>12,277</b>    | <b>1,799</b>                 |

|   |               |               |              |              |
|---|---------------|---------------|--------------|--------------|
| Income tax expenses   | (7,175)       | (1,828)       | (2,721)      | (399)        |
| <b>Income from continuing operations</b>  | <b>16,268</b> | <b>2,231</b>  | <b>9,556</b> | <b>1,400</b> |
| <b>DISCONTINUED OPERATIONS<sup>(3)</sup></b>  |               |               |              |              |
| Income from discontinued operations   | 656           | 1,438         |              |              |
| Gain on disposal of discontinued operations   |               | 26,135        |              |              |
| Sub-total for discontinued operation  | 656           | 27,573        |              |              |
| <b>Net income</b>   | <b>16,924</b> | <b>29,804</b> | <b>9,556</b> | <b>1,400</b> |
| <b>Earnings per share for income attributable to the equity holders of the Company during the year</b>                              |               |               |              |              |
| -Basic earnings per share <sup>(4)</sup>  | 0.73          | 1.25          | 0.40         | 0.06         |
| -Diluted earnings per share <sup>(4)</sup>  | 0.73          | 1.24          | 0.40         | 0.06         |
| -Basic earnings per ADS <sup>(5)</sup>  | 7.33          | 12.55         | 4.02         | 0.59         |
| -Diluted earnings per ADS <sup>(5)</sup>  | 7.26          | 12.45         | 4.00         | 0.59         |
| <b>Earnings per share for income from continuing operations attributable to the equity holders of the Company during the year</b>   |               |               |              |              |
| -Basic earnings per share <sup>(4)</sup>  | 0.70          | 0.09          | 0.40         | 0.06         |
| -Diluted earnings per share <sup>(4)</sup>  | 0.70          | 0.09          | 0.40         | 0.06         |
| -Basic earnings per ADS <sup>(5)</sup>  | 7.04          | 0.94          | 4.02         | 0.59         |
| -Diluted earnings per ADS <sup>(5)</sup>  | 6.98          | 0.93          | 4.00         | 0.59         |
| <b>Earnings per share for income from discontinued operations attributable to the equity holders of the Company during the year</b> |               |               |              |              |
| -Basic earnings per share <sup>(4)</sup>  | 0.03          | 1.16          |              |              |

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|   | <b>For the year ended December 31,</b>   |                           |                |                           |
|---|--|---------------------------|----------------|---------------------------|
|   | <b>2007</b>                              | <b>2008</b>               | <b>2009</b>    | <b>2009</b>               |
|   | <b>As restated</b>                       | <b>As restated</b>        |                | <b>US\$(<sup>1</sup>)</b> |
|   | <b>RMB</b>                               | <b>RMB</b>                | <b>RMB</b>     |                           |
|   | (in millions, except for per share data) |                           |                |                           |
| -Diluted earnings per share <sup>(4)</sup>                                  | 0.03                                     | 1.15                      |                |                           |
| -Basic earnings per ADS <sup>(5)</sup>                                      | 0.29                                     | 11.61                     |                |                           |
| -Diluted earnings per ADS <sup>(5)</sup>                                    | 0.28                                     | 11.52                     |                |                           |
| -Number of shares outstanding for basic earnings per share <sup>(4)</sup>   | 23,075                                   | 23,751                    | 23,767         | 23,767                    |
| -Number of shares outstanding for diluted earnings per share <sup>(4)</sup> | 23,321                                   | 23,941                    | 23,895         | 23,895                    |
| -Number of ADS outstanding for basic earnings per ADS <sup>(5)</sup>        | 2,308                                    | 2,375                     | 2,377          | 2,377                     |
| -Number of ADS outstanding for diluted earnings per ADS <sup>(5)</sup>      | 2,332                                    | 2,394                     | 2,389          | 2,389                     |
|   | <b>As of</b>                             | <b>As of December 31,</b> |                |                           |
|   | <b>January 1,</b>                        | <b>2008</b>               | <b>2009</b>    | <b>2009</b>               |
|   | <b>2008</b>                              | <b>As restated</b>        |                | <b>2009</b>               |
|   | <b>RMB</b>                               | <b>RMB</b>                | <b>RMB</b>     | <b>US\$(<sup>1</sup>)</b> |
|   | (in millions, except for per share data) |                           |                |                           |
| <b>Consolidated Balance Sheet Data</b>                                      |  |                           |                |                           |
| Cash and cash equivalent and short-term bank deposits                       | 13,555                                   | 10,574                    | 8,816          | 1,292                     |
| Property, plant and equipment   | 306,420                                  | 315,546                   | 351,157        | 51,445                    |
| Inventories and consumables   | 2,816                                    | 1,147                     | 2,412          | 353                       |
| Prepayments and other current assets  | 5,181                                    | 2,876                     | 4,252          | 623                       |
| Available-for-sale financial assets   | 287                                      | 95                        | 7,977          | 1,168                     |
| Proceeds receivable for the disposal of the CDMA business                   |  | 13,140                    | 5,121          | 750                       |
| <b>Total assets</b>   | <b>368,435</b>                           | <b>380,318</b>            | <b>417,045</b> | <b>61,097</b>             |
| <b>Liabilities</b>  |  |                           |                |                           |
| Amounts payable and accrued liabilities                                     | 61,331                                   | 73,854                    | 104,072        | 15,247                    |
| Long-term loans due to ultimate holding company                             | 27,213                                   | 35,652                    |                |                           |
| Payables in relation to the disposal of the CDMA business                   |  | 4,232                     | 7              | 1                         |
| Short-term bank loans   | 11,850                                   | 10,780                    | 63,909         | 9,363                     |
| Commercial paper  | 20,000                                   | 10,000                    |                |                           |
| Current portion of long-term bank loans                                     | 7,413                                    | 1,216                     | 62             | 9                         |
| Current portion of other obligations  | 3,381                                    | 3,012                     | 2,534          | 371                       |
| Long-term bank loans  | 16,086                                   | 997                       | 759            | 111                       |
| Corporate bonds   | 2,000                                    | 7,000                     | 7,000          | 1,026                     |
| Tax payable   | 5,091                                    | 11,370                    | 912            | 134                       |
| <b>Total liabilities</b>  | <b>195,146</b>                           | <b>183,085</b>            | <b>210,578</b> | <b>30,850</b>             |

|                            |                |                |                |               |
|----------------------------|----------------|----------------|----------------|---------------|
| <b>Shareholders equity</b> | <b>173,289</b> | <b>197,233</b> | <b>206,467</b> | <b>30,247</b> |
| Share capital              | 1,437          | 2,329          | 2,310          | 339           |

|  | <b>For the year ended December 31,</b>   |                    |             |                           |
|--|--|--------------------|-------------|---------------------------|
|  | <b>2007</b>                              | <b>2008</b>        | <b>2009</b> | <b>2009</b>               |
|  | <b>As restated</b>                       | <b>As restated</b> |             | <b>US\$<sup>(1)</sup></b> |
|  | <b>RMB</b>                               | <b>RMB</b>         | <b>RMB</b>  |                           |
|  | (in millions, except for per share data) |                    |             |                           |

**Other Financial Data****CONTINUING OPERATIONS**

|  |                |                 |              |            |
|--|----------------|-----------------|--------------|------------|
| Net cash inflow from operating activities of continuing operations           | 68,854         | 57,241          | 57,733       | 8,459      |
| Net cash outflow from investing activities of continuing operations          | (54,745)       | (61,026)        | (85,308)     | (12,498)   |
| Net cash (outflow)/inflow from financing activities of continuing operations | (22,830)       | (28,786)        | 30,197       | 4,423      |
| <b>Net cash (outflow)/inflow from continuing operations</b>                  | <b>(8,721)</b> | <b>(32,571)</b> | <b>2,622</b> | <b>384</b> |

**DISCONTINUED OPERATIONS<sup>(3)</sup>**

|  |      |        |         |       |
|--|------|--------|---------|-------|
| Net cash inflow from operating activities of discontinued operations           | 837  | 656    |         |       |
| Net cash (outflow)/inflow from investing activities of discontinued operations | (25) | 29,489 | (5,039) | (738) |
| Net cash outflow from financing activities of discontinued operations          |      |        |         |       |

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|   | <b>For the year ended December 31,</b>   |                    |                |                           |
|---|--|--------------------|----------------|---------------------------|
|   | <b>2007</b>                              | <b>2008</b>        | <b>2009</b>    | <b>2009</b>               |
|   | <b>As restated</b>                       | <b>As restated</b> |                | <b>US\$<sup>(1)</sup></b> |
|   | <b>RMB</b>                               | <b>RMB</b>         | <b>RMB</b>     |                           |
|   | (in millions, except for per share data) |                    |                |                           |
| <b>Net cash inflow/(outflow) from discontinued operations</b> | <b>812</b>                               | <b>30,145</b>      | <b>(5,039)</b> | <b>(738)</b>              |
| <b>Net decrease in cash and cash equivalents</b>              | <b>(7,909)</b>                           | <b>(2,426)</b>     | <b>(2,417)</b> | <b>(354)</b>              |
| <b>Dividend declared per share</b>                            | <b>0.20</b>                              | <b>0.20</b>        | <b>0.16</b>    | <b>0.02</b>               |

- (1) The translation of RMB into US dollars has been made at the rate of RMB6.8259 to US\$1.00, the noon buying rate in New York City for cable transfer in RMB as certified for customs purposes by the Federal Reserve Bank of New York on December 31, 2009. The translations are solely for the convenience of the reader.
- (2) Including fixed-line upfront connection fees for basic telephone access services that were eliminated by order of the former Ministry of Information Industry in July 2001.
- (3) Results of our CDMA business have been disclosed as discontinued operations for the years ended December 31, 2007 and 2008.
- (4) See Note 37 to the financial statements included in this Form 20-F on how basic and diluted earnings per share are calculated under IFRS/HKFRS.
- (5) Earnings per ADS is calculated by multiplying earnings per share by 10, which is the number of shares represented by each ADS.

**Exchange Rate Information**

We publish our consolidated financial statements in Renminbi. Solely for the convenience of the reader, this Amendment No. 1 contains translations of certain Renminbi and Hong Kong dollar amounts into U.S. dollars and vice versa at RMB6.8259 = US\$1.00 and HK\$7.7536 = US\$1.00, the noon buying rates in New York City for cable transfers as certified for customs purposes by the Federal Reserve Bank of New York on December 31, 2009. These translations should not be construed as representations that the Renminbi or Hong Kong dollar amounts could actually be converted into U.S. dollars at such rates or at all.

The noon buying rates in New York City for cable transfers as certified for customs purposes by the Federal Reserve Bank of New York were RMB6.8320 = US\$1.00 and HK\$7,7935 = US\$1.00, respectively, on June 11, 2010. The following table sets forth the high and low noon buying rates between Renminbi and U.S. dollars and between Hong Kong dollars and U.S. dollars for each month during the previous six months:

**Noon Buying Rate**

|               | <b>RMB per US\$1.00</b> |            | <b>HK\$ per US\$1.00</b> |            |
|---------------|-------------------------|------------|--------------------------|------------|
|               | <b>High</b>             | <b>Low</b> | <b>High</b>              | <b>Low</b> |
| December 2009 | 6.8244                  | 6.8299     | 7.7495                   | 7.7572     |
| January 2010  | 6.8258                  | 6.8295     | 7.7539                   | 7.7752     |
| February 2010 | 6.8258                  | 6.8330     | 7.7619                   | 7.7716     |
| March 2010    | 6.8254                  | 6.8270     | 7.7574                   | 7.7648     |
| April 2010    | 6.8229                  | 6.8275     | 7.7565                   | 7.7675     |

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|                                 |        |        |        |        |
|---------------------------------|--------|--------|--------|--------|
| May 2010                        | 6.8310 | 6.8245 | 7.8030 | 7.7626 |
| June 2010 (up to June 11, 2010) | 6.8322 | 6.8268 | 7.8040 | 7.7903 |

The following table sets forth the average noon buying rates between Renminbi and U.S. dollars and between Hong Kong dollars and U.S. dollars in 2005, 2006, 2007, 2008 and 2009, calculated by averaging the noon buying rates on the last day of each month during the relevant year.

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**Average Noon Buying Rate**

|      | <b>RMB per<br/>US\$1.00</b> | <b>HK\$ per<br/>US\$1.00</b> |
|------|-----------------------------|------------------------------|
| 2005 | 8.1826                      | 7.7755                       |
| 2006 | 7.9579                      | 7.7685                       |
| 2007 | 7.5806                      | 7.8008                       |
| 2008 | 6.9193                      | 7.7814                       |
| 2009 | 6.8295                      | 7.7513                       |

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**Table of Contents****Item 5. Operating and Financial Review and Prospects**

*You should read the following discussion and analysis in conjunction with the selected financial data set forth in Item 3 and our consolidated financial statements, together with the related notes, included elsewhere in this Amendment No. 1.*

**Acquisitions of Fixed-Line Business in 21 Provinces in Southern China and Other Assets from Parent Companies, Merger with China Netcom, Acquisitions of Unicom Guizhou and Design Institute, and Disposal of CDMA Business and Fixed-Line Business and Assets in Shanghai and Guangdong**

We completed (i) acquisitions of fixed-line business in 21 provinces in southern China, the local access telephone business in Tianjin Municipality, three subsidiaries (together referred to as the Target Business ) and certain other telecommunication assets from Unicom Group and Netcom Group (which was later merged with Unicom Group in January 2009) in January 2009 and (ii) a merger with China Netcom in October 2008. See A. History and Development of the Company Acquisitions of Fixed-Line Business in 21 Provinces in Southern China and Other Assets from Parent Companies and Lease of Telecommunications Networks in 21 Provinces in Southern China and A. History and Development of the Company Sale of CDMA Business, Merger with China Netcom and Related Transactions Merger with China Netcom and Related Transactions under Item 4, respectively. Because we and the Target Business were under common control of Unicom Group, both prior to and after the acquisitions, and we and China Netcom were under the common control of the PRC Government both prior to and after the merger, each of the acquisitions and the merger is considered as a business combination of entities and businesses under common control, and has been accounted for using merger accounting in accordance with Accounting Guideline 5 Merger accounting for common control combinations , or AG 5, issued by the HKICPA in November 2005. In addition, we completed an acquisition of assets and business of the Guizhou Province branch of Unicom Group, or Unicom Guizhou, from Unicom Group in December 2007 and prior to its merger with us, China Netcom completed an acquisition of the entire equity interest of Beijing Planning and Design Institute, or Design Institute, a wholly-owned subsidiary of Netcom Group, in December 2007. Because we and Unicom Guizhou were under the common control of Unicom Group both prior to and after our acquisition of Unicom Guizhou and China Netcom and Design Institute were under the common control of Netcom Group (which merged with, and was absorbed by, Unicom Group in January 2009) both prior to and after China Netcom s acquisition of Design Institute, both acquisitions have been accounted for using merger accounting in accordance with AG5 issued by the HKICPA. Upon our adoption of IFRS, we adopted the accounting policy to account for business combination of entities and businesses under common control using the predecessor values method, which is consistent with HKFRS. The acquired assets and liabilities mentioned above in this paragraph are stated at historical cost, and are included in the consolidated financial statements included in this Amendment No. 1 as if these entities and their businesses acquired had always been part of our company during all the periods presented. Accordingly, the 2007 and 2008 comparative figures in the consolidated financial information included in this Form 20-F have been restated to reflect the financial position, results of operations and cash flows of these acquired businesses.

We completed the disposal of our CDMA business in October 2008. See A. History and Development of the Company Sale of CDMA Business, Merger with China Netcom and Related Transactions Disposal of CDMA Business and Related Transactions under Item 4. In accordance with IFRS/HKFRS 5, Non-Current Assets Held for Sale and Discontinued Operations , we recognized the CDMA business as discontinued operations and the CDMA business is presented separately as discontinued operations in our audited consolidated statements of income and statements of cash flows for the years ended December 31, 2007 and 2008.

Prior to our merger with China Netcom, China Netcom completed the disposal of the fixed-line telecommunications and related services in its Guangdong and Shanghai branches in February 2007. See A. History and Development of the Company History and Corporate Development of China Netcom under Item 4. After considering that we reacquired the fixed-line business in Guangdong and Shanghai branches in January 2009, we did not present the fixed-line business in Guangdong and Shanghai branches as discontinued operations and derecognized the gain on disposal previously recorded in our 2007 consolidated financial statements.

**Table of Contents****Overview**

As a result of our merger with China Netcom in October 2008, we have become an integrated telecommunications operator in China providing mobile voice and value-added, fixed-line voice and value-added, fixed-line broadband, data communications and other telecommunications services to our customers through our two operating segments comprised of mobile services and fixed-line services. Following our acquisition of fixed-line business in 21 provinces in southern China from our parent companies in January 2009, we have extended the coverage of all of our services nationwide. We, China Mobile and China Telecom are the three major telecommunications operators in China. See A. History and Development of the Company Restructurings of the Telecommunications Industry under Item 4.

The table below sets forth revenues from our major businesses and their respective percentage of our total revenue from continuing operations in 2007, 2008 and 2009 (excluding (i) fixed-line upfront connection fees of RMB1,517 million in 2007, RMB886 million in 2008 and RMB490 million in 2009 and (ii) interconnection revenue of RMB1.00 billion and RMB0.99 billion between certain fixed-line business and the discontinued operations of CDMA business in 2007 and 2008, respectively).

|  | For the Year Ended December 31, |               |                 |               |                 |               |
|--|---------------------------------|---------------|-----------------|---------------|-----------------|---------------|
|  | 2007                            |               | 2008            |               | 2009            |               |
|  | RMB in millions                 | As % of Total | RMB in millions | As % of Total | RMB in millions | As % of Total |
| <b>Continuing Operations</b>   |                                 |               |                 |               |                 |               |
| Total revenue (excluding fixed-line upfront connection fees and interconnection revenue between certain fixed-line business and the discontinued operations of CDMA business) <sup>(1)</sup>             | 157,426                         | 100.0         | 157,914         | 100.0         | 153,455         | 100.0         |
| Total telecommunications service revenue (excluding fixed-line upfront connection fees and interconnection revenue between certain fixed-line business and the discontinued operations of CDMA business) | 151,235                         | 96.1          | 150,953         | 95.6          | 149,103         | 97.2          |
| Include: Mobile business   | 62,236                          | 39.5          | 64,240          | 40.7          | 69,769          | 45.5          |
| Fixed-line business  | 88,579                          | 56.3          | 86,376          | 54.7          | 79,059          | 51.5          |
| Out of which:  |                                 |               |                 |               |                 |               |
| Broadband service  | 16,450                          | 10.4          | 20,962          | 13.3          | 23,898          | 15.6          |
| Information communication technology services and other revenue  | 5,197                           | 3.3           | 5,062           | 3.2           | 2,189           | 1.4           |
| Total sales of telecommunications products.  | 994                             | 0.6           | 1,899           | 1.2           | 2,163           | 1.4           |

(1) Fixed-line upfront connection fees represent the amortization of deferred upfront connection fees received from the customers before July 1, 2001. No upfront connection fee was received from the customers since then. In addition, upon disposal of the CDMA business in 2008, interconnection revenue between certain fixed-line business and the discontinued operations of CDMA business will not be recognized anymore. Therefore, we consider that analyses of our operating results excluding upfront connection fees and interconnection revenue between certain fixed-line business and the discontinued operations of CDMA business are more relevant to the readers of this report.

Our telecommunications service revenues from continuing operations primarily consist of the following: usage fees and monthly fees for our mobile and fixed-line telephone services, which are recognized when we render the service to our customers;

revenue from the provision of value-added services, which is recognized when we render the services to our customers;

revenue from the provision of broadband and other Internet-related services, mainly consisting of Internet access services, and managed data services, which is recognized when we render the service to our customers;

revenue from telephone cards, which is service fees received from customers for telephone services, is recognized when we render the related service upon actual usage of the telephone

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cards by customers;

revenue from interconnection with other telecommunications operators for calls made from their networks to our networks. We recognize interconnection revenue when the relevant calls are made by subscribers;

revenue for offerings which include the sale of mobile handsets and provision of services, the amount of revenue allocated to the handset sale is determined using the residual value method. Under such method, we determine the revenue from the sale of the mobile handsets by deducting the fair value of the service element from the total contract consideration. We recognize revenues related to sale of a handset when the title is passed to the customer whereas service revenues are recognized based upon the actual usage of mobile services. The cost of the mobile handset is expensed immediately to the statement of income.

revenue from information communications technology services, are recognized when goods are delivered to the customers (which generally coincides with the time when the customers have accepted the goods and the related risks and rewards of ownership have been transferred to the customers) or when services are rendered to the customers using the percentage of completion method when the outcome of the services provide can be estimated reliably. If the outcome of the services provided cannot be estimated reliably, the treatment should be as follows: (i) if it is probable that the costs incurred for the services provided is recoverable, service revenue should be recognized only to the extent of reasonable costs incurred, and costs should be recognized as current expenses in the period in which they are incurred, (ii) if it is probable that costs incurred will not be reasonable, costs should be recognized as current expenses immediately and service revenue should not be recognized; and

rental income from leases of customer-end equipment and transmission lines on our networks to business customers and other telecommunications carriers in China. We recognize leased line rental revenue on a straight-line basis over the relevant lease term.

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The following table sets forth our major costs and expenses items and income before income tax, both in terms of amount and as a percentage of total revenue from continuing operations in 2007, 2008 and 2009 (excluding (i) fixed-line upfront connection fees of RMB1,517 million in 2007, RMB886 million in 2008 and RMB490 million in 2009 and (ii) interconnection revenue of RMB1.00 billion and RMB0.99 billion between certain fixed-line business and the discontinued operations of CDMA business in 2007 and 2008, respectively).

|  | <b>For the Year Ended December 31,</b> |              |                           |              |                 |              |
|--|--|--------------|---------------------------|--------------|-----------------|--------------|
|  | <b>2007 (as restated)</b>              |              | <b>2008 (as restated)</b> |              | <b>2009</b>     |              |
|  | <b>RMB in</b>                          |              | <b>RMB in</b>             |              | <b>RMB in</b>   |              |
|  | <b>millions</b>                        | <b>% of</b>  | <b>millions</b>           | <b>% of</b>  | <b>millions</b> | <b>% of</b>  |
|  |  | <b>Total</b> |                           | <b>Total</b> |                 | <b>Total</b> |
| <b>Continuing Operations</b>   |  |              |                           |              |                 |              |
| Total revenue (excluding fixed-line upfront connection fees and interconnection revenue between certain fixed-line business and the discontinued operations of CDMA business) <sup>(1)</sup> | 157,426                                | 100.0        | 157,914                   | 100.0        | 153,455         | 100.0        |
| Costs, expenses and others   | 136,497                                | 86.7         | 155,733                   | 98.6         | 141,668         | 92.3         |
| Interconnection charges  | 12,198                                 | 7.7          | 13,038                    | 8.3          | 12,955          | 8.4          |
| Depreciation and amortization  | 51,275                                 | 32.5         | 51,847                    | 32.8         | 47,587          | 31.0         |
| Networks, operations and support expenses  | 17,877                                 | 11.4         | 18,736                    | 11.9         | 21,728          | 14.2         |
| Leasing fee for telecommunications networks in southern China  |  |              |                           |              | 2,000           | 1.3          |
| Employee benefit expenses  | 19,398                                 | 12.3         | 20,758                    | 13.1         | 21,931          | 14.3         |
| Selling and marketing  | 19,660                                 | 12.5         | 19,614                    | 12.4         | 21,020          | 13.7         |
| Cost in relation to information communication technology services  | 3,808                                  | 2.4          | 3,010                     | 1.9          | 839             | 0.5          |
| General, administrative and other expenses   | 11,947                                 | 7.6          | 13,217                    | 8.4          | 12,175          | 7.9          |
| Cost of telecommunications products sold   | 1,109                                  | 0.7          | 2,156                     | 1.4          | 2,689           | 1.8          |
| Finance costs, net of interest income  | 3,435                                  | 2.2          | 3,004                     | 1.9          | 945             | 0.6          |
| Impairment loss on property, plant and equipment   | 323                                    | 0.2          | 12,494                    | 7.9          |                 |              |
| Realized loss on changes in fair value of derivative component of convertible bonds  | 569                                    | 0.4          |                           |              |                 |              |
| Realized gains on changes in fair value of derivative financial instrument   |  |              |                           |              | (1,239)         | (0.8)        |
| Other income-net   | (5,102)                                | (3.2)        | (2,141)                   | (1.4)        | (962)           | (0.6)        |

<sup>(1)</sup> Fixed-line upfront connection fees represent the amortization of deferred upfront connection fees received from the customers before July 1, 2001. No upfront connection fee was received from the customers since then. In addition, upon disposal of the CDMA business in 2008, interconnection revenue between certain fixed-line business and the discontinued operations of CDMA business will no longer be recognized. Therefore, we consider that analyses of our operating results excluding upfront connection fees and interconnection revenue between certain fixed-line business and the discontinued operations of CDMA business are more relevant to the



readers of this report.

Our major costs and expenses include the following:

interconnection expenses, representing amounts paid to other operators for calls from our networks to their networks and for calls made by our subscribers roaming in their networks;

depreciation and amortization expenses, mainly relating to our property, plant and equipment and other assets;

networks, operations and support expenses, mainly relating to repair, maintenance and operations of our networks;

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leasing fee for telecommunications networks in southern China;

employee benefit expenses, representing staff salaries and wages, bonuses and medical benefits, contributions to defined contribution pension schemes, housing benefits and share-based compensation costs amortized over the vesting period of share options;

selling and marketing expenses, including commissions, promotion and advertising expenses, direct incremental costs for activating subscriber services and customer retention costs;

cost in relation to information communication technology services, primarily including cost of hardware sold ;

general, administrative and other expenses, primarily including provision for doubtful debts, utilities, general office expenses and travel expenses; and

finance costs, net of interest income, primarily including interest expenses, net of interest income.

**Critical Accounting Policies**

The preparation of our financial statements and this Amendment No. 1 requires us to make estimates and judgments that affect the reported and disclosed amounts of assets and liabilities, including contingent assets and liabilities, as of the relevant dates and revenue and expenses for the relevant periods. We have identified below the areas involving a higher degree of judgment or complexity, or areas where assumptions are significant to the accounting policies and estimates, as critical to our business operations and an understanding of our results of operations and financial position. The impact and any associated risks related to these policies on our business operations are discussed throughout this Item 5 where such policies affect our reported and expected financial results. For a discussion of the application of these and other accounting policies, see Note 4 to our consolidated financial statements included in this Amendment No. 1. There can be no assurance that actual results will not differ from those estimates and assumptions.

***Significant Accounting Policies***

***Revenue Recognition***

Revenue comprises the fair value of the consideration received or receivable for the services and sales of goods or telecommunications products in the ordinary course of our business activities. Revenue is shown net of business tax, government surcharges, returns and discounts and after eliminating sales within our company.

We recognize revenue when the amount of revenue can be reliably measured, it is probable that future economic benefits will flow to the entity and specific criteria have been met for each of our activities as described below. The amount of revenue is not considered to be reliably measurable until all contingencies relating to the sale have been resolved. We base our estimates on historical results, taking into consideration of the type of customer, the type of transaction and the specifics of each arrangement.

***Sales of services and goods***

Usage fees and monthly fees are recognized when the services are rendered;

Revenues from the provision of broadband and other Internet-related services and managed data services are recognized when the services are provided to customers;

Revenue from telephone cards, which represents service fees received from customers for telephone services, is recognized when the related service is rendered upon actual usage of the telephone cards by customers;

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Lease income from leasing of lines and customer-end equipment are treated as operating leases with rental income recognized on a straight-line basis over the lease term;

Value-added services revenue, which mainly represents revenue from the provision of services such as SMSs, Cool Ringtone, personalized ring, caller number display and secretarial services to subscribers, is recognized when service is rendered;

Standalone sales of telecommunications products, which mainly represent handsets and accessories, are recognized when title has been passed to the buyers;

For offerings which include the sale of mobile handsets and provision of services, the amount of revenue allocated to the handset sale is determined using the residual value method. Under such method, we determine the revenue from the sale of the mobile handsets by deducting the fair value of the service element from the total contract consideration. We recognize revenues related to sale of a handset when the title is passed to the customer whereas service revenues are recognized based upon the actual usage of mobile services. The cost of the mobile handset is expensed immediately to the statement of income.

Revenue from information communications technology services are recognized when goods are delivered to the customers (which generally coincides with the time when the customers have accepted the goods and the related risks and rewards of ownership have been transferred to the customers) or when services are rendered to the customers using the percentage of completion method when the outcome of the services provided can be estimated reliably. If the outcome of the services provided cannot be estimated reliably, the treatment should be as follows: (i) if it is probable that the costs incurred for the services provided are recoverable, services revenue should be recognized only to the extent of recoverable costs incurred, and costs should be recognized as current expenses in the period in which they are incurred; (ii) if it is probable that costs incurred will not be recoverable, costs should be recognized as current expenses immediately and services revenue should not be recognized.

*Interest income*

Interest income from deposits in banks or other financial institutions is recognized on a time proportion basis, using the effective interest method.

*Dividend income*

Dividend income is recognized when the right to receive payment is established.

*Deferred Revenue, Advances from Customers and Subscriber Points Reward Program*

*Deferred revenue*

Deferred revenue mainly represents upfront non-refundable revenue, including upfront connection fees and installation fees of fixed-line business and receipts from the activation of SIM/USIM cards relating to our mobile businesses, which are deferred and recognized over the expected customer service period.

*Advances from customers*

Advances from customers are amounts paid by customers for prepaid cards, other calling cards and prepaid service fees, which cover future telecommunications services (over a period of one to twelve months). Advances from customers are stated at the amount of proceeds received less the amount already recognized as revenues upon the rendering of services.

*Subscriber points reward program*

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The fair value of providing telecommunications services and the subscriber points reward are allocated based on their relative fair values. The allocated portion of fair value for the subscriber points reward is recorded as deferred revenue when the rewards are granted and recognized as revenue when the points are redeemed or expired. The fair value of deferred revenue is estimated based on (i) the value of each bonus point awarded to subscribers, (ii) the number of bonus points related to subscribers who are qualified or expected to be qualified to exercise their redemption right at each balance sheet date, and (iii) the expected bonus points redemption rate. The fair value of the outstanding subscriber points reward is subject to review by management on a periodic basis.

***Critical Accounting Estimates and Judgments******Recognition of Upfront Non-refundable Revenue and Direct Incremental Costs***

We defer and amortize upfront activation fees of SIM/USIM cards of the mobile business over the expected customer service period of 3 years (2007: approximately 3 years; 2008: approximately 3 years). The related direct incremental costs of acquiring and activating mobile subscribers, including costs of SIM/USIM cards and commissions, are also capitalized and amortized over the same expected customer service period of 3 years.

We defer and amortize upfront customer connection and installation fees of the fixed-line business over the expected customer service period of 10 years (2007: approximately 10 years; 2008: approximately 10 years). The related direct incremental installation costs are deferred and amortized over the same expected customer service period of 10 years.

We only capitalize costs to the extent that they will generate future economic benefits. The excess of the direct incremental costs over the corresponding upfront non-refundable revenue, if any, are expensed to the statement of income immediately.

We estimate the expected customer service period based on the historical customer retention experience and after factoring in the expected level of future competition, the risk of technological or functional obsolescence to our services, technological innovation, and the expected changes in the regulatory and social environment. If our estimate of the expected customer service period changes as a result of increased competition, changes in telecommunications technology or other factors, the amount and timing of recognition of the deferred revenues and direct incremental costs may change for future periods.

***The Acquisition of Target Business ( 2009 Business Combination )***

Our acquisition of Target Business, or the 2009 Business Combination, was considered as a business combination of entities and business under common control, and has been accounted for using merger accounting under HKFRS, which is consistent with the predecessor values method under IFRS.

When applying the merger accounting/predecessor values method to restate the historical financial statements prior to the effective date of the 2009 Business Combination, we included all the assets and liabilities associated with the Acquired Business and the Telecommunications Networks in southern China in the consolidated balance sheets and all the revenue and expenses in the consolidated statements of income throughout the periods presented, including those assets not acquired and liabilities not assumed as well as the related costs and expenses. Pursuant to the agreement dated December 16, 2008, the 2009 Business Combination excluded the Telecommunications Networks in southern China, which are retained by Unicom New Horizon and are leased from Unicom New Horizon to CUCL effective from January 2009. To reflect the economic substance that we have not taken on the risks and rewards associated with the property, plant and equipment and related assets and liabilities relating to the fixed-line business in southern China, we are deemed to have disposed of the assets and liabilities associated with the Telecommunications Networks in southern China and we have recorded the deemed disposal of these assets and liabilities as a distribution from reserves by us to Unicom Group upon the completion of the 2009 Business Combination effective from January 2009.

As of December 31, 2008, the total assets and liabilities associated with the Telecommunications Networks in southern China were approximately RMB31,566 million and RMB42,060 million, respectively, which have been included in the consolidated balance sheet as of December 31, 2008 and have been subsequently recorded as a

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distribution from reserves to Unicom Group in January 2009 upon the completion of 2009 Business Combination. In addition, the depreciation and amortization, impairment loss, other operating expenses, and finance costs associated with the Telecommunications Networks in southern China for the years ended December 31, 2008 were approximately RMB3,886 million, RMB657 million, RMB249 million, and RMB846 million, respectively (2007: RMB3,650 million, RMB323 million, RMB171 million, and RMB499 million). Subsequent to the completion of the 2009 Business Combination, we recorded leasing fees amounting to approximately RMB2.0 billion charged by Unicom New Horizon for the lease of the Telecommunications Networks in southern China for the year ended December 31, 2009.

*Lease of Telecommunications Networks in Southern China*

Pursuant to an agreement in relation to the lease of the fixed-line telecommunications networks in southern China entered between CUCL and Unicom Horizon, Unicom New Horizon has the legal ownership of the fixed-line telecommunications networks in southern China. We believe that we only bear the risks associated with the operation of the fixed-line business in southern China during the relevant leasing periods and are free from any ownership risks of the telecommunications networks, and the risks and rewards of ownership of the leased assets rest substantially with the lessor. The initial term of the lease is two years effective from January 2009 and the lease is renewable at the option of CUCL with at least two months prior notice on the same terms and conditions, except for the future lease fee which will remain subject to further negotiations between the parties, taking into account, among others, the then prevailing market conditions in southern China. Moreover, in connection with the lease, Unicom New Horizon has granted to CUCL an option to purchase the telecommunications networks in southern China and the purchase price will be referenced to the then appraised value of the networks determined by an independent appraiser. Accordingly, we have accounted for the leasing of the aforementioned telecommunications networks as an operating lease.

*PRC Tax Resident Enterprise*

Pursuant to the PRC enterprise income tax law, a 10% withholding income tax is levied on dividends declared on or after January 1, 2008 by foreign investment enterprises to their foreign enterprise shareholders unless the enterprise investor is deemed as a PRC Tax Resident Enterprise ( TRE ). On April 22, 2009, the PRC State Administration of Taxation issued a notice regarding the determination of PRC TRE status and provided implementation guidance in withholding income tax for non-TRE enterprise shareholders. We performed an assessment and concluded that we meet the definition of PRC TRE. Therefore, as of December 31, 2008 and 2009, our subsidiaries in the PRC did not accrue for withholding tax on dividends distributed to us and there has been no deferred tax liability accrued in our consolidated financial statements for the undistributed income of our subsidiaries in the PRC.

If the results of our assessment change, the amount of current income tax and deferred income tax will change in future periods.

*Depreciation on Property, Plant and Equipment*

Depreciation on our property, plant and equipment is calculated using the straight-line method to allocate cost or revalued amounts up to residual values over the estimated useful lives of the assets. We review the useful lives and residual values periodically to ensure that the method and rates of depreciation are consistent with the expected pattern of realization of economic benefits from property, plant and equipment. We estimate the useful lives of property, plant and equipment based on historical experience, taking into account anticipated technological changes. If there are significant changes from previously estimated useful lives, the amount of depreciation expenses may change.

*Revaluation of Property, Plant and Equipment*

Property, plant and equipment other than buildings and telecommunications equipment of the mobile business is carried at revalued amounts, being the fair value at the date of revaluation, less subsequent accumulated

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depreciation and accumulated impairment losses. Such equipment is revalued on a depreciated replacement cost or open market value approach, as appropriate, by an independent valuer on a regular basis.

During the intervals of independent revaluations, management performs the analysis and assessment annually to determine whether the fair values of property, plant and equipment carried at revalued amounts are materially different from their carrying amounts. If the revalued amounts differ significantly from the carrying amounts of such property, plant and equipment in the future, the carrying amounts will be adjusted to the revalued amounts. The key assumptions made to determine the revalued amounts include the estimated replacement costs and the estimated useful lives of the property, plant and equipment. This will have an impact on our future results, since any subsequent decreases in valuation are first set off against increases on earlier valuations in respect of the same item and thereafter are charged as an expense to the statement of income and any subsequent increases are credited as income to the statement of income up to the amount previously charged to the statement of income and thereafter are credited to equity. In addition, the depreciation expenses in future periods will change as the carrying amounts of such property, plant and equipment change as a result of the revaluation.

Most of our property, plant and equipment which are carried at revalued amounts were revalued as at December 31, 2006 by an independent valuation firm. We believe that the fair values of these revalued property, plant and equipment were not materially different from their carrying values as of December 31, 2009.

*Impairment of Non-Current Assets*

We test whether non-current assets have suffered from any impairment, in accordance with the accounting policy stated in Note 2.11 to the audited consolidated financial statements contained elsewhere in this Amendment No. 1. The recoverable amount of an asset is the higher of its fair value less costs to sell and its value in use. Management estimates value in use based on estimated discounted pre-tax future cash flows of the cash generating unit at the lowest level to which the asset belongs. If there is any significant change in management's assumptions, including discount rates or growth rates in the future cash flow projection, the estimated recoverable amounts of the non-current assets and our results would be significantly affected. Such impairment losses are recognized in the statement of income, except where the asset is carried at valuation and the impairment loss does not exceed the revaluation surplus for that same asset, in which case the impairment loss is treated as a revaluation decrease and charged to the revaluation reserve. Accordingly, there will be an impact to the future results if there is a significant change in the recoverable amounts of the non-current assets.

During 2008, we conducted the impairment test for the PHS service related assets, after considering the expected significant decline in revenue and profitability in 2009 and onwards. The impaired PHS business related assets were written down to their recoverable amount, which was determined based on their estimated value in use as there is no active market transaction for PHS business related assets. Estimated value in use was determined based on the present value of estimated future net cash flows expected to arise from the continuing use of the PHS business related assets. In estimating the future net cash flows, we made key assumptions and estimates on the appropriate discount rate of 15%, the period covered by the cash flow forecast of 3 years, the future loss of customers at an annual rate of declining ranging from 60% to 80%, and the decrease in average revenue per subscriber at an annual rate of decline at 15%.

These assumptions and estimates were made after considering the historical trends, the prevailing market trends and the physical conditions of the PHS business related assets. Changes in these assumptions and estimates could have a significant impact on the estimated recoverable amount. Based on above, we recognized RMB11.84 billion of impairment loss on PHS services related assets at the end of 2008. Our total impairment loss on property, plant and equipment was RMB0.32 billion, RMB12.49 billion and nil for the years ended December 31, 2007, 2008 and 2009, respectively.

*Provision for Doubtful Debts*

Accounts receivables are recognized initially at fair value and subsequently measured at amortized cost using the effective interest method, less provision for impairment. We evaluate specific accounts receivable where there are indications that the receivable may be doubtful or is not collectible. We record a provision based on our best estimates to reduce the receivable balance to the amount that is expected to be collected. For the remaining



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receivable balances as at each reporting date, we make a provision based on observable data indicating that there is a measurable decrease in the estimated future cash flows from the remaining balances. We make such estimates based on our past experience, historical collection patterns, subscribers' creditworthiness and collection trends. For general subscribers, we make a full provision for receivables aged over 3 months, which is consistent with our credit policy with respect to the relevant subscribers.

Our estimate described above is based on past experience, historical collection patterns, subscribers' creditworthiness and collection trends. If circumstances change (e.g., due to factors including developments in our business and the external market environment), we may need to reevaluate our policies on doubtful debts, and make additional provisions in the future.

*Income Tax and Deferred Taxation*

We estimate our income tax provision and deferred taxation in accordance with the prevailing tax rules and regulations, taking into account any special approvals obtained from relevant tax authorities and any preferential tax treatment to which we are entitled in each location or jurisdiction in which we operate. There are many transactions and calculations for which the ultimate tax determination is uncertain during the ordinary course of business. We recognize liabilities for anticipated tax audit issues based on estimates of whether additional taxes will be due. Where the final tax outcome of these matters is different from the amounts that were initially recorded, such differences will impact the income tax and deferred tax provisions in the period in which such determination is made.

For temporary differences which give rise to deferred tax assets, we have assessed the likelihood that the deferred tax assets could be recovered. Major deferred tax assets relate to impairment loss on property, plant and equipment, unrecognized revaluation surplus on property, plant and equipment under PRC tax regulations, and provision for doubtful debts. Due to the effects of these temporary differences on income tax, we have recorded deferred tax assets amounting to approximately RMB5,202 million as at December 31, 2009 (2008: approximately RMB5,334 million). Deferred tax assets are recognized based on our estimates and assumptions that they will be recovered from taxable income arising from continuing operations in the foreseeable future.

We believe we have recorded adequate income tax provision and deferred taxes based on the prevailing tax rules and regulations and our current best estimates and assumptions. In the event that future tax rules and regulations or related circumstances change, adjustments to income tax and deferred taxation may be necessary which would impact our results or financial position.

*Recently Issued International Financial Reporting Standards/Hong Kong Financial Reporting Standards*

The IASB has issued a number of new and revised IFRSs and interpretations that are first effective for the current accounting period commencing January 1, 2009 or are available for early adoption. The equivalent new and revised HKFRSs and interpretations consequently issued by the HKICPA have the same effective date as those issued by the IASB and are in all material respects identical to the pronouncements issued by the IASB. There have been no other material changes to HKFRSs.

Up to the date of issue of our 2009 financial statements, the following new standards and amendments or revisions to existing standards have been issued but not yet effective for the annual accounting period ended December 31, 2009 and have not been adopted by us:

|  | <b>Effective for annual<br/>accounting period<br/>beginning on or after</b> |
|--|---|
| IFRS/HKFRS 2 (amendments), Group cash-settled share-based payment transactions | January 1, 2010   |
| IFRS/HKFRS 3 (revised), Business combinations                                  | July 1, 2009  |
| IFRS/HKFRS 9 Financial instrument  | January 1, 2013   |
| IAS/HKAS 27 (revised), Consolidated and separate financial statements          | July 1, 2009  |



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|   | <b>Effective for annual<br/>accounting period<br/>beginning on or after</b> |
|---|---|
| IASB's improvements to IFRS/HKICPA's improvements to HKFRS: |   |
| IFRS/HKFRS 3 Business combinations                          | July 1, 2010  |
| IFRS/HKFRS 7 Financial instruments: disclosures             | January 1, 2011   |
| IAS/HKAS 7 (Amendment), Cash flow statements                | January 1, 2010   |
| IAS/HKAS 17 (Amendment), Leases                             | January 1, 2010   |
| IAS/HKAS 34 Interim financial reporting                     | January 1, 2011   |
| IAS/HKAS 36 (Amendment), Impairment of assets               | January 1, 2010   |
| IAS/HKAS 38 (Amendment), Intangible assets                  | July 1, 2009  |
| IFRIC/(HK)IFRIC 13 Customer loyalty programmes              | January 1, 2011   |

There are a number of new interpretations including IFRIC/HK (IFRIC) 17 Distribution of non-cash assets to owners, IFRIC/HK (IFRIC) 18 Transfer of assets from customers and IFRIC/HK (IFRIC) 19 Extinguishing financial liabilities with equity instruments as well as the amendment to IFRIC/HK (IFRIC) 14 Prepayments of a minimum funding requirement which are not listed above as the interpretations and the amendment are not relevant to our operation and consolidated financial statements. In addition, there are also a number of amendments to IFRS/HKFRS 5, Non-current assets held for sale and discontinued operations, IFRS /HKFRS 8, Operating segments, IAS/HKAS 1, Presentation of financial statements and IAS/HKAS 18, Revenue under IASB's improvements to IFRS/HKICPA's improvements to HKFRS which are not listed above as the amendments are also not relevant to our operation and consolidated financial statements.

We are currently in the process of making an assessment of the expected impact of these new standards, and amendments/revisions to existing standards in the period of initial application.

**Operating Results*****Acquisition of Fixed-Line Telecommunications Business in 21 Provinces in Southern China***

The 2008 and 2007 figures have been restated to reflect the effect of our acquisition of the fixed-line telecommunications business in 21 provinces in southern China from Unicom Group in January 2009, which had been accounted for using merging accounting under HKFRS and predecessor values method under IFRS, which is consistent with HKFRS. In this acquisition, we did not purchase the underlying fixed-line network assets in southern China, but subsequently leased such assets from Unicom New Horizon, a wholly-owned subsidiary of Unicom Group, to operate the acquired fixed-line business. To account for this transaction, we recorded all assets, liabilities, revenue and costs and expenses associated with the acquired fixed-line business in southern China and the underlying network assets in our consolidated financial statements for the historical periods prior to the completion of the transaction in January 2009. Following the completion of this transaction, as we started to lease the fixed-line network assets in southern China, which were retained by the lessor, the assets and liabilities associated with these network assets were treated as a distribution by us to Unicom Group from other reserve using the merger accounting under HKFRS and predecessor values method under IFRS. Accordingly, we no longer include any assets, liabilities, depreciation, finance costs or other costs relating to such assets, but record only revenue generated from the acquired fixed-line business in southern China and the leasing fee for the relevant network assets in our consolidated financial statements for the subsequent periods.

Please refer to Explanatory Note above for the impact of the acquired fixed-line business and the underlying network assets in southern China on assets, liabilities, depreciation, finance costs or other costs for the historical periods in our consolidated financial statements.

**Table of Contents****Year Ended December 31, 2009 Compared to Year Ended December 31, 2008****Revenue**

2009 is the first year that we had a full-year operation following our merger with China Netcom. Despite various challenges, including global financial crisis, intensified telecommunications market competition, further downward adjustments in tariffs and decline of traditional fixed-line business, we actively developed full-service operation with a focus on mobile and fixed-line broadband businesses. Revenues from our continuing operations for 2009 amounted to RMB153.95 billion, a decrease of 3.7% from RMB159.79 billion for 2008. Excluding the effects of fixed-line upfront connection fees of RMB0.49 billion and RMB0.89 billion in 2009 and 2008 respectively, and interconnection revenue of RMB0.99 billion between our certain fixed-line business and the discontinued operations of CDMA business in 2008, our revenues from continuing operations for 2009 would amount to RMB153.46 billion, a decrease of 2.8% from RMB157.91 billion in 2008, of which our telecommunications service revenue would be RMB149.10 billion, down by 1.2% from 2008.

**Mobile Business Revenue**

Revenue from our mobile business was RMB71.99 billion in 2009, of which telecommunications service revenue accounted for RMB69.77 billion, up by 8.6% compared with 2008. Telecommunications service revenue from our mobile business, as a percentage of our total telecommunications service revenues (excluding fixed-line upfront connection fees of RMB0.49 billion and RMB0.89 billion in 2009 and 2008 respectively, and interconnection revenue of RMB0.99 billion between our certain fixed-line business and the discontinued operations of CDMA business in 2008), increased from 42.6% in 2008 to 46.8% in 2009. The growth in revenue from our mobile business is primarily due to the continued increase in the total number of our mobile subscribers, partially offset by the decrease in our subscribers' ARPU.

Our total number of mobile subscribers was 147.59 million as of December 31, 2009, with a net addition of 14.22 million subscribers (including 2.74 million 3G subscribers) from the end of 2008. ARPU of our GSM mobile business was RMB41.2 in 2009, a decrease of 2.64% from RMB42.3 in 2008. ARPU of our 3G business was RMB141.7 in 2009.

The table below sets forth the revenue composition of our mobile business and each revenue item's respective share of total revenue for the years ended December 31, 2008 and 2009.

|   | 2008            |               | 2009            |               |
|---|-----------------|---------------|-----------------|---------------|
|   | RMB in millions | As % of total | RMB in millions | As % of total |
| Total revenue from mobile business          | 65,131          | 100.0         | 71,991          | 100.0         |
| Telecommunications service revenue          | 64,240          | 98.6          | 69,769          | 97.0          |
| Usage fees and monthly fees                 | 40,462          | 62.1          | 42,297          | 58.8          |
| Value-added service revenue                 | 16,263          | 25.0          | 19,070          | 26.5          |
| Interconnection revenue                     | 6,775           | 10.4          | 8,220           | 11.4          |
| Other service revenue                       | 740             | 1.1           | 182             | 0.3           |
| Other revenue                               | 359             | 0.6           | 252             | 0.3           |
| Sales of mobile telecommunications products | 532             | 0.8           | 1,970           | 2.7           |

*Usage Fees and Monthly Fees.* As a result of increase of mobile subscribers, partially offset by the decrease in effective tariffs, usage fees and monthly fees for our mobile services were RMB42.30 billion in 2009, an increase of 4.5% from RMB40.46 billion in 2008.

*Value-Added Service Revenue.* In 2009, we continued to actively promote mobile value-added services and mobile data business, and improved the penetration of SMS and Cool Ringtone services. As a result, revenues from our mobile value-added services amounted to RMB19.07 billion in 2009, an increase of 17.3% from RMB16.26 billion in 2008 and as a percentage of total mobile revenue increased from 25.0% in 2008 to 26.5% in 2009. Of the total revenue from mobile value-added services, revenue from our SMS services decreased by 8.2% from RMB6.52 billion in 2008 to RMB5.98 billion in 2009 and revenue from Cool Ringtone services increased by 15.7% from RMB2.49 billion in 2008 to RMB2.88 billion in 2009.



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*Interconnection Revenue.* Our interconnection revenue increased by 21.3% from RMB6.78 billion in 2008 to RMB8.22 billion in 2009, and represented 11.4% of total mobile revenue in 2009 as compared with 10.4% in 2008. This increase is primarily due to the increased total usage of our mobile services.

*Sales of Telecommunications Products.* Revenues from our sale of mobile telecommunications products increased 270.3% from RMB532 million in 2008 to RMB1,970 million in 2009, mainly due to our efforts in sales of 3G mobile handsets.

*Fixed-Line Business Revenue*

In 2009, as mobile substitution further intensified and the declining trend of the fixed-line voice business continued, we further adjusted our business structure and continued to focus on the development of fixed-line broadband services and innovative business services. Excluding fixed-line upfront connection fees of RMB0.49 billion and RMB0.89 billion in 2009 and 2008 respectively, and interconnection revenue of RMB0.99 billion between our certain fixed-line business and the discontinued operations of CDMA business in 2008, our revenue from fixed-line business would have decreased by 12.2% from RMB92.08 billion in 2008 to RMB80.86 billion in 2009, of which telecommunication service revenue would have decreased by 8.5% from RMB86.38 billion in 2008 to RMB79.06 billion in 2009. See D. Risk Factors We may further lose fixed-line and mobile subscribers and our doubtful debt ratios may increase, which may materially adversely affect our financial condition, results of operations and growth prospects under Item 3.

The table below sets forth the revenue composition of our fixed-line business and each revenue item's respective share of total revenue from our fixed-line business for the years ended December 31, 2008 and 2009.

|   | <b>For the Year Ended December 31,</b> |                          |                            |                          |
|---|--|--------------------------|----------------------------|--------------------------|
|   | <b>2008</b>                            |                          | <b>2009</b>                |                          |
|   | <b>RMB in<br/>millions</b>             | <b>As % of<br/>Total</b> | <b>RMB in<br/>millions</b> | <b>As % of<br/>Total</b> |
| Total revenue from fixed-line business <sup>(1)</sup>           | 92,077                                 | 100.0                    | 80,863                     | 100.0                    |
| Telecommunications service revenue <sup>(1)</sup>               | 86,376                                 | 93.8                     | 79,059                     | 97.8                     |
| Usage fee and monthly fee <sup>(1)</sup>                        | 40,497                                 | 44.0                     | 34,369                     | 42.5                     |
| Fixed-line broadband service revenue                            | 20,962                                 | 22.8                     | 23,898                     | 29.6                     |
| Interconnection revenue   | 7,342                                  | 8.0                      | 5,599                      | 6.9                      |
| Value-added service revenue                                     | 7,074                                  | 7.7                      | 5,238                      | 6.5                      |
| Leased line service revenue                                     | 5,492                                  | 6.0                      | 5,683                      | 7.0                      |
| Managed data, other internet-related service revenue            | 2,662                                  | 2.8                      | 2,466                      | 3.0                      |
| Others  | 2,347                                  | 2.5                      | 1,806                      | 2.3                      |
| Information communication technology services and other revenue | 4,339                                  | 4.7                      | 1,611                      | 2.0                      |
| Sales of fixed-line telecommunications products                 | 1,362                                  | 1.5                      | 193                        | 0.2                      |

<sup>(1)</sup> Excluding fixed-line upfront connection fees of RMB0.49 billion in 2009 and RMB0.89 billion in 2008 and interconnection revenue of RMB0.99 billion between certain fixed-line business and the discontinued operations of CDMA business in 2008. Fixed-line upfront connection fees represent the amortization of deferred upfront connection fees received from the customers before July 1, 2001. No upfront connection fee was received from the customers since then. In addition, upon disposal of the CDMA business in 2008, interconnection revenue between certain fixed-line business and the discontinued operations of CDMA business will not be recognized anymore. Therefore, we consider that analyses of our operating results excluding upfront connection fees and interconnection revenue between certain fixed-line business and the discontinued operations of CDMA business are more relevant to the readers of this report.

*Usage Fees and Monthly Fees.* Usage fees include local usage fees charged for local telephone calls and VoIP long distance calls, long distance usage fees for domestic and international long distance calls originated by our fixed-line

subscribers, users of our pre-paid phone cards and certain other customers. Monthly fees represent the fixed amount of service charges to our customers for using our fixed-line telephone services.

As a result of further implementation of the Calling-Party-Pays tariff policy for mobile services and continuing downward adjustments of tariffs for fixed-line services, the substitution effect of fixed-line local services by mobile services became more intense. We experienced significant decline in the number of our fixed-line local telephone subscribers and substantial decline in revenue. Our local telephone subscribers decreased in 2009 by 6.2%

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from 109.57 million at the end of 2008 to 102.82 million at the end of 2009. ARPU of the local telephone business decreased by 11.3% from 2008 to RMB31.4 in 2009. Total usage of local calls decreased by 8.9% from 2008 to 185.54 billion pulses in 2009 (excluding Internet dial-up usage) and total usage of long distance calls decreased by 18.3% from 41.11 billion minutes in 2008 to 33.58 billion minutes in 2009. As a result, revenues from our usage fees and monthly fees in 2009 decreased by 15.1% from RMB40.50 billion in 2008 to RMB34.37 billion in 2009.

*Fixed-Line Broadband Service Revenue.* Revenue from our fixed-line broadband services consists of revenue generated from DSL, LAN, and broadband-related value-added services. In 2009, our fixed-line broadband business continued to maintain a rapid growth as a result of our efforts in improving broadband access speed, enriching application contents and implementing diversified sales strategies. Our fixed-line broadband subscribers increased by 28.2% from 2008 to 38.55 million in 2009. ARPU of our fixed-line broadband business decreased from RMB63.6 in 2008 to RMB57.2 in 2009, mainly because: (i) a significant portion of our new broadband subscribers consist of users from rural areas in China who tend to have limited usage of broadband services, and (ii) the general decreasing tariff resulted from intensified market competition. However, revenues from our fixed-line broadband service increased significantly by 14.0% from 2008 to RMB23.90 billion in 2009, and as a percentage of the fixed-line service revenue, increased from 22.8% in 2008 to 29.6% in 2009. Fixed-line broadband service has become the main factor in counteracting the effect of mobile substitution in the decline of our fixed-line voice business.

*Interconnection Revenue.* Revenue from our interconnection services consists of interconnection fees charged to other domestic telecommunications operators, principally China Mobile and China Telecom, for both local and long distance calls. Revenue from our interconnection services decreased by 23.7% from RMB7.34 billion in 2008 to RMB5.60 billion in 2009. The decrease in interconnection revenue was mainly due to a decrease in voice traffic from other telecommunications operators as a result of the mobile substitution effect.

*Value-Added Service Revenue.* Revenue from our value-added services consists of fees that we charge our customers for the provision of caller identification, personalized ring, telephone information services, video- and tele-conferencing and other value-added services. Revenue from our value-added services decreased by 26.0% from RMB7.07 billion in 2008 to RMB5.24 billion in 2009, mainly due to the decrease in usage of our caller identification and PHS SMS services as a result of the significant reduction of our fixed-line telephone subscribers, including PHS subscribers.

*Leased Line Service Revenue.* Revenue from our leased line services consists of fees that we receive from our government, corporate and carrier customers for leasing circuit capacity to them, including the lease of digital circuits, digital trunk lines and optic fibers. Revenue from our leased line services increased by 3.5% from RMB5.49 billion in 2008 to RMB5.68 billion in 2009, mainly due to the increased demand of leased line services by our government and SME customers.

*Managed Data Service and Other Internet-Related Service Revenue.* Revenue from our managed data services consists of fees that we charge for our DDN, frame relay, ATM, MPLS-VPN and X.25 services. Revenue from our managed data services increased by 3.7% from RMB1.41 billion in 2008 to RMB1.46 billion in 2009. Revenue from other Internet-related services consists of revenue from the provision of Internet dial-up services (other than communication fees) and dedicated Internet access services. Revenue from other Internet-related services decreased by 19.8% from RMB1.25 billion in 2008 to RMB1.01 billion in 2009.

*Others.* Other fixed-line related revenue mainly consists of miscellaneous revenue items. Other fixed-line related revenue decreased by 23.1% from RMB2.35 billion in 2008 to RMB1.81 billion in 2009.

*Information communication technology services and other revenue.* Information communication technology services and other revenue decreased by 62.9% from RMB4.34 billion in 2008 to RMB1.61 billion in 2009. This decrease was mainly due to the decrease in our ICT service revenue as a result of the change in our ICT business strategy which is changed to focus on the provision of technology/services and reducing hardware sales. In 2009, we reduced sales of third-party products in connection with the provision of our ICT services, which, despite reducing our direct revenue, helped enhance the profit margin, of our ICT services.

*Sales of Telecommunications Products.* Revenue from our sales of fixed-line telecommunications products decreased by 85.8% from RMB1.36 billion in 2008 to RMB0.19 billion in 2009, mainly due to the decrease in sales



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of computers bundled with our fixed-line broadband services in 2008.

**Costs, Expenses and Others**

Total costs, expenses and others for our continuing operations in 2009 were RMB141.67 billion, representing a decrease of 9.0% from RMB155.73 billion in 2008. Excluding the effects of the following non-comparable items: (i) realized gains of RMB1.24 billion on changes in fair value of derivative financial instrument in 2009; (ii) impairment loss of RMB11.84 billion on PHS services related equipment in 2008; and (iii) gain of RMB0.04 billion from the non-monetary assets exchange in 2009 and RMB1.31 billion in 2008, our total costs, expenses and others for our continuing operations in 2009 would have been RMB142.95 billion, representing a decrease of 1.6% from RMB145.20 billion in 2008.

The table below sets forth the major items of costs, expenses and others from continuing operations and their respective percentage of the total telecommunications services revenue from continuing operations for the years 2008 and 2009:

|  | For the Year Ended December 31,<br>2008 (as restated) |               | 2009               |               |
|--|---|---------------|--------------------|---------------|
|  | RMB in<br>millions                                    | % of<br>Total | RMB in<br>millions | % of<br>Total |
| <b>Continuing Operations</b>   |   |               |                    |               |
| Total telecommunications services revenue <sup>(1)</sup>                   | 150,953   | 100.0         | 149,103            | 100.0         |
| Costs, expenses and others   | 155,733   | 103.2         | 141,668            | 95.0          |
| Interconnection charges  | 13,038  | 8.6           | 12,955             | 8.7           |
| Depreciation and amortization  | 51,847  | 34.3          | 47,587             | 31.9          |
| Networks, operations and support expenses                                  | 18,736  | 12.4          | 21,728             | 14.6          |
| Leasing fee for telecommunications networks in southern China              |   |               | 2,000              | 1.3           |
| Employee benefit expenses  | 20,758  | 13.8          | 21,931             | 14.7          |
| Selling and marketing  | 19,614  | 13.0          | 21,020             | 14.1          |
| Cost in relation to information communication technology services          | 3,010   | 2.0           | 839                | 0.6           |
| General, administrative and other expenses                                 | 13,217  | 8.8           | 12,175             | 8.2           |
| Cost of telecommunications products sold <sup>(1)</sup>                    | 2,156   | 1.4           | 2,689              | 1.8           |
| Finance costs, net of interest income                                      | 3,004   | 2.0           | 945                | 0.6           |
| Impairment loss on property, plant and equipment                           | 12,494  | 8.3           |                    |               |
| Realized gains on changes in fair value of derivative financial instrument |   |               | (1,239)            | (0.8)         |
| Other income-net   | (2,141)   | (1.4)         | (962)              | (0.7)         |

<sup>(1)</sup> Excluding fixed-line upfront connection fees of RMB0.49 billion in 2009 and RMB0.89 billion in 2008 and interconnection revenue of RMB0.99 billion between certain fixed-line business and the discontinued operations of CDMA business in 2008.

*Interconnection Charges.* Interconnection charges were RMB12.96 billion in 2009, down by 0.6% from 2008 and as a percentage of telecommunications service revenue (excluding fixed-line upfront connection fees and interconnection revenue between our certain fixed-line business and the discontinued operations of CDMA business in 2008) would remain stable in 2009.

*Depreciation and Amortization.* Our depreciation and amortization expenses were RMB47.59 billion in 2009, down by 8.2% from 2008. The decrease was primarily due to the following factors (i) we no longer record any depreciation of the fixed-line network assets in southern China as a result of our acquisition from Unicom Group of the telecommunications business in 21 provinces in southern China in 2009 (see Acquisition of Fixed-Line



Telecommunications Business in 21 Provinces in Southern China (above), (ii) our full provision of the impairment loss on the PHS service related equipment in 2008, and (iii) to a lesser extent, the full depreciation of certain property, plant and equipment (other than the fixed-line network assets in southern China) in 2008. This decrease was partially offset by the increase in the depreciation and amortization expenses of 3G network assets of RMB0.65

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billion in the fourth quarter of 2009. As a percentage of telecommunications service revenue (excluding fixed-line upfront connection fees and interconnection revenue between certain fixed-line business and the discontinued operations of CDMA business in 2008), our depreciation and amortization expenses decreased from 34.3% in 2008 to 31.9% in 2009.

*Networks, Operations and Support Expenses.* Due to various factors, including the launch of 3G services, the expansion of GSM networks facilities and base stations and the increases in utilities charges and repair and maintenance expenses, we incurred networks, operations and support expenses of RMB21.73 billion in 2009, up by 16.0% from 2008. Networks, operations and support expenses, as a percentage of telecommunications service revenue (excluding fixed-line upfront connection fees and interconnection revenue between certain fixed-line business and the discontinued operations of CDMA business in 2008), increased by 2.2% from 2008 to 14.6% in 2009. As a result of network resources sharing and utilization of synergies, the related line leasing fees was RMB1.19 billion, down by 22.7% from 2008.

*Leasing Fee for Telecommunications Networks in Southern China.* We completed an acquisition of fixed-line business of 21 provinces in southern China in January 2009. As the underlying telecommunications networks for such business are retained by Unicom Group, we operated those networks through an operating lease from Unicom Group from January 2009. As a result, we incurred a lease fee of RMB2.00 billion for leasing those telecommunications networks in 2009.

*Employee Benefit Expenses.* Due to various factors, such as increased employee insurance premium expenses and housing fund resulting from new regulations and generally improved social average wages in China, our employee benefit expenses increased by 5.7% from 2008 to RMB21.93 billion in 2009, and as a percentage of telecommunications service revenue (excluding fixed-line upfront connection fees and interconnection revenue between certain fixed-line business and the discontinued operations of CDMA business in 2008), increased from 13.8% in 2008 to 14.7% in 2009.

*Selling and Marketing Expenses.* Since the commercial launch of 3G business on October 1, 2009, we have been engaged in active advertising campaigns and marketing promotion activities, which resulted in a total selling and marketing expenses for the fourth quarter of 2009 of RMB1.17 billion. In 2009, our total selling and marketing expenses reached RMB21.02 billion, up by 7.2% from 2008, and as a percentage of telecommunications service revenue (excluding fixed-line upfront connection fees and interconnection revenue between certain fixed-line business and the discontinued operations of CDMA business in 2008), increased from 13.0% in 2008 to 14.1% in 2009.

*Cost in Relation to Information Communication Technology Services.* We adjusted the development strategy in relation to our ICT business by focusing on the provision of technology services and reducing hardware sales. As a result, cost in relation to information communication technology in 2009 was RMB0.84 billion, down by 72.1% from last year. Correspondingly, revenue from ICT services in 2009 was RMB1.04 billion, down by 71.9% from last year.

*General, Administrative and Other Expenses.* As we continued to benefit from the post-merger synergies and to closely control the growth of general and administrative expenses, our general, administrative and other expenses was RMB12.18 billion in 2009, down by 7.9% compared with last year, and as a percentage of telecommunications service revenue (excluding fixed-line upfront connection fees and interconnection revenue between certain fixed-line business and the discontinued operations of CDMA business in 2008), slightly decreased from 8.8% in 2008 to 8.2% in 2009.

*Cost of Telecommunications Products Sold.* As a result of the increase in the number of mobile handsets sold after the commercial launch of 3G business, the cost of telecommunications products sold amount to RMB2.69 billion, up by 24.7% from 2008. Correspondingly, revenue from sale of telecommunications products in 2009 amounted to RMB2.16 billion, up by 13.9% from 2008.

*Finance Costs, Net of Interest Income.* In 2009, we further improved our debt structure by enhancing the centralization of fund management and fund operation and obtained low-cost financing. In addition, due to the following factors: (i) reduction of base lending rate and the increase in the amount of capitalized interest related to

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the construction we undertook in 2009, and (ii) we no longer record any finance costs associated with the fixed-line network assets in southern China as a result of our acquisition from Unicom Group of the telecommunications business in 21 provinces in southern China in 2009 (see Acquisition of Fixed-Line Telecommunications Business in 21 Provinces in Southern China above), our finance costs, net of interest income, decreased by 68.5% from RMB3.00 billion in 2008 to RMB0.95 billion in 2009.

*Impairment Loss on Property, Plant and Equipment*

Our impairment loss on property, plant and equipment was nil in 2009 and RMB12.49 billion in 2008, mainly consisting of impairment loss on PHS services related equipment and fixed-line network assets in southern China.

Upon the completion of our merger with China Netcom, we reconsidered our strategy relating to the PHS business. As we expected that the economic performance of the PHS business would deteriorate significantly, we prepared an updated analysis and forecast accordingly to determine if there had been an impairment of assets. After considering the expected significant decline in revenue and profitability in 2009 and onwards, we conducted an impairment test for the PHS business related assets. See D. Risk Factors Risks Relating to Our Business If we fail to achieve a smooth discontinuation of PHS services or retain our PHS subscribers to use our other telecommunications services, our financial condition and results of operations may be adversely affected. under Item 3. Accordingly, we recognized an impairment loss on PHS business related equipment of approximately RMB11.84 billion for the year ended December 31, 2008. As of December 31, 2009, we updated the impairment analysis for the PHS business related equipment and concluded that there was no need for additional recognition or reversal of the previously recognized impairment loss. In addition, we no longer record any impairment loss associated with the fixed-line network assets in southern China as a result of our acquisition from Unicom Group of the telecommunications business in 21 provinces in southern China in 2009 (see Acquisition of Fixed-Line Telecommunications Business in 21 Provinces in Southern China above).

*Realized Gain on Changes in Fair Value of Derivative Financial Instrument.* In order to strengthen our cooperation with Telefónica, we entered into a subscription agreement with Telefónica on September 6, 2009, pursuant to which each party completed the mutual investment of an equivalent of USD1 billion in each other through an acquisition of the other party's shares on October 21, 2009. At the inception of the subscription agreement on September 6, 2009, our agreement to undertake the above mutual investment with Telefónica was accounted for as a derivative financial instrument in accordance with IAS/HKAS 39 Financial instrument: Recognition and measurement, as it represents a forward contract for the purchase of shares by Telefónica and us in each other at predetermined fixed prices and is denominated in a foreign currency. The derivative financial instrument was derecognized upon completion of the transaction on October 21, 2009. The changes in the fair value of the derivative financial instrument during the period from September 6, 2009 to October 21, 2009 resulted in a fair value gain of approximately RMB1.24 billion, which has been recorded in the consolidated statement of income for the year ended December 31, 2009.

*Other Income-Net.* In 2009, other income-net was RMB0.96 billion, down by 55.1% from 2008, of which, gain on non-monetary assets exchanged in connection with our replacement of copper cables in some of our fixed-line network regions with optical fibers was RMB0.04 billion, down by RMB1.27 billion from 2008.

***Income Before Income Tax***

In 2009, our income before income tax was RMB12.28 billion, up by 202.5% from 2008, mainly due to (i) we had provision for impairment loss on PHS business related equipment for 2008 but none for 2009 and (ii) a significant decrease in costs and expenses because (A) we no longer record depreciation, finance or other costs associated with the fixed-line assets in southern China as a result of our acquisition from Unicom Group of the telecommunications business in 21 provinces in southern China in 2009, and (B) the resulting decrease in depreciation, finance or other costs is greater than the amount of the leasing fee that we started to incur in 2009 with respect to such fixed-line assets (see Acquisition of Fixed-Line Telecommunications Business in 21 Provinces in Southern China above).

In order to ensure the comparability of income before tax and income for the year, we exclude the

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following non-comparable factors that are reflected in the figures of 2008 and 2009 for additional analysis purpose:

- (1) deferred fixed-line upfront connection fees of RMB0.49 billion for 2009 and RMB0.89 billion for 2008;
- (2) gain of RMB0.04 billion from the nonmonetary assets exchange for 2009 and RMB1.31 billion for 2008;
- (3) realized gain of RMB1.24 billion on changes in fair value of derivative financial instrument in 2009; and
- (4) impairment loss of RMB11.84 billion on PHS services related equipment in 2008.

After excluding the above factors, our income from continuing operations before income tax would be RMB10.51 billion, down by 23.3% from 2008. Such decrease is mainly due to two reasons: (i) the decline of fixed-line voice business, which has been a consistent trend in recent years due to further intensified mobile substitution and contraction of PHS industry; and (ii) the initial development stage of our 3G business, during which we incurred significant costs in connection with 3G network operations and business development increased in a much more rapid rate than the increase of our revenues from the 3G business. Such decrease in income from continuing operations before income tax was partially offset by the decrease in our total costs and expenses in 2009 as discussed above.

***Income Tax***

Our income tax for continuing operations was RMB2.72 billion in 2009, up by 48.9% from 2008, and our effective tax rate in 2009 was 22.2%. After excluding the factors discussed under Income Before Income Tax above, our effective tax rate in 2008 and 2009 would be 32.6% and 22.9%, respectively.

***Net Income for the Year***

In 2009, our net income from continuing operations reached RMB9.56 billion, up by 328.3% from 2008. Our basic earnings per share was RMB0.402 in 2009. After excluding the factors discussed under the subsection Income Before Income Tax above, our net income from continuing operations would be RMB8.11 billion, down by 12.3% from 2008.

**Year Ended December 31, 2008 Compared to Year Ended December 31, 2007**

***Revenue***

In 2008, we experienced various challenges, including changes in the economic environment, a further intensified trend of mobile substitution in our fixed-line business and downward adjustments in mobile roaming tariffs, as well as the telecommunications industry restructuring. By improving customer value, promoting bundling of fixed-line and mobile services and the application of value-added services, we maintained stable revenue from continuing operations. Revenues from continuing operations for 2008 amounted to RMB159.79 billion, a decrease from RMB159.94 billion for 2007. Excluding fixed-line upfront connection fees of RMB0.89 billion and RMB1.52 billion in 2008 and 2007, respectively, and interconnection revenue of RMB0.99 billion and RMB1.00 billion between our certain fixed-line business and the discontinued operations of CDMA business in 2008 and 2007 respectively, our revenues from continuing operations for 2008 would amount to RMB157.91 billion, representing a increase of 0.3% from RMB157.43 billion in 2007, of which our telecommunications service revenue was RMB150.95 billion, representing a decrease of 0.2% from RMB151.24 billion in 2007, and revenue from sale of telecommunications products was RMB1.90 billion, representing an increase of 91.1% from RMB0.99 billion in 2007.

**Table of Contents***Mobile Business Revenue*

Revenue from our mobile business grew in 2008. Revenue from our mobile business increased by 4.3% from RMB62.44 billion in 2007 to RMB65.13 billion in 2008. Telecommunication service revenue from our mobile business, as a percentage of our total telecommunication service revenues (excluding fixed-line upfront connection fees of RMB0.89 billion and RMB1.52 billion in 2008 and 2007, respectively, and interconnection revenue of RMB0.99 billion and RMB1.00 billion between our certain fixed-line business and the discontinued operations of CDMA business in 2008 and 2007 respectively), from continuing operations, increased from 41.2% in 2007 to 42.6% in 2008. The growth in revenue from our mobile business is primarily due to the continued increase in the total number of our total mobile subscribers, partially offset by the decrease in our subscribers' ARPU.

Our total number of mobile subscribers was 133.37 million as of December 31, 2008, an increase of 10.6% from 120.56 million as of December 31, 2007. Total usage of our mobile services was 376.67 billion minutes, an increase of 10.3% from 2007. ARPU from our mobile business was RMB42.3 in 2008, a decrease of 7.4% from RMB45.7 in 2007. This decrease was primarily due to (i) our decreasing effective tariffs, which mainly resulted from pricing competition with other telecommunication operators in China and downward adjustments on tariffs by the PRC Government (which may continue in the future); and (ii) the fact that a significant portion of our incremental market consists of users from rural areas in China, many of whom tend to have less usage of telecommunications services (mobile services, in particular) and are more cost-sensitive than users from urban areas. The average MOU decreased by 1.3%, from 249.7 minutes in 2007 to 246.4 minutes in 2008, primarily due to the fact that a significant portion of our incremental market consists of users from rural areas in China, many of whom tend to have less usage of telecommunications services than urban users. See **D. Risk Factors** We may further lose subscribers in particular, fixed-line subscribers, which may materially adversely affect our financial condition, results of operations and growth prospects under Item 3.

The table below sets forth the revenue composition of our mobile business and each revenue item's respective share of total mobile revenue for the years ended December 31, 2007 and 2008.

|   | 2007            |               | 2008            |               |
|---|-----------------|---------------|-----------------|---------------|
|   | RMB in millions | As % of total | RMB in millions | As % of total |
| Total revenue from mobile business          | 62,437          | 100.0         | 65,131          | 100.0         |
| Telecommunications service revenue          | 62,236          | 99.7          | 64,240          | 98.6          |
| Usage fees and monthly fees                 | 42,077          | 67.4          | 40,462          | 62.1          |
| Value-added service revenue                 | 13,528          | 21.7          | 16,263          | 25.0          |
| Interconnection revenue                     | 5,767           | 9.2           | 6,775           | 10.4          |
| Other services revenue                      | 864             | 1.4           | 740             | 1.1           |
| Other revenue                               | 187             | 0.3           | 359             | 0.6           |
| Sales of mobile telecommunications products | 14              | 0.0           | 532             | 0.8           |

*Usage Fees and Monthly Fees.* As a result of our tariff adjustments in response to intense market competition and the MIIT's roaming charges adjustment in 2008, usage fees and monthly fees for our mobile services were RMB40.46 billion in 2008, a decrease of 3.8% from RMB42.08 billion in 2007, and as a percentage of our total mobile revenue, decreased from 67.4% in 2007 to 62.1% in 2008.

*Value-Added Service Revenue.* As a result of our promotion of the value-added business, revenues from our mobile value-added services amounted to RMB16.26 billion in 2008, an increase of 20.2% from RMB13.53 billion in 2007 and as a percentage of total mobile revenue increased from 21.7% in 2007 to 25.0% in 2008. Of the total revenue from value-added mobile services, revenue from our SMS services increased by 8.8% from RMB5.99 billion in 2007 to RMB6.52 billion in 2008; revenue from Cool Ringtone services increased by 34.6% from RMB1.85 billion in 2007 to RMB2.49 billion in 2008; and revenue from caller identification services increased by 15.0% from RMB3.26 billion in 2007 to RMB3.75 billion in 2008. In addition, as we further expanded the coverage of our GPRS services and improved the quality of our GPRS network in 2008, our GPRS services grew significantly in 2008, and revenue from our GPRS services increased by 705.8% from RMB155 million in 2007 to RMB1,249 million in 2008 and its share of

total mobile service revenue increased from 0.2% in 2007 to 1.9% in 2008.

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*Interconnection Revenue.* Our interconnection revenue increased by 17.5% from RMB5.77 billion in 2007 to RMB6.78 billion in 2008, and represented 10.4% of total mobile revenue in 2008 as compared with 9.2% in 2007. This increase is primarily due to the increased total usage of our mobile services.

*Sales of Telecommunications Products.* Revenues from our sale of mobile telecommunications products increased 3,700% from RMB14 million in 2007 to RMB532 million in 2008, mainly due to the establishment of our subsidiary, Unicom Vsens Telecommunications Company Limited, in August 2008, which was principally engaged in sales of mobile handsets and telecommunications equipment and provision of technical services.

*Fixed-Line Business Revenue*

In 2008, as mobile substitution further intensified and the declining trend of the fixed-line voice business continued, we further adjusted our business structure and continued to focus on the development of fixed-line broadband services. Excluding fixed-line upfront connection fees of RMB0.89 billion and RMB1.52 billion in 2008 and 2007, respectively, and interconnection revenue of RMB0.99 billion and RMB1.00 billion between our certain fixed-line business and the discontinued operations of CDMA business in 2008 and 2007 respectively, our revenue from fixed-line business would have decreased by 2.4% from RMB94.34 billion in 2007 to RMB92.08 billion in 2008, of which telecommunications service revenue would have decreased by 2.5% from RMB88.58 billion in 2007 to RMB86.38 billion in 2008. See D. Risk Factors We may further lose subscribers in particular, fixed-line subscribers, which may materially adversely affect our financial condition, results of operations and growth prospects under Item 3.

The table below sets forth the revenue composition of our fixed-line business and each revenue item's respective share of total revenue from our fixed-line business for the years ended December 31, 2007 and 2008.

|   | For the Year Ended December 31, |               | For the Year Ended December 31, |               |
|---|---------------------------------|---------------|---------------------------------|---------------|
|   | 2007                            | 2008          | 2007                            | 2008          |
|   | RMB in millions                 | As % of Total | RMB in millions                 | As % of Total |
| Total revenue from fixed-line business <sup>(1)</sup>           | 94,341                          | 100.0         | 92,077                          | 100.0         |
| Telecommunications service revenue <sup>(1)</sup>               | 88,579                          | 93.9          | 86,376                          | 93.8          |
| Usage fee and monthly fee <sup>(1)</sup>                        | 47,908                          | 50.8          | 40,497                          | 44.0          |
| Fixed-line broadband service revenue                            | 16,450                          | 17.4          | 20,962                          | 22.8          |
| Interconnection revenue   | 7,799                           | 8.3           | 7,342                           | 8.0           |
| Value-added service revenue                                     | 7,084                           | 7.5           | 7,074                           | 7.7           |
| Leased line service revenue                                     | 4,433                           | 4.7           | 5,492                           | 6.0           |
| Managed data, other internet-related service revenue.           | 2,363                           | 2.5           | 2,662                           | 2.8           |
| Others  | 2,542                           | 2.7           | 2,347                           | 2.5           |
| Information communication technology services and other revenue | 4,782                           | 5.1           | 4,339                           | 4.7           |
| Sales of fixed-line telecommunications products                 | 980                             | 1.0           | 1,362                           | 1.5           |

<sup>(1)</sup> Excluding (i) fixed-line upfront connection fees of RMB0.89 billion and RMB1.52 billion in 2008 and 2007 respectively; (ii) interconnection revenue of RMB0.99 billion and RMB1.00 billion between certain fixed-line business and the discontinued operations of CDMA business in 2008 and 2007 respectively. Fixed-line upfront connection fees represent the amortization of deferred upfront connection fees received from the customers before July 1, 2001. No upfront connection fee was received from the customers since then. In addition, upon disposal of the CDMA business in 2008, interconnection revenue between certain fixed-line business and the discontinued operations of CDMA business will not be recognized anymore. Therefore, we consider that analyses of our operating results excluding upfront connection fees and interconnection revenue between certain fixed-line business and the discontinued operations of CDMA business are more relevant to the readers of this report.

*Usage Fees and Monthly Fees.* As a result of continuing mobile substitution, we experienced significant decline in the number of our fixed-line local telephone subscribers and usage of fixed-line services. As a result, revenues from our usage fees and monthly fees in 2008 decreased by 15.5% from RMB47.91 billion in 2007 to RMB40.50 billion in 2008.



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*Fixed-Line Broadband Service Revenue.* In 2008, we continued to focus on developing our fixed-line broadband services. Revenues from our fixed-line broadband service increased significantly by 27.4% from RMB16.45 billion in 2007 to RMB20.96 billion in 2008, and as a percentage of the fixed-line revenue, increased from 17.4% in 2007 to 22.8% in 2008. Fixed-line broadband service has become the main factor in counteracting the effect of mobile substitution in the decline of our fixed-line voice business.

*Interconnection Revenue.* Revenue from our interconnection services decreased by 5.9% from RMB7.80 billion in 2007 to RMB7.34 billion in 2008. The decrease in interconnection revenue was mainly due to a decrease in voice traffic from other telecommunications operators as a result of the mobile substitution effect.

*Value-Added Service Revenue.* Revenue from our value-added services decreased slightly by 0.1% from RMB7.08 billion in 2007 to RMB7.07 billion in 2008.

*Leased Line Service Revenue.* Revenue from our leased line services increased by 23.9% from RMB4.43 billion in 2007 to RMB5.49 billion in 2008, mainly due to the increased demand of leased line services by our government and SME customers.

*Managed Data Service and Other Internet-Related Service Revenue.* Revenue from our managed data services and other Internet-related services increased by 12.7% from RMB 2.36 billion in 2007 to RMB2.66 billion in 2008. The increase was primarily due to the growth in demand by SMEs on dedicated Internet access services, partly offset by decrease in usage of traditional DDN and frame relay services as a result of the substitution by new ways of access and our generally decreased effective tariffs.

*Others.* Other fixed-line related revenue mainly consists of miscellaneous revenue items. Other fixed-line related revenue decreased by 7.7% from RMB2.54 billion in 2007 to RMB2.35 billion in 2008.

*Information communication technology services and other revenue.* Information communication technology services and other revenue decreased by 9.3% from RMB4.78 billion in 2007 to RMB4.34 billion in 2008. This decrease was mainly due to the decrease in our ICT service revenue as a result of the change in our ICT business strategy. In 2008, we reduced sales of third-party products in connection with the provision of our ICT services, which, despite reducing our direct revenue, helped enhance the profit margin, of our ICT services.

*Sales of Telecommunications Products.* Revenue from our sales of fixed-line telecommunications products increased by 39.0% from RMB0.98 billion in 2007 to RMB1.36 billion in 2008, mainly due to the increase in sales of computers bundled with our fixed-line broadband services in 2008.

**Costs, Expenses and Others**

In 2008, we experienced upward pressures on costs and expenses brought by various challenges, including changes in the macroeconomic environment, severe natural disasters and our merger and reorganization activities. While stabilizing our operations, we took measures, such as controlling our out-of-pocket expenses, to control our costs and expenses. Total costs, expenses and others for our continuing operations in 2008 were RMB155.73 billion, representing an increase of 14.1% from RMB136.50 billion in 2007. Excluding the effects of the non-comparable items, including impairment loss on PHS business-related assets in 2008, gain from the non-monetary assets exchange, tax refund on reinvestment in subsidiaries and realized loss on changes in fair value of derivative component of the convertible bonds in 2007, our total costs and expenses for our continuing operations in 2008 would have been RMB145.20 billion, representing an increase of 3.5% from RMB140.32 billion in 2007. The 3.5% increase was principally attributable to increases in networks, operations and support expenses, employee benefit expenses and interconnection charges and costs of telecommunications products sold, partially offset by decreases in finance costs, net of interest income.

The table below sets forth the major items of costs, expenses and others from continuing operations and their respective percentage of the total revenue from continuing operations for the years 2007 and 2008:

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|  | <b>For the Year Ended December 31,</b> |                       |                            |                       |
|--|--|-----------------------|----------------------------|-----------------------|
|  | <b>2007 (as restated)</b>              |                       | <b>2008 (as restated)</b>  |                       |
|  | <b>RMB in<br/>millions</b>             | <b>% of<br/>Total</b> | <b>RMB in<br/>millions</b> | <b>% of<br/>Total</b> |
| <b>Continuing Operations</b>   |  |                       |                            |                       |
| Total telecommunications services revenue <sup>(1)</sup>                               | 151,235                                | 100.0                 | 150,953                    | 100.0                 |
| Costs, expenses and others   | 136,497                                | 90.3                  | 155,733                    | 103.2                 |
| Interconnection charges  | 12,198                                 | 8.1                   | 13,038                     | 8.6                   |
| Depreciation and amortization  | 51,275                                 | 33.9                  | 51,847                     | 34.3                  |
| Networks, operations and support expenses  | 17,877                                 | 11.8                  | 18,736                     | 12.4                  |
| Employee benefit expenses  | 19,398                                 | 12.8                  | 20,758                     | 13.8                  |
| Selling and marketing  | 19,660                                 | 13.0                  | 19,614                     | 13.0                  |
| Cost in relation to information communication<br>technology services                   | 3,808                                  | 2.5                   | 3,010                      | 2.0                   |
| General, administrative and other expenses   | 11,947                                 | 7.9                   | 13,217                     | 8.8                   |
| Cost of telecommunications products sold   | 1,109                                  | 0.7                   | 2,156                      | 1.4                   |
| Finance costs, net of interest income  | 3,435                                  | 2.3                   | 3,004                      | 2.0                   |
| Impairment loss on property, plant and<br>equipment                                    | 323                                    | 0.2                   | 12,494                     | 8.3                   |
| Realized loss on changes in fair value of<br>derivative component of convertible bonds | 569                                    | 0.4                   |                            |                       |
| Other income-net   | (5,102)                                | (3.3)                 | (2,141)                    | (1.4)                 |

(1) Excluding (i) fixed-line upfront connection fee of RMB0.89 billion and RMB1.52 billion in 2008 and 2007, respectively, and (ii) interconnection revenue between certain fixed-line business and the discontinued operations of CDMA business of RMB0.99 billion and RMB1.00 billion in 2008 and 2007, respectively.

*Interconnection Charges.* Interconnection charges increased by 6.9% from RMB12.20 billion in 2007 to RMB13.04 billion in 2008, primarily due to an increase in mobile interconnection traffic volume resulting from the increase of total usage of mobile services. The increase in interconnection charges is consistent with the increase of interconnection revenues. Interconnection charges as a percentage of total telecommunications service revenue (excluding fixed-line upfront connection fees and interconnection revenue between certain fixed-line business and CDMA business) also increased from 8.1% in 2007 to 8.6% in 2008.

*Depreciation and Amortization.* Depreciation and amortization expenses amounted to RMB51.85 billion in 2008, up by 1.1% from RMB51.28 billion in 2007, and as a percentage of our total telecommunications service revenue (excluding fixed-line upfront connection fees and interconnection revenue between certain fixed-line business and CDMA business), slightly increased from 33.9% in 2007 to 34.3% in 2008.

*Networks, Operations and Support Expenses.* Due to various factors, including large-scale expansion of network facilities and base stations and increases in utilities charges and repair and maintenance expenses (mainly resulting from natural disasters and additional network maintenance work during the Beijing Olympics Games period), we incurred networks, operations and support expenses of RMB18.74 billion in 2008, up by 4.8% from RMB17.88 billion in 2007. Networks, operations and support expenses as a percentage of our total telecommunications services revenue (excluding fixed-line upfront connection fees and interconnection revenue between certain fixed-line business and CDMA business), was 12.4% in 2008, a slight increase from 11.8% in 2007. After our merger with China Netcom, we were able to share the network resources from China Netcom, which resulted in reduced costs for leasing telecommunications networks. Our line leasing fee was RMB1.54 billion in 2008, down by 3.9% from 2007.

*Employee Benefit Expenses.* As a result of our compliance with the new Labor Contract Law in China in 2008 and generally improved social average wages in China, our employee insurance premium expenses increased. In addition, we also incurred additional employee benefits-related costs for maintaining the continuity of our personnel during our

integration with China Netcom. Our employee benefit expenses increased by 7.0% from RMB19.40 billion in 2007 to RMB20.76 billion in 2008, and as a percentage of our total telecommunications services revenue (excluding fixed-line upfront connection fees and interconnection revenue between certain fixed-

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line business and CDMA business), increased from 12.8% in 2007 to 13.8% in 2008.

*Selling and Marketing Expenses.* In 2008, we continued to strengthen our control on selling and marketing costs and ensure that agency fees paid to our sales agents are strictly in proportion to revenue contribution by the subscribers brought by such agents. In addition, during our restructuring and integration period in 2008, we consolidated our self-owned distribution channels and our sales agent resources to achieve increased synergies. As a result, we enhanced the overall effectiveness of our selling and marketing activities and our selling and marketing expenses decreased by 0.2% from RMB19.66 billion in 2007 to RMB19.61 billion in 2008. As a percentage of our total telecommunications services revenue (excluding fixed-line upfront connection fees and interconnection revenue between certain fixed-line business and CDMA business), our selling and marketing expenses were 13.0% in 2008, the same level as in 2007.

*General, Administrative and Other Expenses.* As the loss of our fixed-line subscribers increased in 2008, the delinquencies associated with such loss also increased. As a result, we increased our provision for doubtful debts in 2008 and our general, administrative and other expenses increased by 10.6% from RMB11.95 billion in 2007 to RMB13.22 billion in 2008, and as a percentage of total telecommunications services revenue increased from 7.9% in 2007 to 8.8% in 2008.

*Cost of Telecommunications Products Sold.* As a result of a 91.0% increase in revenue from the sale of telecommunications products, we incurred RMB2.16 billion in cost of telecommunications products sold, up by 94.4% from RMB1.11 billion in 2007.

*Finance Costs, Net of Interest Income.* Our finance costs, net of interest income, decreased by 12.5% from RMB3.44 billion in 2007 to RMB3.00 billion in 2008. This decrease was primarily due to the following factors: (i) in 2008, we further strengthened and improved our capital structure by enhancing the centralization of fund management and fund operation and (ii) we made early repayments of interest-bearing debts using the proceeds received from the disposal of the CDMA business, which is partially offset by the increase in finance costs of RMB347 million associated with long-term intercompany loans for financing the construction of the fixed-line network assets in southern China.

*Impairment Loss on Property, Plant and Equipment*

Our impairment loss on property, plant and equipment was RMB12.49 billion in 2008, consisting of impairment loss of RMB11.84 billion on PHS services related equipment and RMB0.65 billion on fixed-line network assets in southern China. Our impairment loss was RMB0.32 billion in 2007, all of which being the impairment loss on fixed-line network assets in southern China.

Upon the completion of our merger with China Netcom, we reconsidered our strategy relating to the PHS business. As we expected that the economic performance of the PHS business would deteriorate significantly, we prepared an updated analysis and forecast accordingly to determine if there had been an impairment of assets. After considering the expected significant decline in revenue and profitability in 2009 and onwards, we conducted an impairment test for the PHS business related assets. See **D. Risk Factors** **Risks Relating to Our Business** If we fail to achieve a smooth discontinuation of PHS services or retain our PHS subscribers to use our other telecommunications services, our financial condition and results of operations may be adversely affected. under Item 3. The impaired PHS business related assets were written down to their recoverable value, which was determined to be based on their estimated value in use. Value in use was determined based on the present value of estimated future net cash flows expected to arise from the continuing use of the PHS business related assets. In estimating the future net cash flows, we made key assumptions and estimates on the appropriate discount rate adopted, the period covered by the cash flow forecast, the future loss of customers and the expected average revenue per subscriber.

These assumptions and estimates were made after considering the historical trends, the prevailing market trends and the physical conditions of the PHS business related equipment. Based on the above, we recognized an impairment loss on PHS business related assets of approximately RMB11.84 billion for the year ended 31 December 2008 and nil for the year ended December 31, 2007.

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*Other Income-Net.* In 2008, other income-net was RMB2.14 billion, mainly from the net gain on non-monetary asset exchange in connection with our replacement of copper cables in some of our fixed-line network regions with optical fibers. In 2007, we reinvested the undistributed profits of our certain PRC subsidiaries into these subsidiaries and were granted a refund on a portion of the taxes previously paid by these subsidiaries amounting to approximately RMB4.00 billion. We recognized this tax refund as other income for 2007. Excluding the effect of RMB4.00 billion tax refund, other income-net for 2008 would be up by 94.5% from 2007.

***Income from Continuing Operations before Income Tax***

In 2008, our income from continuing operations before income tax was RMB4.06 billion, down by 82.7% from RMB23.44 billion in 2007.

In order to ensure the comparability of income before tax and income for the year, we exclude the following non-comparable factors that are reflected in the figures of 2007 and 2008 for additional analysis purposes:

- (1) deferred fixed-line upfront connection fees of RMB0.89 billion for 2008 and RMB1.52 billion for 2007;
- (2) gain of RMB1.31 billion from the non-monetary assets exchange for 2008 and RMB0.39 billion for 2007;
- (3) tax refund on reinvestment in subsidiaries of RMB4.00 billion in 2007;
- (4) realized loss on changes in fair value of derivative component of the convertible bonds of RMB0.57 billion in 2007; and
- (5) impairment loss of RMB11.84 billion on PHS services related equipment in 2008.

After excluding the above factors, our income from continuing operations before income tax would be RMB13.71 billion in 2008, down by 24.3% from 2007.

In 2008, our income before income tax from the discontinued CDMA services was RMB1.91 billion.

***Income Tax***

Our income tax for continuing operations was RMB1.83 billion in 2008, down by 74.5% from RMB7.18 billion in 2007. Our effective tax rate for continuing operations in 2007 and 2008 was 30.6% and 45.0%, respectively. After excluding the factors discussed under *Income from Continuing Operations Before Income Tax* above, our effective tax rates in 2007 and 2008 would be 32.7% and 32.6%, respectively.

The decrease in our income tax was mainly due to our reduced profit before income tax. In addition, due to a downward adjustment of the enterprise income tax from 33% to 25% pursuant to the PRC Enterprise Income Tax Law which became effective on January 1, 2008, our income tax for 2008 also decreased.

***Income from Continuing Operations***

Our income from continuing operations was RMB2.23 billion in 2008, as compared to RMB16.27 billion in 2007. Excluding the factors discussed under *Income from Continuing Operations Before Income Tax* above, down by 24.2% from RMB12.19 billion in 2007.

***Income from Discontinued Operations***

Our income from discontinued operations was RMB1.44 billion in 2008. We also had a gain on the disposal of discontinued operations of RMB26.14 billion in 2008.

**Table of Contents****Net Income for the Year**

In 2008, our net income (including the income from continuing operations and discontinued operations) reached RMB29.80 billion, up by 76.1% from RMB16.92 billion in 2007. Our basic earnings per share was RMB1.25 in 2008, up by 71.1% from 2007. Excluding the factors discussed under Income from Continuing Operations Before Income Tax above, our basic earnings per share would be RMB1.55, up by 178.4% from 2007 and the significant increase of earnings per share was mainly due to the gain on sale of the CDMA business.

**Additional Pro Forma Information**

As discussed above under Acquisition of Fixed-Line Telecommunications Business in 21 Provinces in Southern China, in our acquisition of the fixed-line business in southern China in 2009 we did not acquire any assets or assume any liabilities associated with the underlying telecommunication networks assets, but leased such network assets following the acquisition of the relevant business. In connection with these network assets in southern China, our financial statements reflect the depreciation and costs associated with the assets not acquired and liabilities not assumed for the years of 2007 and 2008, but only the leasing fee for these network assets for the year of 2009 (since the acquisition was completed in January 2009 and the lease of the network assets commenced from January 2009). Our management believes that the presentation of pro forma financial information for the year ended December 31, 2008, by assuming that the acquisition had been completed and the relevant lease had been in existence as of January 1, 2008, would be necessary to ensure the comparability of the financial information between the years of 2008 and 2009 and a better understanding by the readers of our financial statements on the financial effects of the lease.

The following pro forma financial information for the year ended December 31, 2008 has been prepared as if the acquisition had been completed and the lease had taken place since January 1, 2008. Such information is presented for illustrative purpose only, and do not purport to present what the results of operations and financial position of our company would actually have been if the events described above had in fact occurred on such dates, or to project the results of operations or financial position of our company for any future dates or period.

|   | For the year ended December 31,                                 |  |      |                                   | 2009<br>As<br>Previously<br>Reported<br>In RMB<br>millions |
|---|---|--|------|-----------------------------------|--|
|   | 2008 (Unaudited Pro Forma)<br>As Restated<br>In RMB<br>millions | Pro Forma<br>Adjustments<br>In RMB<br>millions | Note | As Adjusted<br>In RMB<br>millions |  |
| <b>Continuing operations</b>  |   |  |      |                                   |  |
| Revenue   | 159,792   |  |      | 159,792                           | 153,945  |
| Interconnection charges   | (13,038)  |  |      | (13,038)                          | (12,955)   |
| Depreciation and amortization<br>Networks, operations and support<br>expenses             | (51,847)  | 3,886  | 1    | (47,961)                          | (47,587)   |
| Leasing for telecommunications<br>networks in southern China                              | (18,736)  |  |      | (18,736)                          | (21,728)   |
| Employee benefit expenses   | (20,758)  | (2,000)  | 3    | (2,000)                           | (2,000)  |
| Other operating expenses  | (37,997)  | 249  | 1    | (37,748)                          | (36,723)   |
| Finance costs   | (3,269)   | 846  | 2    | (2,423)                           | (1,036)  |
| Interest income   | 265   |  |      | 265                               | 91   |
| Impairment loss on property, plant<br>and equipment                                       | (12,494)  | 657  | 1    | (11,837)                          |  |
| Realized loss on changes in fair value<br>of derivative component of<br>convertible bonds |   |  |      |                                   |  |

|                  |       |      |          |       |     |
|------------------|-------|------|----------|-------|-----|
| Other income net | 2,141 | (44) | <i>1</i> | 2,097 | 962 |
|------------------|-------|------|----------|-------|-----|

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|  | For the year ended December 31,         |                                   |                                | 2009                           |
|--|---|-----------------------------------|--------------------------------|--------------------------------|
|  | 2008 (Unaudited Pro Forma)<br>Pro Forma |                                   | As                             | As<br>Previously               |
|  | As Restated<br>In RMB<br>millions       | Adjustments<br>In RMB<br>millions | Adjusted<br>In RMB<br>millions | Reported<br>In RMB<br>millions |
| <b>Profit from continuing operations<br/>before income tax</b> | 4,059                                   | 3,594                             | 7,653                          | 12,277                         |
| Income tax expenses  | (1,828)                                 |                                   | (1,828)                        | (2,721)                        |
| <b>Profit from continuing operations</b>                       | <b>2,231</b>                            | <b>3,594</b>                      | <b>5,825</b>                   | <b>9,556</b>                   |
| <b>Discontinued operations</b>                                 |   |                                   |                                |                                |
| Profit from discontinued operations                            | 1,438                                   |                                   | 1,438                          |                                |
| Gain on disposal of discontinued<br>operations                 | 26,135                                  |                                   | 26,135                         |                                |
| <b>Profit for the year</b>                                     | <b>29,804</b>                           | <b>3,594</b>                      | <b>33,398</b>                  | <b>9,556</b>                   |
| Attributable to:   |   |                                   |                                |                                |
| Equity holders of the Company                                  | 29,804                                  | 3,594                             | 33,398                         | 9,556                          |
| Minority interest  |   |                                   |                                |                                |
|  | 29,804                                  | 3,594                             | 33,398                         | 9,556                          |

## Notes:

1. The adjustments are to reverse the depreciation, amortization and other costs associated with the fixed-line network assets in southern China as if (i) such depreciation, amortization and other costs had not been included in the financial statements and (ii) the acquisition had been completed and such network assets had been leased since January 1, 2008.
2. The adjustments are to reverse the finance costs relating to the liabilities associated with the financing for the construction of the fixed-line network assets in southern China in the form of intercompany loans due to Unicom Group, as if (i) such finance costs had not been included in the financial statements and (ii) the acquisition had been completed and such network assets had been leased since January 1, 2008.
3. The adjustment is to record the leasing fee expenses as if the lease arrangement was in existence as of January 1, 2008, assuming the leasing fee were RMB2 billion for the year ended December 31, 2008.

Our income from continuing operation before tax was RMB12,277 million in 2009, up by 60.4% as compared to the pro forma income from continuing operation before tax of RMB7,653 million in 2008. This increase was mainly due to the fact that we had provision for impairment loss of RMB11.84 billion on PHS business related equipment for 2008 but none for 2009. Such increase was partially offset by the ramp-up effect of our 3G business in 2009, which caused our costs relating to 3G network operations and developments to increase in a more rapid rate than the increase



of our revenue from 3G business in 2009. Our profit from continuing operation was RMB9,556 million in 2009, up by 64.1% as compared to the pro forma profit from continuing operation of RMB5,825 million in 2008.

**Liquidity and Capital Resources**

***Working Capital and Cash Flows***

As of December 31, 2009, we had RMB7.82 billion of cash and cash equivalents, as compared with RMB10.24 billion as of December 31, 2008 and RMB12.66 billion as of January 1, 2008. As of December 31, 2009, we had RMB1.00 billion of short-term bank deposits, as compared with RMB0.34 billion as of December 31, 2008. As of the end of 2009, we had a working capital deficit (current assets minus current liabilities) of RMB169.21 billion, increasing by 76.3% from the working capital deficit of RMB96.00 billion as of the end of 2008. The increase in working capital deficit in 2009 primarily resulted from the increase in our short-term borrowings and

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accounts payable, which mainly associated with the off-market share repurchase and the development of our 3G business, including 3G network constructions.

A global financial crisis that unfolded in 2008 and has continued during 2009 has widely and adversely affected the financing markets of a number of countries where the banks and other financial institutions are reluctant to lend and impose stricter terms in their lending. Changes in the macroeconomic environment arising from the current global financial crisis have had an adverse impact on economic activity in the PRC. However, under a series of economic stimulus packages launched by the PRC Government, we, due to our enterprise nature and our good credit records with PRC banks, generally have not experienced and do not expect to experience in the foreseeable future significant difficulties in obtaining bank financing in the PRC. As of December 31, 2009, we had revolving banking facilities of RMB113.3 billion, of which, RMB58.8 billion was unutilized. Meanwhile, we will continue to optimize our fund raising strategy from short, medium and long-term perspectives and to pursue opportunities in the current capital market, to take advantage of the low interest rates. Therefore, we believe that we will be able to fund our anticipated capital and liquidity needs with our access to debt and equity financing, in particular bank financing in the PRC, and net cash inflows from our operations.

The following table sets forth cash inflows and outflows in 2007, 2008 and 2009.

|  | <b>For the Year Ended December 31,</b> |                               |                |
|--|--|-------------------------------|----------------|
|  | <b>2007 (as<br/>restated)</b>          | <b>2008 (as<br/>restated)</b> | <b>2009</b>    |
|  | (RMB in millions)                      |                               |                |
| Net cash inflow from operating activities of continuing operations           | 68,854                                 | 57,241                        | 57,733         |
| Net cash outflow from investing activities of continuing operations          | (54,745)                               | (61,026)                      | (85,308)       |
| Net cash (outflow)/inflow from financing activities of continuing operations | (22,830)                               | (28,786)                      | 30,197         |
| <b>Net cash (outflow)/inflow from continuing operations</b>                  | <b>(8,721)</b>                         | <b>(32,571)</b>               | <b>2,622</b>   |
| <b>Net cash inflow /(outflow) from discontinued operations</b>               | <b>812</b>                             | <b>30,145</b>                 | <b>(5,039)</b> |
| <b>Net decrease in cash and cash equivalents</b>                             | <b>(7,909)</b>                         | <b>(2,426)</b>                | <b>(2,417)</b> |

Our net cash inflow from operating activities of continuing operations decreased by 16.9% from RMB68.85 billion in 2007 to RMB57.24 billion in 2008, but slightly increased by 0.9% to RMB57.73 billion in 2009. The decrease in net cash inflow from operating activities in 2008 was mainly due to our settlement of payables.

Our net cash outflow from investing activities of continuing operations increased by 11.5% from RMB54.75 in 2007 to RMB61.03 billion in 2008, and further increased by 39.8% to RMB85.31 billion in 2009. The increase in 2008 was mainly due to the increase in GSM network expansion and upgrade and payment for the purchase of businesses under common control. The increase in 2009 was mainly due to the significant increase in our capital expenditure attributable to 3G network construction, partially offset by the effect that we no longer have any cash outflow from investing activities associated with the construction of fixed-line network assets in southern China, as a result of our acquisition from Unicom Group of the telecommunications business in 21 provinces in southern China in 2009 (see Acquisition of Fixed-Line Telecommunications Business in 21 Provinces in Southern China above).

Our net cash outflow from financing activities increased by 26.1% from RMB22.83 billion in 2007 to RMB28.79 billion in 2008, primarily because our proceeds from commercial paper, bank loans and corporate bonds in 2008 decreased to a greater extent than our repayment of commercial paper, bank loans, corporate bonds and related party loans. We had a net cash inflow from financing activities of RMB30.20 billion, primarily due to the increase of our short-term bank loans in 2009, partially offset by the effect that we no longer have any cash inflow from intercompany loans associated with the construction of fixed-line network assets, as a result of our acquisition from

Unicom Group of the telecommunications business in 21 provinces in southern China in 2009 (see Operating Results above).

Our net cash inflow from discontinued operations increased by 3,612.4% from RMB0.81 billion in 2007 to RMB30.15 billion in 2008, mainly resulting from the gain on disposal of our CDMA business.

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Our net cash outflow of approximately RMB0.50 billion from discontinued operations in 2009 represented the income tax paid on the gain on disposal of our CDMA business in 2008 and related professional services paid totaling RMB0.93 billion, offset by our receipt of proceeds of approximately RMB0.43 billion from the disposal of our CDMA business.

**Indebtedness and Capital Structure**

The following table sets forth the amount of cash, assets, short-term and long-term debt and equity as well as debt-to-capitalization and debt-to-equity ratios as of the end of 2007, 2008 and 2009.

|  | January 1,<br>2008                    | As of<br>December 31,<br>2008 (as<br>restated) | December 31,<br>2009 |
|--|---------------------------------------|--|----------------------|
|  | (RMB in millions, except percentages) |  |                      |
| Cash and cash equivalent and short-term bank deposits                            | 13,555                                | 10,652   | 8,816                |
| Total assets   | 368,435                               | 380,318  | 417,045              |
| Short-term debt  | 44,662                                | 21,996   | 66,601               |
| Short-term bank loans  | 11,850                                | 10,780   | 63,909               |
| Commercial paper   | 20,000                                | 10,000   |                      |
| Current portion of long-term bank loans  | 7,413                                 | 1,216  | 62                   |
| Amounts due to related parties   | 5,399                                 |  | 2,104                |
| Notes payables included in accounts payable and accrued liabilities              |                                       |  | 500                  |
| Current portion of obligations under finance lease included in other obligations |                                       |  | 26                   |
| Long-term debt   | 47,259                                | 43,649   | 7,862                |
| Long-term loans due to ultimate holding company                                  | 27,213                                | 35,652   |                      |
| Corporate bonds  | 2,000                                 | 7,000  | 7,000                |
| Non-current portion of long-term bank loans                                      | 16,086                                | 997  | 759                  |
| Amounts due to related parties   | 1,960                                 |  |                      |
| Non-current portion of obligations under finance lease                           |                                       |  | 103                  |
| Shareholders' equity   | 173,289                               | 197,233  | 206,467              |
| Debt-to-capitalization ratio <sup>(1)</sup>                                      | 34.7%                                 | 25.0%  | 26.5%                |
| Debt-to-equity ratio <sup>(2)</sup>  | 53.0%                                 | 33.3%  | 36.1%                |

(1) Debt-to-capitalization ratio = (long-term interest-bearing debt + short-term interest-bearing debt)/(long-term interest-bearing debt + short-term interest-bearing debt + shareholders' equity).

(2) Debt-to-equity ratio = (long-term interest-bearing debt + short-term interest-bearing debt)/shareholders' equity.

Our debt-to-capitalization ratio was 26.5% at the end of 2009, compared to 25.0% at the end of 2008, and 34.7% at the beginning of 2008. Our debt-to-equity ratio was 36.1%, compared to 33.3% at the end of 2008, and 53.0% at the beginning of 2008. The sum of our long-term and short-term interest-bearing debt exceeds the amount of our cash and cash equivalents and short-term bank deposits by RMB65.65 billion as of December 31, 2009, compared to 54.99 billion as of December 31, 2008 and RMB78.37 billion as of January 1, 2008. We continue to seek to optimize our capital structure, develop multiple financing sources and reduce overall financing costs.

Our outstanding short-term and long-term bank loans, denominated in RMB, U.S. dollar, HK dollar and Euro, was RMB64.73 billion at the end of 2009, compared to RMB12.99 billion at the end of 2008 and RMB35.35 billion at the beginning of 2008. The increase in 2009 resulted primarily from the borrowings of short-term bank loans to finance the telecommunications network construction and the off-market share repurchase completed during the year. The

decrease in 2008 was primarily due to our repayment of prior bank loans with proceeds from the disposal of the CDMA business. The loan agreement does not include financial performance or other covenants which may materially restrict our operations or those of CUCL, our principal operating subsidiary in China. As of December 31, 2009, no short-term bank loans or long-term bank loans were guaranteed by Unicom Group.

In order to further rationalize our debt structure and reduce our interest expense, we may continue to finance a portion of our business operations and capital expenditures through short-term borrowings. Our liquidity in the future will primarily depend on our ability to maintain adequate cash inflow from operations and obtain adequate external financing to meet our debt service obligations and planned capital expenditures. Our operating cash flows could be adversely affected by numerous factors beyond our control, including, but not limited to, changes in

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telecommunications tariffs, decreased demand for our telecommunications services and further intensified competition. Our ability to obtain external financing also depends on numerous factors, including, but not limited to, our financial condition and creditworthiness as well as our relationship with lenders. See **D. Risk Factors Risks Relating to Our Business** If we are unable to fund our capital expenditure and debt service requirements, our financial condition, results of operations and growth prospects will be adversely affected under Item 3.

On June 8, 2007, we issued RMB2 billion 10-year corporate bonds, bearing interest at 4.5% per annum. The corporate bonds are secured by a guarantee issued by Bank of China Limited. On September 3, 2008, we issued another RMB5 billion 5-year corporate bonds, bearing interest at 5.29% per annum. The corporate bonds are secured by a guarantee issued by State Grid Corporation of China.

In addition, prior to our merger with China Netcom, China Netcom's wholly-owned subsidiary, CNC China (which merged with, and was absorbed by, our wholly-owned subsidiary, CUCL, in January 2009), issued two tranches of RMB10 billion unsecured commercial paper in the PRC capital market with repayment periods of 365 days and 270 days on April 30, 2007 and September 18, 2007, respectively. The effective interest rates were 3.34% and 3.93% per annum, respectively. These commercial papers were fully repaid on May 9, 2008 and June 16, 2008, respectively. On October 6, 2008, CNC China also issued RMB10 billion unsecured commercial paper in the PRC capital market with payment period of 365 days. The effective interest rate is 4.47% per annum. The commercial paper was fully repaid in October 2009.

On April 1, 2010, CUCL completed the issue of the first tranche of commercial paper for the year 2010 in an amount of RMB15 billion, with a maturity period of 365 days and at an interest rate of 2.64% per annum. On April 2, 2010, CUCL completed the issue of the first tranche of promissory note for the year 2010 in an amount of RMB3 billion, with a maturity period of 3 years and at an interest rate of 3.73% per annum.

**Contractual Obligations and Commercial Commitments**

The following table sets forth the amounts of our outstanding contractual cash obligations as of December 31, 2009.

|   | <b>Total</b>  | <b>Less than 1<br/>year</b> | <b>Between 1<br/>and<br/>3 years</b> | <b>Between 3<br/>and<br/>5 years</b> | <b>Over 5<br/>years</b> |
|---|---------------|-----------------------------|--------------------------------------|--------------------------------------|-------------------------|
| Short-term bank loans <sup>(1)*</sup>   | 64,752        | 64,752                      |                                      |                                      |                         |
| Long-term bank loans <sup>(2)*</sup>  | 881           | 72                          | 123                                  | 124                                  | 562                     |
| Corporate bonds <sup>(3)*</sup>   | 8,665         | 355                         | 709                                  | 5,372                                | 2,229                   |
| Other obligations   | 2,726         | 2,537                       | 117                                  | 12                                   | 60                      |
| Capital commitments <sup>(4)</sup>  | 12,840        | 11,553                      | 1,176                                | 45                                   | 66                      |
| Operating leases commitments <sup>(4)</sup>   |               |                             |                                      |                                      |                         |
| Telecommunications networks<br>leasing arrangement in 21 provinces<br>in southern China | 2,200         | 2,200                       |                                      |                                      |                         |
| Other commitments   | 6,703         | 1,909                       | 2,289                                | 1,326                                | 1,179                   |
| <b>Total obligations</b>  | <b>98,767</b> | <b>83,378</b>               | <b>4,414</b>                         | <b>6,879</b>                         | <b>4,096</b>            |

\* Interest included

(1) See Note 26 **Short-Term Bank Loans** to our consolidated financial statements.

(2) See Note 20 **Long-Term Bank Loans** to our consolidated financial statements.

(3) See Note 21 Corporate Bonds to our consolidated financial statements.

(4) See Note 40 Contingencies and Commitments to our consolidated financial statements.

***Off-Balance Sheet Arrangements***

As of December 31, 2009, except for the operating lease of the telecommunications networks in 21 provinces in southern China set forth above in Contractual Obligations and Commercial Commitments, we did not have any other off-balance sheet arrangement.

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**Table of Contents****Capital Expenditures**

The following table sets forth our historical and planned capital expenditure requirements for the periods indicated. Actual future capital expenditures may differ from the amounts indicated below.

|   | For the Year Ended December 31, |            |           |            |           |            |
|---|---------------------------------|------------|-----------|------------|-----------|------------|
|   | 2008 <sup>(3)</sup>             |            | 2009      |            | 2010      |            |
|   | (RMB in                         | As a       | (RMB in   | As a       | (RMB in   | As a       |
|   | billions)                       | percentage | billions) | percentage | billions) | percentage |
| 3G mobile                               |                                 |            | 36.40     | 32.4%      | 23.00     | 31.3%      |
| GSM mobile <sup>(1)</sup>               | 33.13                           | 43.0%      | 20.58     | 18.3%      | 8.00      | 10.9%      |
| Fixed-line broadband and data services  | 15.34                           | 19.9%      | 18.80     | 16.7%      | 15.30     | 20.8%      |
| Fixed-line business                     | 0.73                            | 0.9%       | 0.60      | 0.5%       | 0.60      | 0.8%       |
| Innovation and value-added platform     | 4.15                            | 5.4%       | 2.08      | 1.8%       | 2.70      | 3.7%       |
| IT system                               | 2.41                            | 3.1%       | 6.74      | 6.0%       | 4.30      | 5.9%       |
| Infrastructure and transmission network | 18.28                           | 23.7%      | 25.01     | 22.2%      | 17.40     | 23.7%      |
| Others <sup>(2)</sup>                   | 3.06                            | 4.0%       | 2.26      | 2.0%       | 2.20      | 3.0%       |
| Total                                   | 77.10                           | 100.0%     | 112.47    | 100.0%     | 73.50     | 100.0%     |

(1) Including the capital expenditure attributable to the initial preparation relating to the development of the 3G business.

(2) Other expenditures consist of procurement of miscellaneous assets, equipment and spare parts.

(3) Capital expenditures of 2008 had been restated to reflect the effect of 2009 Business Combination.

Our capital expenditure totaled RMB112.47 billion in 2009, which mainly consisted of investment in the GSM, 3G, fixed-line broadband and data, transmission and IT network infrastructure. In 2009, capital expenditure attributable to 3G mobile business was RMB36.40 billion; capital expenditure attributable to GSM mobile business was RMB20.58 billion; capital expenditure attributable to fixed-line broadband and data business and RMB18.80 billion; capital expenditure attributable to infrastructure and transmission networks was RMB25.01 billion; capital expenditure attributable to IT system was RMB6.74 billion.

Our projected capital expenditure for 2010 is estimated to be approximately RMB73.50 billion, a significant portion of which will continue to be used for investments in our 3G business, fixed-line broadband and data business and infrastructure and networks.

We expect to fund our capital expenditure needs through a combination of cash generated from operating activities, granted and unused banking facilities and other available financing sources. See **D. Risk Factors Risks Relating to Our Business** If we are unable to fund our capital expenditure and debt service requirements, our financial condition, results of operations and growth prospects will be adversely affected. under Item 3.



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**PART III**

**Item 18. Financial Statements**

See Index to Consolidated Financial Statements for a list of all financial statements filed as part of this Amendment No. 1.

**Item 19. Exhibits**

- 12.1 Certification of Chief Executive Officer pursuant to Rule 13a-14(a).\*
- 12.2 Certification of Chief Financial Officer pursuant to Rule 13a-14(a).\*
- 13.1 Certification of Chief Executive Officer pursuant to Rule 13a-14(b).\*
- 13.2 Certification of Chief Financial Officer pursuant to Rule 13a-14(b).\*

\* Filed herewith.

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**SIGNATURE**

The registrant hereby certifies that it meets all of the requirements for filing on Form 20-F and that it has duly caused and authorized the undersigned to sign this Amendment No.1 on its behalf.

Date: February 18, 2011

CHINA UNICOM (HONG KONG) LIMITED

By: /s/ Chang Xiaobing

Name: Chang Xiaobing

Title: Chairman and Chief Executive  
Officer

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| <u>Consolidated statements of income for the years ended December 31, 2007, 2008 and 2009</u>               | F-5  |
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**Report of Independent Registered Public Accounting Firm  
TO THE BOARD OF DIRECTORS AND SHAREHOLDERS OF  
CHINA UNICOM (HONG KONG) LIMITED**

*(Incorporated in the Hong Kong Special Administrative Region of the People's Republic of China ( Hong Kong ) with limited liability)*

In our opinion, the accompanying consolidated balance sheets and the related consolidated statements of income, comprehensive income, changes in equity and cash flows present fairly, in all material respects, the financial position of China Unicom (Hong Kong) Limited and its subsidiaries (together, the Group ) at December 31, 2009 and 2008, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2009 in conformity with International Financial Reporting Standards as issued by the International Accounting Standards Board and in conformity with Hong Kong Financial Reporting Standards issued by the Hong Kong Institute of Certified Public Accountants. Also in our opinion, the Group maintained, in all material respects, effective internal control over financial reporting as of December 31, 2009, based on criteria established in *Internal Control Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission ( COSO ). The Group's management is responsible for these financial statements, for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the Management's Annual Report on Internal Control Over Financial Reporting included in Item 15 of the Group's Annual Report on Form 20-F filed on June 18, 2010 not included herein. Our responsibility is to express opinions on these financial statements and on the Group's internal control over financial reporting based on our integrated audits. We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement and whether effective internal control over financial reporting was maintained in all material respects. Our audits of the financial statements included examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audits also included performing such other procedures as we considered necessary in the circumstances. We believe that our audits provide a reasonable basis for our opinions.

As discussed in Note 2.2 (b) to the consolidated financial statements, the Group has restated its consolidated financial statements for the years ended December 31, 2008 and 2007.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

**PricewaterhouseCoopers**  
Hong Kong

June 18, 2010, except for the effects of the restatement discussed in Note 2.2 (b) and subsequent events discussed in Notes 41 (b), (c), (d) to the consolidated financial statements, which are as of February 18, 2011

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**CHINA UNICOM (HONG KONG) LIMITED**  
**CONSOLIDATED BALANCE SHEETS**  
**AS OF DECEMBER 31, 2008 AND 2009**  
(All amounts in Renminbi ( RMB ) millions)

|  |         | As of December 31                  |  |             |              |
|--|---------|------------------------------------|--|-------------|--------------|
|  | Note    | As of<br>January 1,<br>2008<br>RMB | 2008<br>As restated<br>(Note 2.2(a)<br>(b))<br>RMB | 2009<br>RMB | 2009<br>US\$ |
| <b>ASSETS</b>  |         |                                    |  |             |              |
| <b>Non-current assets</b>                                |         |                                    |  |             |              |
| Property, plant and equipment                            | 6       | 306,420                            | 315,546  | 351,157     | 51,445       |
| Lease prepayments  | 7       | 8,807                              | 8,738  | 7,729       | 1,132        |
| Goodwill   | 8       | 3,144                              | 2,771  | 2,771       | 406          |
| Deferred income tax assets                               | 9       | 2,473                              | 5,334  | 5,202       | 762          |
| Available-for-sale financial<br>assets                   | 12      | 287                                | 95   | 7,977       | 1,168        |
| Other assets   | 10      | 12,740                             | 9,485  | 11,596      | 1,699        |
|  |         | 333,871                            | 341,969  | 386,432     | 56,612       |
| <b>Current assets</b>                                    |         |                                    |  |             |              |
| Inventories and consumables                              | 13      | 2,816                              | 1,147  | 2,412       | 353          |
| Accounts receivable, net                                 | 14      | 11,760                             | 9,341  | 8,825       | 1,293        |
| Prepayments and other current<br>assets                  | 15      | 5,181                              | 2,876  | 4,252       | 623          |
| Amounts due from ultimate<br>holding company             | 39.1    |                                    | 169  |             |              |
| Amounts due from related<br>parties                      | 39.1    | 244                                | 128  | 53          | 8            |
| Amounts due from domestic<br>carriers                    | 39.2    | 1,008                              | 974  | 1,134       | 166          |
| Proceeds receivable for<br>disposal of the CDMA business | 35,39.2 |                                    | 13,140   | 5,121       | 750          |
| Short-term bank deposits                                 | 16      | 892                                | 337  | 996         | 146          |
| Cash and cash equivalents                                | 17      | 12,663                             | 10,237   | 7,820       | 1,146        |
|  |         | 34,564                             | 38,349   | 30,613      | 4,485        |
| <b>Total assets</b>                                      |         | 368,435                            | 380,318  | 417,045     | 61,097       |

**EQUITY**

**Capital and reserves  
attributable to equity holders  
of the Company**

|                                    |    |         |          |          |         |
|------------------------------------|----|---------|----------|----------|---------|
| Share capital                      | 18 | 1,437   | 2,329    | 2,310    | 339     |
| Share premium                      | 18 | 64,320  | 166,784  | 173,435  | 25,408  |
| Reserves                           | 19 | 77,381  | (25,958) | (18,088) | (2,650) |
| Retained profits                   |    |         |          |          |         |
| - Proposed final dividend          | 36 | 6,427   | 4,754    | 3,770    | 552     |
| - Others                           |    | 23,717  | 49,322   | 45,038   | 6,598   |
|                                    |    | 173,282 | 197,231  | 206,465  | 30,247  |
| <b>Minority interest in equity</b> |    | 7       | 2        | 2        |         |
| <b>Total equity</b>                |    | 173,289 | 197,233  | 206,467  | 30,247  |

The accompanying notes are an integral part of the consolidated financial statements.

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**CHINA UNICOM (HONG KONG) LIMITED**  
**CONSOLIDATED BALANCE SHEETS (Continued)**  
**AS OF DECEMBER 31, 2008 AND 2009**  
**(All amounts in RMB millions)**

|   |      | As of December 31                  |  |             |              |
|---|------|------------------------------------|--|-------------|--------------|
|   | Note | As of<br>January 1,<br>2008<br>RMB | 2008<br>As restated<br>(Note 2.2(a)<br>(b))<br>RMB | 2009<br>RMB | 2009<br>US\$ |
| <b>LIABILITIES</b>                                    |      |                                    |  |             |              |
| <b>Non-current liabilities</b>                        |      |                                    |  |             |              |
| Long-term bank loans                                  | 20   | 16,086                             | 997  | 759         | 111          |
| Long-term loans due to ultimate holding company       | 39.1 | 27,213                             | 35,652   |             |              |
| Amounts due to related parties                        | 39.1 | 6,169                              |  |             |              |
| Corporate bonds                                       | 21   | 2,000                              | 7,000  | 7,000       | 1,026        |
| Deferred income tax liabilities                       | 9    | 18                                 | 16   | 245         | 36           |
| Deferred revenue                                      |      | 5,330                              | 3,398  | 2,562       | 375          |
| Other obligations                                     | 23   | 2,079                              | 1,681  | 187         | 27           |
|   |      | 58,895                             | 48,744   | 10,753      | 1,575        |
| <b>Current liabilities</b>                            |      |                                    |  |             |              |
| Accounts payable and accrued liabilities              | 24   | 61,331                             | 73,854   | 104,072     | 15,247       |
| Taxes payable   |      | 5,091                              | 11,370   | 912         | 134          |
| Amounts due to ultimate holding company               | 39.1 | 3,524                              |  | 308         | 45           |
| Amounts due to related parties                        | 39.1 | 2,183                              | 1,658  | 5,438       | 797          |
| Amounts due to domestic carriers                      | 39.2 | 318                                | 956  | 1,136       | 166          |
| Payables in relation to disposal of the CDMA business | 39.2 |                                    | 4,232  | 7           | 1            |
| Dividend payable                                      | 36   |                                    | 149  | 331         | 48           |
| Commercial paper                                      | 25   | 20,000                             | 10,000   |             |              |
| Short-term bank loans                                 | 26   | 11,850                             | 10,780   | 63,909      | 9,363        |
| Current portion of long-term bank loans               | 20   | 7,413                              | 1,216  | 62          | 9            |
| Current portion of deferred revenue                   |      | 3,103                              | 2,200  | 1,397       | 205          |
| Current portion of obligations under finance leases   |      | 103                                |  |             |              |
| Current portion of other obligations                  | 23   | 3,381                              | 3,012  | 2,534       | 371          |
| Advances from customers                               |      | 17,954                             | 14,914   | 19,719      | 2,889        |



|  |           |          |           |          |
|--|-----------|----------|-----------|----------|
|  | 136,251   | 134,341  | 199,825   | 29,275   |
| <b>Total liabilities</b>                     | 195,146   | 183,085  | 210,578   | 30,850   |
| <b>Total equity and liabilities</b>          | 368,435   | 380,318  | 417,045   | 61,097   |
| <b>Net current liabilities</b>               | (101,687) | (95,992) | (169,212) | (24,790) |
| <b>Total assets less current liabilities</b> | 232,184   | 245,977  | 217,220   | 31,822   |

The accompanying notes are an integral part of the consolidated financial statements.

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**CHINA UNICOM (HONG KONG) LIMITED**  
**CONSOLIDATED STATEMENTS OF INCOME**  
**FOR THE YEARS ENDED DECEMBER 31, 2007, 2008 AND 2009**

(All amounts in RMB millions, except per share data)

|   | Note      | Year ended December 31                             |  |             |              |
|---|-----------|--|--|-------------|--------------|
|   |           | 2007<br>As restated<br>(Note 2.2(a)<br>(b))<br>RMB | 2008<br>As restated<br>(Note 2.2(a)<br>(b))<br>RMB | 2009<br>RMB | 2009<br>US\$ |
| <b>Continuing operations</b>  |           |  |  |             |              |
| Revenue   | 5, 27, 39 | 159,940  | 159,792  | 153,945     | 22,553       |
| Interconnection charges   |           | (12,198)   | (13,038)   | (12,955)    | (1,898)      |
| Depreciation and amortization   |           | (51,275)   | (51,847)   | (47,587)    | (6,971)      |
| Networks, operations and support expenses   | 28        | (17,877)   | (18,736)   | (21,728)    | (3,183)      |
| Leasing fee for telecommunications networks in Southern China                       | 1(b)      |  |  | (2,000)     | (293)        |
| Employee benefit expenses   | 29        | (19,398)   | (20,758)   | (21,931)    | (3,213)      |
| Other operating expenses  | 30        | (36,524)   | (37,997)   | (36,723)    | (5,380)      |
| Finance costs   | 31        | (3,740)  | (3,269)  | (1,036)     | (152)        |
| Interest income   |           | 305  | 265  | 91          | 13           |
| Impairment loss on property, plant and equipment                                    | 6         | (323)  | (12,494)   |             |              |
| Realized loss on changes in fair value of derivative component of convertible bonds | 22        | (569)  |  |             |              |
| Realized gain on changes in fair value of derivative financial instrument           | 32        |  |  | 1,239       | 182          |
| Other income net  | 33        | 5,102  | 2,141  | 962         | 141          |
| <b>Income from continuing operations before income tax</b>                          |           | 23,443   | 4,059  | 12,277      | 1,799        |
| Income tax expenses   | 9         | (7,175)  | (1,828)  | (2,721)     | (399)        |
| <b>Income from continuing operations</b>  |           | 16,268   | 2,231  | 9,556       | 1,400        |
| <b>Discontinued operations</b>  |           |  |  |             |              |
| Income from discontinued operations   | 35        | 656  | 1,438  |             |              |
| Gain on disposal of discontinued operations   | 35        |  | 26,135   |             |              |

|                               |        |        |       |       |
|-------------------------------|--------|--------|-------|-------|
| <b>Net income</b>             | 16,924 | 29,804 | 9,556 | 1,400 |
| <b>Attributable to:</b>       |        |        |       |       |
| Equity holders of the Company | 16,924 | 29,804 | 9,556 | 1,400 |
| Minority interest             |        |        |       |       |
|                               | 16,924 | 29,804 | 9,556 | 1,400 |

The accompanying notes are an integral part of the consolidated financial statements.

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**CHINA UNICOM (HONG KONG) LIMITED**  
**CONSOLIDATED STATEMENTS OF INCOME (Continued)**  
**FOR THE YEARS ENDED DECEMBER 31, 2007, 2008 AND 2009**

(All amounts in RMB millions, except per share data)

|   |    | 2007<br>As<br>restated<br>(Note<br>2.2(a)<br>(b))<br>RMB | Year ended December 31<br>2008<br>As restated<br>(Note 2.2(a)<br>(b))<br>RMB | 2009<br>RMB | 2009<br>US\$ |
|---|----|--|--|-------------|--------------|
| <b>Earnings per share for income attributable to equity holders of the Company during the year</b>                            |    |  |  |             |              |
| Basic earnings per share (RMB)  | 37 | 0.73   | 1.25   | 0.40        | 0.06         |
| Diluted earnings per share (RMB)  | 37 | 0.73   | 1.24   | 0.40        | 0.06         |
| <b>Earnings per ADS for income attributable to equity holders of the Company during the year</b>                              |    |  |  |             |              |
| Basic earnings per ADS (RMB)  | 37 | 7.33   | 12.55  | 4.02        | 0.59         |
| Diluted earnings per ADS (RMB)  | 37 | 7.26   | 12.45  | 4.00        | 0.59         |
| <b>Earnings per share for income from continuing operations attributable to equity holders of the Company during the year</b> |    |  |  |             |              |
| Basic earnings per share (RMB)  | 37 | 0.70   | 0.09   | 0.40        | 0.06         |
| Diluted earnings per share (RMB)  | 37 | 0.70   | 0.09   | 0.40        | 0.06         |
| <b>Earnings per ADS for income from continuing operations attributable to equity holders of the Company during the year</b>   |    |  |  |             |              |

|                                |    |      |      |      |      |
|--------------------------------|----|------|------|------|------|
| Basic earnings per ADS (RMB)   | 37 | 7.04 | 0.94 | 4.02 | 0.59 |
| Diluted earnings per ADS (RMB) | 37 | 6.98 | 0.93 | 4.00 | 0.59 |

**Earnings per share for income from discontinued operations attributable to equity holders of the Company during the year**

|                                  |    |      |      |
|----------------------------------|----|------|------|
| Basic earnings per share (RMB)   | 37 | 0.03 | 1.16 |
| Diluted earnings per share (RMB) | 37 | 0.03 | 1.15 |

**Earnings per ADS for income from discontinued operations attributable to equity holders of the Company during the year**

|                                |    |      |       |
|--------------------------------|----|------|-------|
| Basic earnings per ADS (RMB)   | 37 | 0.29 | 11.61 |
| Diluted earnings per ADS (RMB) | 37 | 0.28 | 11.52 |

Details of dividends attributable to equity holders of the Company for the years ended December 31, 2007, 2008 and 2009 are set out in Note 36.

The accompanying notes are an integral part of the consolidated financial statements.

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**CHINA UNICOM (HONG KONG) LIMITED**  
**CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME**  
**FOR THE YEARS ENDED DECEMBER 31, 2007, 2008 AND 2009**  
**(All amounts in RMB millions)**

|  | <b>2007</b>     | <b>Year ended December 31</b> |             |             |
|--|-----------------|-------------------------------|-------------|-------------|
|  | <b>As</b>       | <b>2008</b>                   |             |             |
|  | <b>restated</b> | <b>As restated</b>            |             |             |
|  | <b>(Note</b>    | <b>(Note 2.2</b>              |             |             |
|  | <b>2.2 (b))</b> | <b>(b))</b>                   |             |             |
|  | <b>RMB</b>      | <b>RMB</b>                    | <b>2009</b> | <b>2009</b> |
|  |                 |                               | <b>RMB</b>  | <b>US\$</b> |
| <b>Net income</b>  | 16,924          | 29,804                        | 9,556       | 1,400       |
| <b>Other comprehensive income/(loss)</b>                                       |                 |                               |             |             |
| Fair value gains/(losses) on available-for-sale financial assets               | 246             | (188)                         | (71)        | (10)        |
| Tax effect on fair value (gains)/losses on available-for-sale financial assets | (81)            | 47                            | 33          | 5           |
| Fair value gains/(losses) on available-for-sale financial assets, net of tax   | 165             | (141)                         | (38)        | (5)         |
| Currency translation differences   | (15)            | (29)                          |             |             |
| <b>Other comprehensive income/(loss) for the year, net of tax</b>              | 150             | (170)                         | (38)        | (5)         |
| <b>Total comprehensive income for the year</b>                                 | 17,074          | 29,634                        | 9,518       | 1,395       |
| <b>Total comprehensive income attributable to:</b>                             |                 |                               |             |             |
| Equity holders of the Company  | 17,074          | 29,634                        | 9,518       | 1,395       |
| Minority interest  |                 |                               |             |             |
|  | 17,074          | 29,634                        | 9,518       | 1,395       |

The accompanying notes are an integral part of the consolidated financial statements.

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**CHINA UNICOM (HONG KONG) LIMITED**  
**CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY**  
**FOR THE YEARS ENDED DECEMBER 31, 2007, 2008 AND 2009**  
(All amounts in RMB millions)

|  | Attributable to equity holders of the Company |               |   |         |                                       |        |                    |               |                  |                 |         |
|--|---|---------------|---|---------|---------------------------------------|--------|--------------------|---------------|------------------|-----------------|---------|
|  | Share capital                                 | Share premium | Employee share-based compensation reserve |         | Available-for-sale fair value reserve |        | Statutory reserves | Other Reserve | Retained profits | Minority Total  |         |
| reserve  |   |               | reserve                                   | reserve | reserve                               | Total  |                    |               |                  | interest equity |         |
| Balance at January 1, 2007 (As previously reported)                                  | 1,344   | 53,223        | 389                                       | 3,150   |                                       | 14,830 | 41,116             | 39,214        | 153,266          | 3               | 153,269 |
| Adjusted for 2009 Business Combination under common control (As previously reported) |   |               |   | 39      | 1                                     | 827    | 4,957              | (6,467)       | (643)            | 4               | (639)   |
| Adjusted for 2009 Business Combination under common control (Note 2.2(b))            |   |               |   |         |                                       |        | (692)              | 433           | (259)            |                 | (259)   |
| Balance at January 1, 2007 (As restated)   | 1,344   | 53,223        | 389                                       | 3,189   | 1                                     | 15,657 | 45,381             | 33,180        | 152,364          | 7               | 152,371 |
| Total comprehensive income/(loss) for the year (As previously reported)              |   |               |   |         | 165                                   |        | (15)               | 21,565        | 21,715           |                 | 21,715  |
| Adjustments on total comprehensive income/(loss) for the year (Note 2.2(b))          |   |               |   |         |                                       |        |                    | (4,641)       | (4,641)          |                 | (4,641) |
| Total comprehensive income/(loss)  |   |               |   |         | 165                                   |        | (15)               | 16,924        | 17,074           |                 | 17,074  |

|  |         |    |         |         |         |
|--|---------|----|---------|---------|---------|
| for the year (As restated)   |         |    |         |         |         |
| Effect of 2009 Business Combination (As previously reported)   |         |    |         |         |         |
| Adjustment on effect of 2009 Business Combination (Note 2.2(b))  |         |    | (4,208) | 4,208   |         |
| Effect of 2009 Business Combination (As restated)  |         |    | (4,208) | 4,208   |         |
| Transfer to retained profits in respect of depreciation on revalued assets                             | (2,179) |    | (84)    | 2,263   |         |
| Effect of change of statutory income tax rate on deferred tax recognized in equity                     | 135     | 19 | (664)   | (510)   | (510)   |
| Consideration for purchase of entity under common control (Note 1)                                     |         |    | (1,179) | (1,179) | (1,179) |
| Distributions due to business combinations of entities and business under common control (Note 1)      |         |    | (101)   | (48)    | (149)   |
| Transfer of net income to other reserve due to purchase of Guizhou Business under common control (Note |         |    | 95      | (95)    |         |



|  |       |        |      |       |     |        |        |          |         |   |         |
|--|-------|--------|------|-------|-----|--------|--------|----------|---------|---|---------|
| 1)<br>Capitalization<br>of retained<br>profits                     |       |        |      |       |     |        | 17,295 | (17,295) |         |   |         |
| Transfer to<br>statutory<br>reserves                               |       |        |      |       |     | 1,517  |        | (1,517)  |         |   |         |
| Appropriation<br>to statutory<br>reserves                          |       |        |      |       |     | 1,591  |        | (1,591)  |         |   |         |
| Equity-settled<br>share option<br>schemes:                         |       |        |      |       |     |        |        |          |         |   |         |
| -Value of<br>employee<br>services                                  |       |        | 216  |       |     |        |        |          | 216     |   | 216     |
| -Issuance of<br>shares upon<br>exercise of<br>options (Note<br>34) | 5     | 366    | (89) |       |     |        | 250    |          | 532     |   | 532     |
| -Conversion of<br>convertible<br>bonds (Note<br>22)                | 88    | 10,731 |      |       |     |        |        |          | 10,819  |   | 10,819  |
| Dividends<br>relating to 2006<br>(Note 36)                         |       |        |      |       |     |        |        | (5,885)  | (5,885) |   | (5,885) |
| Balance at<br>December 31,<br>2007 (As<br>restated)                | 1,437 | 64,320 | 516  | 1,145 | 185 | 18,765 | 56,770 | 30,144   | 173,282 | 7 | 173,289 |

The accompanying notes are an integral part of the consolidated financial statements.

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**CHINA UNICOM (HONG KONG) LIMITED**  
**CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY (Continued)**  
**FOR THE YEARS ENDED DECEMBER 31, 2007, 2008 AND 2009**  
(All amounts in RMB millions)

|  | Attributable to equity holders of the Company |               |   |                                       |                    |               |                  |         |   | Minority Total interest equity |
|--|---|---------------|---|---------------------------------------|--------------------|---------------|------------------|---------|---|--------------------------------|
|  | Share capital                                 | Share premium | Employee share-based compensation reserve | Available-for-sale fair value reserve | Statutory reserves | Other Reserve | Retained profits | Total   |   |                                |
| Balance at January 1, 2008 (As previously reported)                                  | 1,437   | 64,320        | 516                                       | 1,113                                 | 17,933             | 56,713        | 36,480           | 178,512 | 4 | 178,516                        |
| Adjusted for 2009 Business Combination under common control (As previously reported) |   |               |   | 32                                    | 185                | 832           | (6,336)          | (330)   | 3 | (327)                          |
| Adjusted for 2009 Business Combination under common control (Note 2.2(b))            |   |               |   |                                       |                    |               | (4,900)          | (4,900) |   | (4,900)                        |
| Balance at January 1, 2008 (As restated)   | 1,437   | 64,320        | 516                                       | 1,145                                 | 185                | 18,765        | 30,144           | 173,282 | 7 | 173,289                        |
| Total comprehensive (loss)/income for the year (As previously reported)              |   |               |   |                                       | (141)              |               | 35,398           | 35,228  |   | 35,228                         |
| Adjustment on total comprehensive (loss)/income for the year (Note 2.2(b))           |   |               |   |                                       |                    |               | (5,594)          | (5,594) |   | (5,594)                        |
| Total comprehensive (loss)/income  |   |               |   |                                       | (141)              |               | 29,804           | 29,634  |   | 29,634                         |

|  |     |         |       |       |           |         |         |         |
|--|-----|---------|-------|-------|-----------|---------|---------|---------|
| for the year (As restated)   |     |         |       |       |           |         |         |         |
| Effect of 2009 Business Combination (As previously reported)               |     |         |       | (201) | 2,062     | (1,861) |         |         |
| Adjustment on effect of 2009 Business Combination (Note 2.2(b))            |     |         |       |       | (5,594)   | 5,594   |         |         |
| Effect of 2009 Business Combination (As restated)                          |     |         |       | (201) | (3,532)   | 3,733   |         |         |
| Transfer to retained profits in respect of depreciation on revalued assets |     |         | (984) |       | (70)      | 1,054   |         |         |
| Transfer to statutory reserves   |     |         |       | 886   |           | (886)   |         |         |
| Appropriation to statutory reserves  |     |         |       | 3,542 |           | (3,542) |         |         |
| Equity-settled share option schemes:                                       |     |         |       |       |           |         |         |         |
| -Value of employee services  |     |         | 96    |       |           | 96      |         | 96      |
| -Issuance of shares upon exercise of options (Note 34)                     | 3   | 252     | (72)  |       | 267       | 450     |         | 450     |
| Issuance of shares in connection with 2008 Business Combination (Note 1)   | 889 | 102,212 |       |       | (103,101) |         |         |         |
| Transfer out upon disposal of the CDMA business                            |     |         |       |       |           | (6,231) | (5)     | (5)     |
|  |     |         |       |       |           | (6,231) | (6,231) | (6,231) |

Dividends  
relating to 2007  
(Note 36)

Balance at  
December 31,  
2008 (As  
restated)

|       |         |     |     |    |        |          |        |         |   |         |
|-------|---------|-----|-----|----|--------|----------|--------|---------|---|---------|
| 2,329 | 166,784 | 540 | 161 | 44 | 22,992 | (49,695) | 54,076 | 197,231 | 2 | 197,233 |
|-------|---------|-----|-----|----|--------|----------|--------|---------|---|---------|

The accompanying notes are an integral part of the consolidated financial statements.

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**CHINA UNICOM (HONG KONG) LIMITED**  
**CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY (Continued)**  
**FOR THE YEARS ENDED DECEMBER 31, 2007, 2008 AND 2009**  
(All amounts in RMB millions)

|  | Attributable to equity holders of the Company |               |                               |                             |                    |               |                  |                   |         |              |          |
|--|---|---------------|-------------------------------|-----------------------------|--------------------|---------------|------------------|-------------------|---------|--------------|----------|
|  | Share capital                                 | Share premium | Employee share-based reserves | Available-for-sale reserves | Statutory reserves | Other Reserve | Retained profits | Minority interest |         | Total equity |          |
| Capital  |   |               |                               |                             |                    |               |                  | Reserve           | value   |              | Total    |
| Balance at January 1, 2009 (As previously reported)  | 2,329   | 166,784       | 540                           | 136                         | 22,361             | (46,220)      | 60,780           | 206,710           |         | 206,710      |          |
| Adjusted for 2009 Business Combination under common control (As previously reported)                         |   |               |                               | 25                          | 44                 | 631           | 7,019            | (6,704)           | 1,015   | 2            | 1,017    |
| Adjusted for 2009 Business Combination under common control (Note 2.2(b))                                    |   |               |                               |                             |                    |               | (10,494)         | (10,494)          |         |              | (10,494) |
| Balance at January 1, 2009 (As restated)   | 2,329   | 166,784       | 540                           | 161                         | 44                 | 22,992        | (49,695)         | 54,076            | 197,231 | 2            | 197,233  |
| Total comprehensive (loss)/income for the year   |   |               |                               |                             | (38)               |               |                  | 9,556             | 9,518   |              | 9,518    |
| Transfer of profit of entities under common control to Unicom Group in relation to 2009 Business Combination |   |               |                               |                             |                    |               |                  | (64)              | (64)    |              | (64)     |
| Transfer of assets and   |   |               |                               |                             |                    |               | 10,494           |                   | 10,494  |              | 10,494   |

|  |       |         |      |     |     |   |        |          |         |         |         |         |
|--|-------|---------|------|-----|-----|---|--------|----------|---------|---------|---------|---------|
| liabilities under common control to Unicom Group in relation to 2009 Business Combination (Note 2.2 (b)) Consideration for 2009 Business Combination under common control (Note 1) |       |         |      |     |     |   |        |          | (3,896) | (3,896) | (3,896) |         |
| Transfer to retained profits in respect of depreciation on revalued assets   |       |         | (55) |     |     |   |        |          |         | 55      |         |         |
| Transfer to statutory reserves   |       |         |      |     |     |   | 490    |          |         | (490)   |         |         |
| Appropriation to statutory reserves  |       |         |      |     |     |   | 769    |          |         | (769)   |         |         |
| Equity-settled share option schemes:   |       |         |      |     |     |   |        |          |         |         |         |         |
| -Value of employee services  |       |         | 27   |     |     |   |        |          |         | 27      | 27      |         |
| Issuance of shares for mutual investment by the Company and Telefónica (Note 18 & Note 32)   | 60    | 6,651   |      |     |     |   |        |          |         | 6,711   | 6,711   |         |
| Off-market share repurchase (Note 18)  | (79)  |         | 79   |     |     |   |        |          |         | (8,802) | (8,802) |         |
| Dividends relating to 2008 (Note 36)   |       |         |      |     |     |   |        |          |         | (4,754) | (4,754) |         |
| Balance at December 31, 2009   | 2,310 | 173,435 | 79   | 567 | 106 | 6 | 24,251 | (43,097) | 48,808  | 206,465 | 2       | 206,467 |

The accompanying notes are an integral part of the consolidated financial statements.

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**CHINA UNICOM (HONG KONG) LIMITED**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**  
**FOR THE YEARS ENDED DECEMBER 31, 2007, 2008 AND 2009**  
**(All amounts in RMB millions)**

|  |             | <b>2007</b>     | <b>Year ended December 31</b> |               |              |
|--|-------------|-----------------|-------------------------------|---------------|--------------|
|  |             | <b>As</b>       | <b>2008</b>                   |               |              |
|  |             | <b>restated</b> | <b>As restated</b>            |               |              |
|  |             | <b>(Note</b>    | <b>(Note 2.2 (a)</b>          |               |              |
|  | <b>Note</b> | <b>2.2(a)</b>   | <b>(b))</b>                   |               |              |
|  |             | <b>(b))</b>     | <b>(b))</b>                   |               |              |
|  |             | <b>RMB</b>      | <b>RMB</b>                    | <b>2009</b>   | <b>2009</b>  |
|  |             |                 |                               | <b>RMB</b>    | <b>US\$</b>  |
| <b>Cash flows from operating activities</b>                              |             |                 |                               |               |              |
| Cash generated from continuing operations                                | (a)         | 80,252          | 67,794                        | 63,990        | 9,375        |
| Interest received  |             | 308             | 269                           | 93            | 14           |
| Interest paid  |             | (3,511)         | (3,011)                       | (1,681)       | (246)        |
| Income tax paid  |             | (8,195)         | (7,811)                       | (4,669)       | (684)        |
| Net cash inflow from operating activities of continuing operations       |             | 68,854          | 57,241                        | 57,733        | 8,459        |
| Net cash inflow from operating activities of discontinued operations     | 35          | 837             | 656                           |               |              |
| <b>Net cash inflow from operating activities</b>                         |             | <b>69,691</b>   | <b>57,897</b>                 | <b>57,733</b> | <b>8,459</b> |
| <b>Cash flows from investing activities</b>                              |             |                 |                               |               |              |
| Purchase of property, plant and equipment                                |             | (48,925)        | (54,496)                      | (78,130)      | (11,446)     |
| Proceeds from disposal of property, plant and equipment and other assets |             | 164             | 573                           | 611           | 90           |
| Dividends received from available-for-sale financial assets              |             | 4               | 3                             | 177           | 26           |
| Consideration for purchase of business and entities under common control |             | (3,139)         | (5,880)                       | (3,896)       | (571)        |
| (Increase)/decrease in short-term bank deposits                          |             | (433)           | 415                           | (659)         | (97)         |
| Purchase of other assets   |             | (2,416)         | (1,641)                       | (3,411)       | (500)        |
| Net cash outflow from investing activities of continuing operations      |             | (54,745)        | (61,026)                      | (85,308)      | (12,498)     |
| Net cash (outflow) /inflow from investing activities of discontinued     | 35          | (25)            | 29,489                        | (5,039)       | (738)        |



operations

|   |          |          |          |          |
|---|----------|----------|----------|----------|
| <b>Net cash outflow from investing activities</b> | (54,770) | (31,537) | (90,347) | (13,236) |
|---|----------|----------|----------|----------|

The accompanying notes are an integral part of the consolidated financial statements.

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**CHINA UNICOM (HONG KONG) LIMITED**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS (Continued)**  
**FOR THE YEARS ENDED DECEMBER 31, 2007, 2008 AND 2009**  
**(All amounts in RMB millions)**

|  | Note | 2007                               | Year ended 31 December |                                    | 2009     | 2009    |
|--|------|------------------------------------|------------------------|------------------------------------|----------|---------|
|  |      | As restated (Note 2.2 (a) (b)) RMB | 2008                   | As restated (Note 2.2 (a) (b)) RMB |          |         |
| <b>Cash flows from financing activities</b>                                  |      |                                    |                        |                                    |          |         |
| Proceeds from exercise of share options                                      |      | 532                                |                        | 450                                |          |         |
| Proceeds from commercial paper   |      | 20,000                             |                        | 10,000                             |          |         |
| Proceeds from short-term bank loans  |      | 63,837                             |                        | 50,714                             | 96,204   | 14,094  |
| Proceeds from long-term bank loans   |      | 2,559                              |                        | 2,888                              |          |         |
| Proceeds from issuance of corporate bonds                                    |      | 2,000                              |                        | 5,000                              |          |         |
| Proceeds from related party loans  |      | 9,224                              |                        | 6,284                              | 2,114    | 310     |
| Repayment of commercial paper  |      | (16,646)                           |                        | (20,000)                           | (10,000) | (1,465) |
| Repayment of short-term bank loans   |      | (82,965)                           |                        | (51,784)                           | (43,075) | (6,311) |
| Repayment of long-term bank loans  |      | (13,416)                           |                        | (23,832)                           | (1,406)  | (206)   |
| Repayment of capital element of finance lease payments                       |      | (890)                              |                        | (101)                              |          |         |
| Repayment of related party loans   |      |                                    |                        | (2,222)                            |          |         |
| Payment of prior year profit transfer  |      | (1,180)                            |                        | (101)                              | (266)    | (39)    |
| Consideration for off-market share repurchase                                |      |                                    |                        |                                    | (8,802)  | (1,290) |
| Dividends paid to equity holders   | 36   | (5,885)                            |                        | (6,082)                            | (4,572)  | (670)   |
| Net cash (outflow)/inflow from financing activities of continuing operations |      | (22,830)                           |                        | (28,786)                           | 30,197   | 4,423   |
| Net cash outflow from financing activities of discontinued operations        |      |                                    |                        |                                    |          |         |
| <b>Net cash (outflow)/inflow from financing activities</b>                   |      | (22,830)                           |                        | (28,786)                           | 30,197   | 4,423   |
| <b>Net cash (outflow)/inflow from continuing operations</b>                  |      | (8,721)                            |                        | (32,571)                           | 2,622    | 384     |
| <b>Net cash inflow/(outflow) from discontinued operations</b>                | 35   | 812                                |                        | 30,145                             | (5,039)  | (738)   |

|   |    |         |         |         |       |
|---|----|---------|---------|---------|-------|
| <b>Net decrease in cash and cash equivalents</b>              |    | (7,909) | (2,426) | (2,417) | (354) |
| Cash and cash equivalents, beginning of year                  |    | 20,572  | 12,663  | 10,237  | 1,500 |
| <b>Cash and cash equivalents, end of year</b>                 | 17 | 12,663  | 10,237  | 7,820   | 1,146 |
| <b>Analysis of the balances of cash and cash equivalents:</b> |    |         |         |         |       |
| Cash balances   |    | 11      | 8       | 7       | 1     |
| Bank balances   |    | 12,652  | 10,229  | 7,813   | 1,145 |
|   |    | 12,663  | 10,237  | 7,820   | 1,146 |

The accompanying notes are an integral part of the consolidated financial statements.

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**CHINA UNICOM (HONG KONG) LIMITED**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS (Continued)**  
**FOR THE YEARS ENDED DECEMBER 31, 2007, 2008 AND 2009**

(All amounts in RMB millions)

(a) The reconciliation of income from continuing operations before income tax to cash generated from continuing operations is as follows:

|   | Year ended December 31 |             |         |       |
|---|------------------------|-------------|---------|-------|
|   | 2007                   | 2008        |         |       |
|   | As                     | As restated |         |       |
|   | restated               | (Note 2.2   |         |       |
|   | (Note                  | (b)         |         |       |
|   | 2.2 (b))               | (b))        |         |       |
|   | RMB                    | RMB         |         |       |
|   |                        |             | 2009    | 2009  |
|   |                        |             | RMB     | US\$  |
| Income from continuing operations before income tax                                 | 23,443                 | 4,059       | 12,277  | 1,799 |
| Adjustments for:  |                        |             |         |       |
| Depreciation and amortization   | 51,275                 | 51,847      | 47,587  | 6,971 |
| Interest income   | (305)                  | (265)       | (91)    | (13)  |
| Finance costs   | 3,431                  | 2,999       | 828     | 121   |
| Loss/(gain) on disposal of property, plant and equipment and other assets           | 311                    | 239         | (91)    | (14)  |
| Gain on non-monetary assets exchange  | (386)                  | (1,305)     | (38)    | (6)   |
| Share-based compensation costs  | 170                    | 84          | 27      | 4     |
| Provision for doubtful debts  | 2,260                  | 3,025       | 2,355   | 345   |
| Impairment loss on property, plant and equipment                                    | 323                    | 12,494      |         |       |
| Realized loss on changes in fair value of derivative component of convertible bonds | 569                    |             |         |       |
| Realized gain on changes in fair value of derivative financial instruments          |                        |             | (1,239) | (182) |
| Dividends from available-for-sale financial assets                                  | (4)                    | (3)         | (215)   | (32)  |
| Changes in working capital:   |                        |             |         |       |
| Increase in accounts receivable   | (2,021)                | (2,044)     | (1,839) | (269) |
| Decrease /(increase) in inventories and consumables                                 | 7                      | (126)       | (1,320) | (193) |
| Decrease/(increase) in other assets   | 1,638                  | 834         | (125)   | (18)  |
| (Increase)/decrease in prepayments and other current assets                         | (939)                  | 1,000       | (1,539) | (225) |
| (Increase)/decrease in amounts due from related parties                             | (34)                   | 116         | 75      | 11    |
| Decrease/(increase) in amounts due from domestic carriers                           | 52                     | 267         | (160)   | (23)  |
| Increase/(decrease) in accounts payable, accrued liabilities and taxes payable      | 3,336                  | (2,200)     | 4,659   | 682   |
| Increase in advances from customers   | 533                    | 1,653       | 4,805   | 704   |
| Decrease in deferred revenue  | (2,880)                | (2,993)     | (1,639) | (240) |
| Decrease in other obligations   | (863)                  | (767)       | (2,101) | (307) |
| Increase/(decrease) in amounts due to ultimate holding company                      | 735                    | (1,733)     | 413     | 61    |
| (Decrease)/increase in amounts due to related parties                               | (120)                  | (551)       | 1,942   | 284   |
|   | (279)                  | 396         | 180     | 26    |

|  |        |        |        |       |
|--|--------|--------|--------|-------|
| (Decrease)/increase in amounts due to domestic carriers                      |        |        |        |       |
| Increase/(decrease) in payables in relation to disposal of the CDMA business |        | 768    | (761)  | (111) |
| Cash generated from continuing operations                                    | 80,252 | 67,794 | 63,990 | 9,375 |

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**CHINA UNICOM (HONG KONG) LIMITED  
CONSOLIDATED STATEMENTS OF CASH FLOWS (Continued)  
FOR THE YEARS ENDED DECEMBER 31, 2007, 2008 AND 2009**

**(All amounts in RMB millions)**

(b) Major non-cash transactions:

- (i) Payables to equipment suppliers for construction-in-progress during 2009 increased by approximately RMB26.8 billion (2007: approximately RMB1.2 billion; 2008: approximately RMB14.1 billion).
- (ii) On October 21, 2009, the Company and Telefónica S.A. ( Telefónica ) completed the mutual investment of the equivalent of USD1 billion in each other, which was implemented by way of the subscription by Telefónica for 693,912,264 new shares of the Company at a price of HKD11.17 each, satisfied by the contribution by Telefónica of 40,730,735 Telefónica treasury shares at a price of Euro17.24 each to the Company. Please refer to Note 18 and Note 32 for details.
- (iii) On October 15, 2008, the Company issued 10,102,389,377 ordinary shares of HKD0.10 each at a price of HKD11.60 per share with fair value or total price of approximately RMB103.1 billion (equivalent to approximately HKD117.2 billion) in exchange for the entire issued share capital of China Netcom Group Corporation (Hong Kong) Limited. Please refer to Note 1 and Note 18 for details.
- (iv) On August 20, 2007, convertible bonds of USD1 billion outstanding as of December 31, 2006 were fully converted into 899,745,075 ordinary shares of HKD0.10 each of the Company. Please refer to Note 22 for details.
- (v) For the years ended December 31, 2007, 2008 and 2009, the Group replaced copper cables in certain fixed-line network infrastructure with optical fibers and related equipment. Some of this replacement was done through non-monetary assets exchanges with suppliers, through which optical fibers and related equipment were received in exchange for the Group's own copper cables. The cost of the assets received was recorded at the fair value of the assets surrendered. In 2009, the net book value and fair value of copper cables surrendered were RMB60 million (2007: RMB182 million; 2008: RMB805 million) and RMB98 million (2007:RMB568 million; 2008: RMB2,110 million), respectively. Gain on the non-monetary assets exchange of RMB38 million (2007:RMB386 million; 2008: RMB1,305 million) was recognized in the statement of income for the year ended December 31, 2009.

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**CHINA UNICOM (HONG KONG) LIMITED**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

**(All amounts in RMB millions unless otherwise stated)**

**1. ORGANISATION AND PRINCIPAL ACTIVITIES**

China Unicom (Hong Kong) Limited (the Company) was incorporated as a limited liability company in the Hong Kong Special Administrative Region ( Hong Kong ), the People's Republic of China (the PRC) on February 8, 2000. After disposal of the CDMA business to China Telecom Corporation Limited ( China Telecom ) on October 1, 2008, the merger with China Netcom Group Corporation (Hong Kong) Limited ( China Netcom ) on October 15, 2008 and the launch of WCDMA mobile business on October 1, 2009, the principal activities of the Company are investment holding and the Company's subsidiaries are principally engaged in the provision of cellular and fixed-line voice and related value-added services, broadband and other Internet-related services, information communications technology services, and business and data communications services in the PRC. The GSM cellular voice, WCDMA cellular voice and related value-added services is referred to as the Mobile business, the services aforementioned other than the Mobile business is hereinafter collectively referred to as the Fixed-line business. The Company and its subsidiaries are hereinafter referred to as the Group. The address of its registered office is 75th Floor, The Center, 99 Queen's Road Central, Hong Kong.

The shares of the Company were listed on the Stock Exchange of Hong Kong Limited ( SEHK ) on June 22, 2000 and the American Depositary Shares ( ADS ) of the Company were listed on the New York Stock Exchange on June 21, 2000.

On November 15, 2008, the Company was notified by its substantial shareholders, namely China Unicom (BVI) Limited ( Unicom BVI ) and China Netcom Group Corporation (BVI) Limited ( Netcom BVI ), that their respective parent companies, namely, China United Network Communications Group Company Limited (a state-owned enterprise established in the PRC, the parent company of Unicom BVI, hereinafter referred to as Unicom Group) and China Network Communications Group Corporation (a state-owned enterprise established in the PRC, the parent company of Netcom BVI, hereinafter referred to as Netcom Group), had agreed to undertake a merger (the Parent Merger). On January 6, 2009, the Company was notified by its substantial shareholders that the Parent Merger, through the absorption of Netcom Group by Unicom Group, had been approved by the State-owned Assets Supervision and Administration Commission of the State Council ( SASAC ) and had become effective. As a result of the Parent Merger, Unicom Group has assumed all the rights and obligations of Netcom Group, all the assets, liabilities and business of Netcom Group including the connected transaction agreements with the Group have vested in Unicom Group and Unicom Group remains the ultimate holding company of the Company.

**Table of Contents****1. ORGANISATION AND PRINCIPAL ACTIVITIES (Continued)****(a) Acquisitions of certain assets and businesses from Unicom Group and Netcom Group in 2009**

On January 31, 2009, China United Network Communications Corporation Limited ( CUCL , a wholly-owned subsidiary of the Company) completed the acquisition from Unicom Group and Netcom Group of (i) the fixed-line business, but not the underlying telecommunications networks, across the 21 provinces in Southern China and related non-current assets and liabilities (hereinafter referred to as the Fixed-line Business in Southern China ) and the local access telephone business and related assets in Tianjin Municipality operated by Netcom Group and Unicom Group and/or their respective subsidiaries and branches; (ii) the backbone transmission assets in Northern China owned by Netcom Group and/or its subsidiaries ( Target Assets ); (iii) a 100% equity interest in Unicom Xingye Science and Technology Trade Company Limited ( Unicom Xingye ) owned by Unicom Group; (iv) a 100% equity interest in China Information Technology Designing & Consulting Institute Company Limited ( CITDCI ) owned by Unicom Group and (v) a 100% equity interest in New Guoxin Telecom Corporation of China Unicom ( New Guoxin ) owned by Unicom Group at a consideration of approximately RMB4.43 billion. The businesses and assets described in (i), (iii), (iv) and (v) above are hereinafter collectively referred to as the Target Business and the acquisition of the Target Business is referred to as the 2009 Business Combination .

**(b) Lease of telecommunications networks in Southern China from Unicom New Horizon Mobile Telecommunications Company Limited in 2009**

In connection with the 2009 Business Combination, on December 16, 2008, CUCL, Unicom Group, Netcom Group and Unicom New Horizon Mobile Telecommunications Company Limited ( Unicom New Horizon , a wholly-owned subsidiary of Unicom Group) entered into an agreement (the Network Lease Agreement ) in relation to the lease (the Lease ) of the fixed-line telecommunications networks of the 21 provinces in Southern China ( Telecommunications Networks in Southern China ) by CUCL from Unicom New Horizon on an exclusive basis immediately following and subject to the completion of the 2009 Business Combination. Under the Network Lease Agreement, CUCL shall pay annual leasing fees of RMB2.0 billion and RMB2.2 billion for the two financial years ending December 31, 2009 and December 31, 2010, respectively. The initial term of the Lease is two years effective from January 2009 and the Lease is renewable at the option of CUCL with at least two months prior notice on the same terms and conditions, except for the future lease fee which will remain subject to further negotiations between the parties, taking into account, among others, the then prevailing market conditions in Southern China. Moreover, in connection with the Lease, Unicom New Horizon has granted to CUCL an option to purchase the Telecommunications Networks in Southern China and the purchase price will be referenced to the then appraised value of the networks determined by an independent appraiser.



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**1. ORGANISATION AND PRINCIPAL ACTIVITIES (Continued)**

**(c) Merger between CUCL and China Netcom (Group) Company Limited in 2009**

On January 1, 2009, as part of the Company's integration with China Netcom, the Company completed the reorganization of its wholly-owned subsidiaries, namely (i) CUCL and (ii) China Netcom (Group) Company Limited ( "CNC China", a wholly-owned foreign enterprise established in the PRC and a wholly-owned subsidiary of China Netcom), pursuant to which CUCL merged with, and absorbed, CNC China. The merged company retains the name of China United Network Communications Corporation Limited and remains a wholly-owned subsidiary of the Company. The CNC China mentioned below represents CNC China before the merger with CUCL on January 1, 2009.

The merger between CUCL and CNC China does not have any impact on the consolidated financial statements.

**(d) 2008 disposal and business combination activities**

**Disposal of the Group's CDMA business to China Telecom in 2008**

On October 1, 2008, the Company completed disposal of the CDMA business to China Telecom in accordance with the CDMA business framework agreement ( "the Framework Agreement") and the CDMA business disposal agreement ( "the Disposal Agreement") entered into among the Company, CUCL and China Telecom.

**Merger between the Company and China Netcom by way of a scheme of arrangement of China Netcom in 2008 (hereinafter referred to as the "2008 Business Combination")**

On October 15, 2008, the Company completed its merger with China Netcom by way of a scheme of arrangement of China Netcom (the "Scheme") under Section 166 of the Hong Kong Companies Ordinance. The consideration for the 2008 Business Combination was approximately HKD117.2 billion which was satisfied by the issuance of 10,102,389,377 ordinary shares of HKD0.10 each of the Company to the shareholders of China Netcom.

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**1. ORGANISATION AND PRINCIPAL ACTIVITIES (Continued)**

**(e) 2007 disposal and business combination activities**

**Disposal of the fixed-line telecommunications and operations in Guangdong province and Shanghai municipality branches ( Guangdong and Shanghai Branches )**

On February 28, 2007, the Company's wholly-owned subsidiary, CNC China completed its sale of assets and liabilities in relation to the fixed-line telecommunication operations in Guangdong and Shanghai Branches in the PRC to Netcom Group at a cash consideration of RMB 3.5 billion. The Guangdong and Shanghai Branches were reacquired by the Group during the 2009 Business Combination (Note 1(a) and Note 2.2(d)).

**Purchase of assets and business of Guizhou branch of Unicom Group**

On December 31, 2007, CUCL completed its purchase of the GSM cellular telecommunication assets and business, and the CDMA cellular telecommunication business (operated through a leasing of CDMA network capacity from Unicom New Horizon) of Guizhou branch of Unicom Group ( Guizhou Business ) at a cash consideration of RMB880 million. In addition, pursuant to an asset transfer agreement, the income or loss of the Guizhou Business for the period from December 31, 2006 to December 31, 2007 (i.e. the effective date of the acquisition) was transferred to Unicom Group.

**Acquisition of Beijing Telecommunications Planning and Designing Institute Corporation Limited ( Beijing Telecom P&D Institute )**

On December 31, 2007, China Netcom Group System Integration Limited Corporation ( System Integration Corporation ), a wholly-owned subsidiary of CNC China) completed its acquisition of the entire equity interest of Beijing Telecom P&D Institute from China Netcom Group Beijing Communications Corporation ( Beijing Communications Corporation ), a subsidiary of Netcom Group) at a total consideration of RMB299 million.

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**2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

The principal accounting policies applied in the preparation of these consolidated financial statements are set out below. These policies have been consistently applied to all the years presented, unless otherwise stated.

**2.1 Statement of Compliance**

These financial statements have been prepared in accordance with all applicable International Financial Reporting Standards ( IFRSs ) issued by the International Accounting Standards Board ( IASB ), which collective term includes all applicable individual International Financial Reporting Standards, International Accounting Standards ( IASs ) and Interpretations issued by the IASB. Hong Kong Financial Reporting Standards ( HKFRSs ), which collective term includes all applicable individual Hong Kong Financial Reporting Standards, Hong Kong Accounting Standards ( HKASs ) and Interpretations issued by the Hong Kong Institute of Certified Public Accountants ( HKICPA ), are consistent with IFRSs. These financial statements also comply with HKFRSs.

**2.2 Basis of Preparation**

The consolidated financial statements have been prepared under the historical cost convention, modified by the revaluation of property, plant and equipment (other than buildings and telecommunications equipment of the Mobile business), available-for-sale financial assets and derivative financial instrument at fair value through income or loss. The consolidated financial statements prepared by the PRC subsidiaries for PRC statutory reporting purposes are based on the Chinese Accounting Standards for Business Enterprises ( CAS ) issued by the Ministry of Finance of the PRC, which became effective from January 1, 2007 with certain transitional provisions. There are certain differences between the Group's IFRSs/HKFRSs financial statements and PRC statutory financial statements. The principal adjustments made to the PRC statutory financial statements to conform to IFRSs/HKFRSs include the following:

reversal of the revaluation surplus or deficit and related depreciation and amortization charges arising from the revaluation of assets (mainly property, plant and equipment) performed by independent valuers for the purpose of reporting to relevant PRC government authorities;

recognition of the revaluation surplus or deficit and related depreciation charges for the purpose of reporting the property, plant and equipment (other than buildings and telecommunications equipment of the Mobile business) at revalued amounts under IFRSs/HKFRSs;

recognition of goodwill associated with the acquisition of certain subsidiaries prior to 2005;

capitalization of the direct costs associated with the acquisition of subsidiaries prior to 2005;

additional capitalization of borrowing costs prior to the adoption of CAS on January 1, 2007;

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**2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)**

**2.2 Basis of Preparation (Continued)**

capitalization and amortization of upfront non-refundable revenue and the related direct incremental costs for activating mobile subscribers prior to the adoption of CAS on January 1, 2007; and

adjustments for deferred taxation in relation to IFRSs/HKFRSs adjustments.

**(a) Business Combination of Entities and Business under Common Control and Purchase of Target Assets**

The 2009 Business Combination was considered a business combination of entities and businesses under common control as the Target Business before and after the acquisition was both under the control of Unicom Group, the Group's ultimate holding company.

The merger between the Company and China Netcom in 2008 was considered a business combination of entities under common control as their respective ultimate holding companies, namely Unicom Group and Netcom Group, were both under the common control of SASAC. Further, the 2008 Business Combination was carried out by reference to the Announcement on Deepening the Reform of the Structure of the Telecommunications Sector dated May 24, 2008 jointly issued by the Ministry of Industry and Information Technology (MIIT), the National Development and Reform Commission (NDRC) and the Ministry of Finance of the PRC. As set out in Note 1, Unicom Group and Netcom Group had merged on January 6, 2009 following the merger between the Company and China Netcom.

The acquisition of Beijing Telecom P&D Institute in 2007 was considered to be a business combination of entities under common control of Netcom Group as Beijing Telecom P&D Institute was a wholly-owned subsidiary of Beijing Communications Corporation, which is a wholly-owned subsidiary of Netcom Group.

The acquisition of Guizhou Business in 2007 was also considered to be a business combination of entity and business under common control as the Group and Guizhou Business were both under the common control of Unicom Group.

Under HKFRSs, the above transactions were accounted for using merger accounting in accordance with the Accounting Guideline 5 Merger accounting for common control combinations (AG 5) issued by the HKICPA. Upon the adoption of IFRSs by the Group in 2008, the Group adopted the accounting policy to account for business combinations of entities and businesses under common control using the predecessor values method, which is consistent with HKFRSs. Accordingly, the acquired assets and liabilities are stated at predecessor values, and were included in the consolidated financial statements from the beginning of the earliest period presented as if the entities and businesses acquired had always been part of the Group.

Under IFRSs/HKFRSs, the purchase of the Target Assets in 2009 of approximately RMB0.53 billion was accounted for as an asset purchase in accordance with IAS/HKAS 16 Property, plant and equipment in the period of purchase.

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**2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)**

2.2 Basis of Preparation (Continued)

**(b) Restatement of Previously Reported Financial Statements Included in the Annual Report on Form 20-F for the Fiscal Year Ended December 31, 2009**

The Group previously recognized the 2009 Business Combination at historical cost or predecessor values as if such business had always been part of the Group during all the periods presented, and (i) included all the assets, liabilities, revenue and expenses directly related to the 2009 Business Combination, except for the Telecommunications Networks in Southern China and associated loans that were not acquired ( Excluded Assets and Liabilities ) and the related depreciation and finance costs, and (ii) supplemented such information with disclosure of the assets and related liabilities, and the related charges that were excluded, together with details of the lease payments that were made to Unicom New Horizon following the completion of the 2009 Business Combination.

As part of a review of the Company's 2009 Form 20-F in 2010, the Staff of Division of Corporation Finance of the Securities and Exchange Commission ( DCF ) raised questions on the accounting treatment of the 2009 Business Combination. The Company has discussed with the DCF and determined to include all Excluded Assets and Liabilities and the related charges in the financial statements for the historical periods prior to the completion of the Acquired Business, instead of disclosing such information in the notes to the financial statements. Accordingly, the Company has amended and restated the financial statements for the historical periods prior to the completion of the Acquired Business. As a result, this presentation of the financial statements for the historical periods prior to the completion of the Acquired Business includes Excluded Assets and Liabilities and charges incurred in the generation of the reported revenues, although the Excluded Assets and Liabilities were not acquired in the Acquired Business. Upon the completion of the 2009 Business Combination, the Excluded Assets and Liabilities were deemed to be disposed, which had been recorded as a distribution from reserves to Unicom Group.

**Table of Contents****2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)**

## 2.2 Basis of Preparation (Continued)

**(b) Restatement of Previously Reported Financial Statements Included in the Annual Report on Form 20-F for the Fiscal Year Ended December 31, 2009 (Continued)**

The following table presents the financial statements accounts which are restated:

|   | Note | As<br>previously<br>reported | Adjustments | As<br>restated |
|---|------|------------------------------|-------------|----------------|
| <b>For the year ended December 31, 2007</b>   |      |                              |             |                |
| <b>Results of continuing operations:</b>  |      |                              |             |                |
| Depreciation and amortization   | (i)  | (47,625)                     | (3,650)     | (51,275)       |
| Other operating expenses  | (i)  | (36,353)                     | (171)       | (36,524)       |
| Finance costs   | (ii) | (3,241)                      | (499)       | (3,740)        |
| Impairment loss on property, plant and equipment  | (i)  |                              | (323)       | (323)          |
| Other income net  |      | 5,100                        | 2           | 5,102          |
| Income from continuing operations before income tax   |      | 28,084                       | (4,641)     | 23,443         |
| Income from continuing operations   |      | 20,909                       | (4,641)     | 16,268         |
| Net income  |      | 21,565                       | (4,641)     | 16,924         |
| <b>Earnings per share for income attributable to equity holders of the Company during the year</b>                              |      |                              |             |                |
| Basic earnings per share (RMB)  |      | 0.93                         | (0.20)      | 0.73           |
| Diluted earnings per share (RMB)  |      | 0.92                         | (0.19)      | 0.73           |
| <b>Earnings per share for income from continuing operations attributable to equity holders of the Company during the year</b>   |      |                              |             |                |
| Basic earnings per share (RMB)  |      | 0.90                         | (0.20)      | 0.70           |
| Diluted earnings per share (RMB)  |      | 0.89                         | (0.19)      | 0.70           |
| <b>Earnings per share for income from discontinued operations attributable to equity holders of the Company during the year</b> |      |                              |             |                |
| Basic earnings per share (RMB)  |      | 0.03                         |             | 0.03           |
| Diluted earnings per share (RMB)  |      | 0.03                         |             | 0.03           |

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**Table of Contents****2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

## 2.2 Basis of Preparation (Continued)

**(b) Restatement of Previously Reported Financial Statements Included in the Annual Report on Form 20-F for the Fiscal Year Ended December 31, 2009 (Continued)**

The following table presents the financial statements accounts which are restated (**Continued**):

|   | Note | As<br>previously<br>reported | Adjustments | As<br>restated |
|---|------|------------------------------|-------------|----------------|
| <b>For the year ended December 31, 2008</b>   |      |                              |             |                |
| <b>Results of continuing operations:</b>  |      |                              |             |                |
| Depreciation and amortization   | (i)  | (47,961)                     | (3,886)     | (51,847)       |
| Other operating expenses  | (i)  | (37,748)                     | (249)       | (37,997)       |
| Finance costs   | (ii) | (2,423)                      | (846)       | (3,269)        |
| Impairment loss on property, plant and equipment  | (i)  | (11,837)                     | (657)       | (12,494)       |
| Other income net  |      | 2,097                        | 44          | 2,141          |
| Income from continuing operations before income tax   |      | 9,653                        | (5,594)     | 4,059          |
| Income from continuing operations   |      | 7,825                        | (5,594)     | 2,231          |
| Net income  |      | 35,398                       | (5,594)     | 29,804         |
| <b>Earnings per share for income attributable to equity holders of the Company during the year</b>                              |      |                              |             |                |
| Basic earnings per share (RMB)  |      | 1.49                         | (0.24)      | 1.25           |
| Diluted earnings per share (RMB)  |      | 1.48                         | (0.24)      | 1.24           |
| <b>Earnings per share for income from continuing operations attributable to equity holders of the Company during the year</b>   |      |                              |             |                |
| Basic earnings per share (RMB)  |      | 0.33                         | (0.24)      | 0.09           |
| Diluted earnings per share (RMB)  |      | 0.33                         | (0.24)      | 0.09           |
| <b>Earnings per share for income from discontinued operations attributable to equity holders of the Company during the year</b> |      |                              |             |                |
| Basic earnings per share (RMB)  |      | 1.16                         |             | 1.16           |
| Diluted earnings per share (RMB)  |      | 1.15                         |             | 1.15           |

The 2009 Business Combination was completed on January 31, 2009 and therefore the consolidated statement of income for the year ended December 31, 2009 would have included the depreciation and amortization charges of approximately RMB308 million of the Excluded Assets and Liabilities and the finance costs associated with the long-term intercompany loans for the financing of the construction of the Telecommunications Networks in Southern China of approximately RMB26 million for the period from January 1, 2009 to January 31, 2009. However, considering the amounts were not material, the Company did not restate the consolidated statement of income for the year ended December 31, 2009.

**Table of Contents****2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)**

## 2.2 Basis of Preparation (Continued)

**(b) Restatement of Previously Reported Financial Statements Included in the Annual Report on Form 20-F for the Fiscal Year Ended December 31, 2009 (Continued)**

The following table presents the financial statements accounts which are restated (**Continued**):

|   |       | As<br>previously |             | As       |
|---|-------|------------------|-------------|----------|
|   | Note  | reported         | Adjustments | restated |
| <b>As of December 31, 2008</b>                  |       |                  |             |          |
| <b>Financial position:</b>                      |       |                  |             |          |
| Property, plant and equipment                   | (i)   | 285,469          | 30,077      | 315,546  |
| Lease prepayments                               | (i)   | 7,863            | 875         | 8,738    |
| Other assets                                    | (i)   | 9,087            | 398         | 9,485    |
| Total non-current assets                        |       | 310,619          | 31,350      | 341,969  |
| Inventories and consumables                     | (iii) | 1,092            | 55          | 1,147    |
| Prepayments and other current assets            | (iii) | 2,715            | 161         | 2,876    |
| Total current assets                            |       | 38,133           | 216         | 38,349   |
| Total assets                                    |       | 348,752          | 31,566      | 380,318  |
| Reserves  | (iv)  | (15,464)         | (10,494)    | (25,958) |
| Total equity                                    |       | 207,727          | (10,494)    | 197,233  |
| Long-term loans due to ultimate holding company | (ii)  |                  | 35,652      | 35,652   |
| Total non-current liabilities                   |       | 13,092           | 35,652      | 48,744   |
| Accounts payable and accrued liabilities        | (ii)  | 67,509           | 6,345       | 73,854   |
| Taxes payable                                   | (iii) | 11,307           | 63          | 11,370   |
| Total current liabilities                       |       | 127,933          | 6,408       | 134,341  |
| Total liabilities                               |       | 141,025          | 42,060      | 183,085  |

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**Table of Contents****2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)**

## 2.2 Basis of Preparation (Continued)

**(b) Restatement of Previously Reported Financial Statements Included in the Annual Report on Form 20-F for the Fiscal Year Ended December 31, 2009 (Continued)**

- (i) The adjustment items primarily represented property, plant and equipment and related non-current assets (including lease prepayments for land use rights and other assets relating to the Telecommunications Networks in Southern China), and the corresponding depreciation and amortization expenses, as well as impairment loss and loss on disposal of property, plant and equipment which have been recorded in other operating expenses .
- (ii) The adjustment items primarily represented the related long-term interest bearing intercompany loans from Unicom Group for the financing of the construction of the Telecommunications Networks in Southern China and the related payables to network contractors and equipment suppliers, and the finance costs associated with the long-term intercompany loans.
- (iii) The adjustment items primarily represented other miscellaneous assets not acquired and liabilities not assumed associated with the Telecommunications Networks in Southern China.
- (iv) The adjustment items represented the net liabilities associated with the Excluded Assets and Liabilities which have been included as other reserve in the consolidated balance sheet as of December 31, 2008 and have been subsequently recorded as a distribution from reserves to Unicom Group in January 2009 upon the completion of 2009 Business Combination.

The consolidated balance sheet as of January 1, 2008, with note disclosures of the more significant 2007 consolidated balance sheet items, was presented in accordance with IAS 1/HKAS 1 Presentation of financial statements which requires an entity to present the financial position as at the beginning of the earliest comparative period when an entity applies an accounting policy retrospectively or makes a retrospective restatement of items in its financial statements, or when it reclassifies items in its financial statements. The following table reflects the effects of 2009 Business Combination as described in Note 2.2(a) and the restatement as described in Note 2.2(b).

|                              | <b>Before 2009<br/>Business<br/>Combination<br/>Adjustments</b> | <b>2009<br/>Business<br/>Combination</b> | <b>Eliminations</b> | <b>After 2009<br/>Business<br/>Combination<br/>Adjustments</b> |
|------------------------------|---|--|---------------------|--|
| <b>As of January 1, 2008</b> |   |  |                     |  |
| <b>Financial position:</b>   |   |  |                     |  |
| Non-current assets           | 301,912   | 31,992                                   | (33)                | 333,871  |
| Current assets               | 32,175  | 3,437                                    | (1,048)             | 34,564   |
| Total assets                 | 334,087   | 35,429                                   | (1,081)             | 368,435  |
| Non-current liabilities      | 31,525  | 27,370                                   |                     | 58,895   |
| Current liabilities          | 124,046   | 13,140                                   | (935)               | 136,251  |
| Total liabilities            | 155,571   | 40,510                                   | (935)               | 195,146  |
| Net assets                   | 178,516   | (5,081)                                  | (146)               | 173,289  |

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**Table of Contents****2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)**

## 2.2 Basis of Preparation (Continued)

**(c) Summary of the Restatement to 2007 and 2008 Comparative Financial Information**

The impact of the restatement of 2007 and 2008 comparative financial information in connection with the 2009 Business Combination is summarized as follows:

|   | <b>As<br/>previously<br/>reported</b> | <b>2009<br/>Business<br/>Combination<br/>(As<br/>restated)</b> | <b>Eliminations</b> | <b>As restated</b>     |
|---|---------------------------------------|--|---------------------|------------------------|
| <b>For the year ended December 31, 2007</b> |                                       |  |                     |                        |
| <b>Results of continuing operations:</b>    |                                       |  |                     |                        |
| Revenue                                     | 150,687                               | 12,618   | (3,365)             | 159,940                |
| Net income                                  | 20,158                                | (3,842)  | (48)                | 16,268                 |
|   | <b>As<br/>previously<br/>reported</b> | <b>2009<br/>Business<br/>Combination<br/>(As<br/>restated)</b> | <b>Eliminations</b> | <b>As<br/>restated</b> |
| <b>For the year ended December 31, 2008</b> |                                       |  |                     |                        |
| <b>Results of continuing operations:</b>    |                                       |  |                     |                        |
| Revenue                                     | 148,906                               | 14,337   | (3,451)             | 159,792                |
| Net income                                  | 6,340                                 | (4,057)  | (52)                | 2,231                  |
| <b>As of December 31, 2008</b>              |                                       |  |                     |                        |
| <b>Financial position:</b>                  |                                       |  |                     |                        |
| Non-current assets                          | 308,804                               | 33,309   | (144)               | 341,969                |
| Current assets                              | 36,120                                | 3,666  | (1,437)             | 38,349                 |
| Total assets                                | 344,924                               | 36,975   | (1,581)             | 380,318                |
| Non-current liabilities                     | 12,995                                | 35,749   |                     | 48,744                 |
| Current liabilities                         | 125,219                               | 10,470   | (1,348)             | 134,341                |
| Total liabilities                           | 138,214                               | 46,219   | (1,348)             | 183,085                |
| Net assets                                  | 206,710                               | (9,244)  | (233)               | 197,233                |
|   | F-26                                  |  |                     |                        |

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**2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)**

2.2 Basis of Preparation (Continued)

**(d) Discontinued Operations**

On June 2, 2008, the Company, CUCL and China Telecom entered into the Framework Agreement to dispose of the assets and liabilities in relation to the CDMA business and the disposal was completed on October 1, 2008. In accordance with IFRS/HKFRS 5 Non-current assets held for sale and discontinued operations issued by the IASB/HKICPA ( IFRS/HKFRS 5 ), the results and cash flows of the operations of the CDMA operating segment of the Group have been presented as discontinued operations in the consolidated statements of income and statements of cash flows of the Group for the years ended December 31, 2007 and 2008. The difference between the consideration received and receivable and the book value of net assets disposed of is recorded as gain on disposal of discontinued operations in the consolidated statement of income for the year ended December 31, 2008.

As discussed in Note 1(e), in 2007, CNC China completed its disposal of assets and liabilities in relation to the fixed-line telecommunication operations in Guangdong and Shanghai Branches in the PRC to Netcom Group. After considering that the Guangdong and Shanghai Branches were reacquired by the Group as part of the 2009 Business Combination, the results and cash flows for the operations of Guangdong and Shanghai Branches have not been presented as discontinued operations in the consolidated statement of income and statement of cash flows of the Group for the year ended December 31, 2007, and the previously recorded gain on the disposal amounting to approximately RMB626 million was derecognized in the consolidated statement of income for the year ended December 31, 2007.

For details, please refer to Note 35.

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**2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)**

2.2 Basis of Preparation (Continued)

**(e) Going Concern Assumption**

As of December 31, 2009, current liabilities of the Group exceeded current assets by approximately RMB169.2 billion (2008: approximately RMB96.0 billion). Given the current global economic conditions and the Group's expected capital expenditures in the foreseeable future, management has comprehensively considered the Group's available sources of funds as follows:

The Group's continuous net cash inflow from operating activities;

Revolving banking facilities of approximately RMB113.3 billion, of which approximately RMB58.8 billion was unutilized as of December 31, 2009; and

Other available sources of financing from domestic banks and other financial institutions given the Group's credit history.

In addition, the Group will continue to optimize its fund raising strategy from the short, medium and long-term perspectives and will consider the opportunities in the current capital market to take advantage of low interest rates by issuing medium to long-term debts with low financing cost.

Based on the above considerations, the Board of Directors is of the opinion that the Group has sufficient funds to meet its working capital requirements and debt obligations. As a result, the consolidated financial statements of the Group for the year ended December 31, 2009 have been prepared under the going concern basis.

**(f) Critical Accounting Estimates and Judgment**

The preparation of the consolidated financial statements in conformity with IFRSs/HKFRSs requires the use of certain critical accounting estimates. It also requires management to exercise its judgment in the process of applying the Group's accounting policies. The areas involving a higher degree of judgment or complexity, or areas where assumptions and estimates significant to the consolidated financial statements are disclosed in Note 4.

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**2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)**

2.2 Basis of Preparation (Continued)

**(g) New Accounting Standards, Amendments and Interpretations Pronouncements**

- (i) The following revised standard is early adopted by the Group  
IAS/HKAS 24 (revised) Related party disclosure (effective from January 1, 2011). The revised standard primarily amends the disclosure requirements applicable to transactions and balances with government-related entities and the government. The revised standard also clarifies and simplifies the definition of a related party. Upon the early adoption of IAS/HKAS 24 (revised), the Group revised the disclosure on the transactions and balances with the major state-owned financial institutions in its related party transactions footnote. Please refer to Note 39 for details.
- (ii) The following new and amended IFRSs/HKFRSs are adopted by the Group as of January 1, 2009  
IFRS/HKFRS 2 (amendment), Share-based payment (effective from January 1, 2009). The amended standard deals with vesting conditions and cancellations. It clarifies that vesting conditions are service conditions and performance conditions only. Other features of a share-based payment are not vesting conditions. These features would need to be included in the grant date fair value for transactions with employees and others providing similar services; they would not impact the number of awards expected to vest or valuation thereof subsequent to grant date. All cancellations, whether by the entity or by other parties, should receive the same accounting treatment. The amendment does not have any material impact on the Group's consolidated financial statements.  
IFRS/HKFRS 7 (amendment) Financial instruments Disclosures (effective from January 1, 2009). The amendment requires enhanced disclosures about fair value measurement and liquidity risk. In particular, the amendment requires disclosure of fair value measurements by level of a fair value measurement hierarchy. As the change in accounting policy only results in additional disclosures, there is no impact on net income and earnings per share. Please refer to Note 3 for details.  
IFRS/HKFRS 8, Operating segments (effective from January 1, 2009). IFRS/HKFRS 8 replaces IAS/HKAS 14, Segment reporting. The new standard requires a management approach, under which segment information is presented on the same basis as that used for internal reporting purposes.

The adoption of IFRS/HKFRS 8, the completion of 2009 Business Combination and the launch of the WCDMA mobile business in 2009 have not resulted in changes in the number of reportable segments presented and operating segments are reported in a manner consistent with the internal reporting provided to the chief operating decision maker ( CODM ). The CODM has been identified as the Board of Directors. Starting from 2009, the CODM evaluates results of each operating segment based on revenue and costs that are directly attributable to the operating segment. Other statement of income items such as employee benefit expenses, interest income, income tax expenses, finance costs and other income, which cannot be directly identified to specific operating segments, are presented as unallocated amounts. The 2007 and 2008 comparative financial information has been restated to conform to current year's presentation. Please refer to Note 5 for details.

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**2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)**

2.2 Basis of Preparation (Continued)

**(g) New Accounting Standards, Amendments and Interpretations Pronouncements (Continued)**

(ii) The following new and amended IFRSs/HKFRSs are adopted by the Group as of January 1, 2009 (Continued)

IAS/HKAS 1 (revised) Presentation of financial statements (effective from January 1, 2009). The revised standard prohibits the presentation of items of income and expenses (that is, non-owner changes in equity ) in the statement of changes in equity, requiring non-owner changes in equity to be presented separately from owner changes in equity in a statement of comprehensive income. As a result, the Group presents in the consolidated statement of changes in equity all owner changes in equity, whereas all non-owner changes in equity are presented in the consolidated statement of comprehensive income. Comparative information has been re-presented so that it is also in conformity with the revised standard. Since the change in accounting policy only impacts presentation aspects, there is no impact on the net income and earnings per share.

IAS/HKAS 23 (Revised), Borrowing costs (effective from January 1, 2009). The amendment requires an entity to capitalize borrowing costs directly attributable to the acquisition, construction or production of a qualifying asset (one that takes a substantial period of time to get ready for use or sale) as part of the cost of that asset. The option of immediately expensing those borrowing costs is removed. As the Group had previously capitalized borrowing costs directly attributable to the acquisition, construction or production of a qualifying asset, the adoption of IAS/HKAS 23 (revised) does not have any impact on the Group's consolidated financial statements.

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**2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)**

2.2 Basis of Preparation (Continued)

**(g) New Accounting Standards, Amendments and Interpretations Pronouncements (Continued)**

- (ii) The following new and amended IFRSs/HKFRSs are adopted by the Group as of January 1, 2009 (Continued)

IASB's annual improvement project published in May 2008/HKICPA's improvements to HKFRS published in October 2008

IAS/HKAS 1 (Amendment), Presentation of financial statements (effective from January 1, 2009). The amendment clarifies that some rather than all financial assets and liabilities

classified as held for trading in accordance with IAS/HKAS 39, Financial instruments: Recognition and measurement are examples of current assets and liabilities respectively.

IAS/HKAS 23 (Amendment), Borrowing costs (effective from January 1, 2009). The definition of borrowing costs has been amended so that interest expense is calculated using the effective interest method defined in IAS/HKAS 39 Financial instruments: Recognition and measurement. This eliminates the inconsistency of terms between IAS/HKAS 39 and IAS/HKAS 23.

There are a number of amendments to IFRS/HKFRS 7, Financial instruments: Disclosures, IAS/HKAS 8, Accounting policies, changes in accounting estimates and errors, IAS/HKAS 10, Events after the balance sheet date, IAS/HKAS 18, Revenue, IAS/HKAS 19, Employee benefits, IAS/HKAS 27, Consolidated and separate financial statements, IAS/HKAS 34,

Interim financial reporting, IAS/HKAS 36, Impairment of assets and IAS/HKAS 40,

Investment property which are not addressed in details as the amendments are not relevant to the Group's operations and consolidated financial statements.

The adoption of the IASB's/HKICPA's improvements does not have a material impact on the Group's consolidated financial statements.

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**Table of Contents****2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)**

## 2.2 Basis of Preparation (Continued)

**(g) New Accounting Standards, Amendments and Interpretations Pronouncements (Continued)**

(iii) Standards, amendments and interpretations to existing standards that are not yet effective and have not been early adopted by the Group

IFRS/HKFRS 2 (amendments), Group cash-settled share-based payment transactions (effective from January 1, 2010). In addition to incorporating IFRIC/HK(IFRIC)-Int 8, Scope of IFRS/HKFRS 2, and IFRIC/HK(IFRIC)-Int 11, IFRS/HKFRS 2 Group and treasury share transactions, the amendments expand on the guidance in IFRIC/HK(IFRIC)-Int 11 to address the classification of group arrangements that were not covered by the interpretations. IFRS/HKFRS 3 (revised), Business combinations (effective for annual periods beginning on or after July 1, 2009). The revised standard continues to apply the acquisition method to business combinations, with some significant changes. For example, all payments to purchase a business are to be recorded at fair value at the acquisition date, with contingent payments classified as debt subsequently re-measured through the statement of income. There is a choice on an acquisition-by-acquisition basis to measure the non-controlling interest in the acquiree either at fair value or at the non-controlling interest's proportionate share of the acquiree's identifiable net assets. All acquisition-related costs should be expensed.

IFRS/HKFRS 9 Financial instrument (effective from January 1, 2013). Under IFRS/HKFRS 9, financial assets are required to be classified into two measurement categories: those to be measured subsequently at fair value, and those to be measured subsequently at amortized cost. The decision is to be made at initial recognition. The classification depends on the entity's business model for managing its financial instruments and the contractual cash flow characteristics of the instrument. IAS/HKAS 27 (revised), Consolidated and separate financial statements (effective for annual periods beginning on or after July 1, 2009). The revised standard requires the effects of all transactions with non-controlling interest to be recorded in equity if there is no change in control and these transactions will no longer result in goodwill or gains and losses. The standard also specifies the accounting when control is lost. Any remaining interest in the entity is re-measured to fair value, and a gain or loss is recognized in income or loss.

There are a number of new interpretations including IFRIC/HK (IFRIC) 17 Distribution of non-cash assets to owners, IFRIC/HK (IFRIC) 18 Transfer of assets from customers and IFRIC/HK(IFRIC) 19 Extinguishing financial liabilities with equity instruments as well as the amendment to IFRIC/HK(IFRIC) 14 Prepayments of a minimum funding requirement which are not addressed in details as the interpretations and the amendment are not relevant to the Group's operation and consolidated financial statements.

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**2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)**

**2.2 Basis of Preparation (Continued)**

**New Accounting Standards, Amendments and Interpretations Pronouncements (Continued)**

(iii) Standards, amendments and interpretations to existing standards that are not yet effective and have not been early adopted by the Group (Continued)

IASB's annual improvement project published in April 2009/HKICPA's improvements to HKFRS published May 2009

IAS/HKAS 7 (Amendment), Cash flow statements (effective from January 1, 2010). The amendment requires that only expenditures that result in a recognized asset in the statement of financial position can be classified as investing activities.

IAS/HKAS 17 (Amendment), Leases (effective from January 1, 2010). The amendment deletes specific guidance regarding classification of leases of land, so as to eliminate inconsistency with the general guidance on lease classification. As a result, leases of land should be classified as either finance lease or operating lease using the general principles of IAS/HKAS 17.

IAS/HKAS 36 (Amendment), Impairment of assets (effective from January 1, 2010). The amendment clarifies that the largest cash-generating unit (or group of units) to which goodwill should be allocated for the purposes of impairment testing is an operating segment as defined by paragraph 5 of IFRS/HKFRS 8, Operating segments (that is, before the aggregation of segments with similar economic characteristics permitted by paragraph 12 of IFRS/HKFRS 8).

IAS/HKAS 38 (Amendment), Intangible assets (effective for annual periods beginning on or after July 1, 2009). The amendment clarifies that the description of the valuation techniques commonly used to measure intangible assets acquired in a business combination when they are not traded in an active market. In addition, an intangible asset acquired in a business combination might be separable but only together with a related contract, identifiable asset or liability. In such cases, the intangible asset is recognized separately from goodwill but together with the related item.

There are a number of amendments to IFRS/HKFRS 5, Non-current assets held for sale and discontinued operations, IFRS /HKFRS 8, Operating segments, IAS/HKAS 1, Presentation of financial statements and IAS/HKAS 18, Revenue which are not addressed in details as the amendments are not relevant to the Group's operation and consolidated financial statements.

In addition, improvements to IFRS/HKFRS 2010 were issued in May 2010. There are a number of amendments to IFRS/HKFRS 3 Business combinations, IFRS/HKFRS 7 Financial instruments: disclosures, IAS/HKAS 1 Presentation of financial statements, IAS/HKAS 34 Interim financial reporting and IFRIC/(HK)IFRIC 13 Customer loyalty programmes. The effective dates vary standard by standard but most are effective from January 1, 2011. The Group is currently evaluating the impact of adopting the above standards, amendments and interpretations on the Group's consolidated financial statements.

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**2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)**

**2.3 Consolidation**

The consolidated financial statements include the financial statements of the Company and all of its subsidiaries made up to December 31.

**(a) Subsidiaries**

Subsidiaries are all entities (including special purpose entities) over which the Group has the power to govern the financial and operating policies generally accompanying a shareholding of more than one half of the voting rights. The existence and effect of potential voting rights that are currently exercisable or convertible are considered when assessing whether the Group controls another entity.

Subsidiaries are fully consolidated from the date on which control is transferred to the Group. They are de-consolidated from the date that control ceases. Upon the disposal of subsidiaries, the difference between the consideration received and receivable and the book value of net assets disposed of is recorded as gain/loss on disposal in the consolidated statement of income in the year of disposal.

The Group has acquired the equity interests of certain subsidiaries prior to 2005 (refer to Note 8 for details). Prior to the adoption of HKFRSs in 2005, the Group accounted for the acquisition of subsidiaries under common control in accordance with the original HK SSAP 27 Accounting for Group Reconstructions ( HK SSAP 27 ) under the previous accounting principles generally accepted in Hong Kong and the requirement of the Hong Kong Companies Ordinance. Since the criteria for applying merger accounting under HK SSAP 27 was not satisfied, the purchase method of accounting was used to account for the acquisitions of those subsidiaries (including common control transactions) by the Group prior to 2005.

Under the purchase method of accounting, the cost of an acquisition is measured at 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. Identifiable assets acquired and liabilities and contingent liabilities assumed are measured initially at their fair values at the acquisition date, irrespective of the extent of any minority interest. The excess of the cost of acquisition over the fair value of the Group's share of the identifiable net assets acquired is recorded as goodwill. If the cost of acquisition is less than the fair value of the Group's share of the identifiable net assets of the subsidiary acquired, the difference is recognized directly in the statement of income.

Upon the adoption of HKFRSs in 2005, merger accounting is used by the Group to account for the business combination of entities and businesses under common control in accordance with AG 5 issued by the HKICPA. The results of operations and financial position of such entities or businesses at carrying value are included in the consolidated financial statements as if the businesses were always part of the Group from the beginning of the earliest period presented or since the date when the combining entities or businesses first came under common control, where this is a shorter period, regardless of the date of the common control combination.

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**2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)**

2.3 Consolidation (Continued)

(a) Subsidiaries (Continued)

Upon the adoption of IFRSs in 2008, the Group has elected not to apply IFRS 3 Business Combination retrospectively to past business combination that occurred prior to January 1, 2005. In addition, the Group adopted the accounting policy to account for business combination of entities and businesses under common control using the predecessor values method which is consistent with HKFRS.

Inter-company transactions, balances and unrealized gains on transactions between group companies are eliminated. Unrealized losses are also eliminated unless the transaction provides evidence of an impairment of the asset transferred. Accounting policies of subsidiaries would be changed where necessary in the consolidated financial statements to ensure consistency with the policies adopted by the Group.

(b) Minority interests

Minority interests at the balance sheet date, being the portion of the net assets of subsidiaries attributable to interests that are not owned by the Company, whether directly or indirectly through subsidiaries, are presented in the consolidated balance sheets and statements of changes in equity within equity, separately from equity attributable to the equity holders of the Company. Minority interests in the results of the Group are presented on the face of the consolidated statement of incomes as an allocation of the total income or loss for the year between minority shareholders and the equity holders of the Company.

Where losses applicable to the minority exceed the minority's interest in the equity of a subsidiary, the excess, and any further losses applicable to the minority, are charged against the Group's interest except to the extent that the minority has a binding obligation to, and is able to, make additional investment to cover the losses. If the subsidiary subsequently reports income, the Group's interest is allocated all such income until the minority's share of losses previously absorbed by the Group has been recovered.

The Group applies a policy of treating transactions with minority interests as transactions with parties external to the Group. Disposals to minority interests that result in gains or losses for the Group are recorded in the consolidated financial statements. Purchases from minority interests result in goodwill, being the difference of any consideration paid and the relevant share of the carrying value of the net assets of the subsidiary acquired.

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**2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)**

**2.4 Segment Reporting**

Operating segments are reported in a manner consistent with the internal reporting provided to the chief operating decision-maker. The chief operating decision-maker, who is responsible for allocating resources and assessing performance of the operating segments regularly, has been identified as the Board of Directors that makes strategic decisions.

**2.5 Foreign Currency Translation**

**(a) Functional and presentation currency**

Items included in the financial statements of each of the Group's entities are measured using the currency of the primary economic environment in which the entities operate (the functional currency). The consolidated financial statements are presented in RMB, which is the Company's functional and presentation currency.

**(b) Transactions and balances**

Foreign currency transactions are translated into the functional currency using the exchange rates prevailing at the dates of the transactions. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation at year-end exchange rates of monetary assets and liabilities denominated in foreign currencies are recognized in the statement of income.

**(c) Group companies**

The results and financial position of all the Group entities (none of which has the currency of a hyperinflationary economy) that have a functional currency different from the presentation currency are translated into the presentation currency as follows:

Assets and liabilities for each balance sheet presented are translated at the closing rate at the date of that balance sheet;

Income and expenses for each statement of income are translated at average exchange rates (unless this average is not a reasonable approximation of the cumulative effect of the rates prevailing on the transaction dates, in which case income and expenses are translated at the dates of the transactions); and

All resulting exchange differences are recognized as a separate component of equity into other reserve.

On consolidation, exchange differences arising from the translation of the net investment in foreign operations, and of borrowings and other currency instruments designated as hedges of such investments, are taken to shareholders' equity. When a foreign operation is sold, such exchange differences are recognized in the statement of income as part of the gain or loss on disposal.

For the convenience of the reader, the translation of RMB into United States dollars (US\$) has been made at the rate of RMB6.8259 to US\$1.00, the noon buying rate in New York city for cable transfer in RMB as certified for customs purposes by the Federal Reserve Bank of New York on December 31, 2009.

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**2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)**

**2.6 Property, Plant and Equipment**

**(a) Construction-in-progress**

Construction-in-progress ( CIP ) represents buildings, plant and equipment under construction and pending installation, and is stated at cost less accumulated impairment losses. Costs include construction and acquisition costs, and interest charges arising from borrowings used to finance the assets during the construction period. No provision for depreciation is made on construction-in-progress until such time as the assets are completed and ready for use. When the asset being constructed becomes available for use, the CIP is transferred to the appropriate category of property, plant and equipment.

**(b) Buildings**

Buildings held by the Group are stated at cost less accumulated depreciation and accumulated impairment losses, and are depreciated over their expected useful lives.

**(c) Other property, plant and equipment**

Other property, plant and equipment comprise telecommunications equipment, leasehold improvements, office furniture, fixtures, motor vehicles and others. The cost of an asset, except for those acquired in exchange for a non-monetary asset or assets, comprises its purchase price and any directly attributable costs of bringing the asset to its working condition and location for its intended use.

If an item of property, plant and equipment is acquired in exchange for another item of property, plant and equipment, the cost of such an item of property, plant and equipment is measured at fair value unless (i) the exchange transactions lacks commercial substance or (ii) the fair value of neither the asset received nor the asset given up is reliably measurable. If the acquired item is not measured at fair value, its cost is measured at the carrying amount of the asset given up.

Subsequent costs are included in the asset's carrying amount or recognized as a separate asset, as appropriate, only when it is probable at the time the costs are incurred that future economic benefits associated with the item will flow to the Group, and the cost of the item can be measured reliably. The carrying amount of the replaced part is derecognized. All other repairs and maintenance are charged to the statement of income during the financial period in which they are incurred.

Telecommunications equipment of the Mobile business are stated at cost less accumulated depreciation and accumulated impairment losses. All other property, plant and equipment are stated at revalued amounts less accumulated depreciation and accumulated impairment losses.

**Table of Contents****2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)**

## 2.6 Property, Plant and Equipment (Continued)

## (c) Other property, plant and equipment (Continued)

When an item of fixed asset is revalued, any accumulated depreciation at the date of the revaluation is restated proportionately together with the change in the gross carrying amount of the asset so that the carrying amount of the asset after revaluation equals its revalued amount. Increases in valuation are credited to the revaluation reserve. Decreases in valuation are first set off against any revaluation surplus on earlier valuations in respect of the same item and thereafter are debited to statement of income. Any subsequent increases are credited to the statement of income up to the amount previously debited. Each year the difference between depreciation based on the revalued carrying amount of the asset expensed in the statement of income and depreciation based on the asset's original cost is transferred from the revaluation reserve to retained profits.

Revaluations on fixed assets will be performed with sufficient regularity by independent valuers and in each of the intervening years, valuations are reviewed by directors of the Group. The revalued amount is the fair value at the date of revaluation.

## (d) Depreciation

Depreciation on property, plant and equipment is calculated using the straight-line method to allocate their costs or revalued amounts less their residual values over their estimated useful lives, as follows:

|   | Depreciable life | Residual rate |
|---|------------------|---------------|
| Buildings   | 10 - 30 years    | 3-5%          |
| Telecommunications equipment of Mobile business       | 5 - 10 years     | 3-5%          |
| Telecommunications equipment of Fixed-line business   | 5 - 10 years     | 3-5%          |
| Office furniture, fixtures, motor vehicles and others | 5 - 10 years     | 3-5%          |

Leasehold improvements are depreciated over the shorter of their estimated useful lives and the lease periods.

The assets' residual values and useful lives are reviewed, and adjusted if appropriate, at each balance sheet date.

An asset's carrying amount is written down immediately to its recoverable amount if the asset's carrying amount is greater than its estimated recoverable amount (Note 2.11).

## (e) Gain or loss on disposal of property, plant or equipment

Gains or losses on disposal of a property, plant or equipment are determined by comparing the net sales proceeds with the carrying amounts, and are recognized in the statement of income. When revalued assets are sold, the residual amounts included in the revaluation reserve are transferred to retained profits.

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**2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)**

**2.7 Goodwill**

Goodwill represents the excess of the cost of an acquisition over the fair value of the Group's share of the net identifiable assets of the acquired subsidiaries at the date of acquisition. Goodwill is tested annually for impairment and carried at cost less accumulated impairment losses. Impairment losses on goodwill are not reversed. Gain or loss on the disposal of an entity includes the carrying amount of goodwill relating to the entity sold.

Goodwill is allocated to cash-generating units for the purpose of impairment testing. The allocation is made to those cash-generating units or groups of cash-generating units that are expected to benefit from the business combination in which the goodwill arose.

**2.8 Lease Prepayments**

Lease prepayments represent payments for land use rights. Lease prepayments for land use rights are stated at cost initially and expensed on a straight line basis over the lease period.

**2.9 Other Assets**

Other assets mainly represent (i) capitalized direct incremental costs for activating mobile subscribers; (ii) capitalized installation costs of fixed-line services; (iii) computer software and (iv) prepaid rental for premises and leased lines.

- (i) Capitalized direct incremental costs for activating mobile subscribers, including costs of SIM/USIM cards and commissions which are directly associated with upfront non-refundable revenue received upon activation of mobile services, are deferred and amortized over the expected customer service periods of 3 years except when the direct incremental costs exceed the corresponding upfront non-refundable revenue. In such cases, the excess of the direct incremental costs over the non-refundable revenue are recorded immediately as expenses in the statement of income.
- (ii) Capitalized installation costs of Fixed-line business are deferred and expensed to the statement of income over the expected customer service period of 10 years except when the direct incremental costs exceed the corresponding upfront installation fees. In such cases, the excess of the direct incremental costs over the installation fees are recorded immediately as expenses in the statement of income.
- (iii) Acquired computer software licenses are capitalized on the basis of the costs incurred to acquire and bring to use the specific software. These costs are amortized over their estimated useful lives on a straight-line basis.
- (iv) Long-term prepaid rental for premises and leased lines are amortized using a straight-line method over the lease period.

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**2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)**

2.10 Financial Assets

2.10.1 Classification

The Group classifies its financial assets in the following categories: loans and receivables and available-for-sale. The classification depends on the purpose for which the financial assets were acquired. Management determines the classification of its financial assets at initial recognition.

(a) Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. They are included in current assets, except for maturities greater than 12 months after the end of the reporting period. These are classified as non-current assets. The Group's loans and receivables comprise accounts receivable and other receivables, short-term bank deposits and cash and cash equivalents in the balance sheet (Note 2.14, 2.15 and 2.16).

(b) Available-for-sale financial assets

Available-for-sale financial assets are non-derivatives that are either designated in this category or not classified in any of the other categories. They are included in non-current assets unless the investment matures or management intends to dispose of it within 12 months of the end of the reporting period.



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**2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)**

2.10 Financial Assets (Continued)

2.10.2 Recognition and measurement

Available-for-sale financial assets are carried at fair value. Loans and receivables are recognized initially at fair value and subsequently carried at amortized cost using the effective interest method.

The translation differences on non-monetary securities are recognized in other comprehensive income/loss. Changes in the fair value of non-monetary securities classified as available-for-sale are recognized in other comprehensive income/loss until impairment.

When securities classified as available-for-sale are sold or impaired, the accumulated fair value adjustments recognized in equity are included in the statement of income as gains and losses from investment securities .

Interest on available-for-sale securities calculated using the effective interest method is recognized in the statement of income as part of other income. Dividends on available-for-sale equity instruments are recognized in the statement of income as part of other income when the right to receive payments is established.

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**2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)**

**2.11 Impairment of Non-Financial Assets**

Assets that have an indefinite useful life or are not yet available for use are not subject to amortization and are tested for impairment at each balance sheet date. Assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. An impairment loss is recognized for the amount by which the asset's carrying amount exceeds its recoverable amount. The recoverable amount is the higher of (i) an asset's fair value less costs to sell and (ii) value in use. For the purposes of assessing impairment, assets are grouped at the lowest levels for which there are separately identifiable cash flows (cash-generating units). Assets other than goodwill that suffered from impairment are reviewed for possible reversal of the impairment at each reporting date.

**2.12 Impairment of Financial Assets**

**(a) Accounts receivable and other receivables**

The Group assesses at the end of each reporting period whether there is objective evidence that accounts receivable and other receivable are impaired. A provision for impairment of accounts receivable and other receivables is established when there is objective evidence that the Group will not be able to collect all amounts due according to the original terms of the receivables. The amount of the provision is the difference between the assets' carrying amount and the present value of estimated future cash flows which is discounted at the original effective interest rate. The carrying amount of the assets is reduced through the use of a provision account, and the amount of the loss is recognized in the statement of income. When a receivable is proven to be uncollectible with sufficient evidence, it is written off against the provision account for receivables. Subsequent recoveries of amounts previously written off are credited in the statement of income.

**(b) Available-for-sale financial assets**

The Group assesses at the end of each reporting period whether there is objective evidence that available-for-sale financial assets are impaired. For equity investments classified as available-for-sale, a significant or prolonged decline in the fair value of the security below its cost is evidence that the assets are impaired. If any such evidence exists for available-for-sale financial assets, the cumulative loss measured as the difference between the acquisition cost and the current fair value, less any impairment loss on that financial asset previously recognized in income or loss, is removed from equity and recognized in the statement of income. Impairment losses recognized in the statement of income on equity instruments are not reversed.

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**2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)**

**2.13 Inventories and Consumables**

Inventories, which primarily comprise handsets, SIM/USIM cards and accessories, are stated at the lower of cost and net realizable value. Cost is based on the first-in-first-out method and comprises all costs of purchase and other costs incurred in bringing the inventories to their present location and condition. Net realizable value for all the inventories is determined on the basis of anticipated sales proceeds less estimated selling expenses.

Consumables consist of materials and supplies used in maintaining the Group's telecommunication networks and are charged to the statement of income when brought into use. Consumables are stated at cost less any provision for obsolescence.

**2.14 Accounts Receivable and Other Receivables**

Accounts receivable are amounts due from customers for services performed in the ordinary course of business. If collection of accounts receivable and other receivables is expected in one year or less (or in the normal operating cycle of the business if longer), they are classified as current assets. If not, they are presented as non-current assets.

**2.15 Short-term Bank Deposits**

Short-term bank deposits are cash invested in fixed-term deposits with original maturities ranging from more than 3 months to 1 year.

**2.16 Cash and Cash Equivalents**

Cash and cash equivalents include cash in hand, deposits held at call with banks and other short-term highly liquid investments with original maturities of 3 months or less.

**2.17 Convertible Bonds**

As the functional currency of the Company is RMB, the conversion of the convertible bonds denominated in Hong Kong Dollars would not result in settlement by the exchange of a fixed amount of cash in RMB, the functional currency of the Company, for a fixed number of the Company's shares. In accordance with the requirements of IAS/HKAS 39, *Financial Instruments - Recognition and Measurement*, the convertible bond contract must be separated into two component elements: a derivative component consisting of the conversion option and a liability component consisting of the straight debt element of the bonds.

On the issue of the convertible bonds, the fair value of the embedded conversion option was calculated using the Binomial model. The derivative component, the embedded conversion option, was carried at fair value on the balance sheet with any changes in fair value being charged or credited to the statement of income in the period when the change occurred. The remainder of the proceeds was allocated to the debt element of the bonds, net of transaction costs, and was recorded as the liability component. The liability component was subsequently carried at amortized cost until extinguished on conversion or redemption. Interest expense was calculated using the effective interest method by applying the effective interest rate to the liability component through the maturity date.

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**2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)**

**2.17 Convertible Bonds (Continued)**

When the convertible bonds were converted, the carrying amounts of the derivative and liability components were transferred to share capital and share premium as consideration for the shares issued. If the convertible bonds had been redeemed, any difference between the amount paid and the carrying amounts of both components would have been recognized in the statement of income.

**2.18 Deferred Revenue, Advances from Customers and Subscriber Point Rewards Program**

**(a) Deferred revenue**

Deferred revenue mainly represents upfront non-refundable revenue, including upfront connection fees and installation fees of fixed-line business and receipts from the activation of SIM/USIM cards relating to the Mobile business, which are deferred and recognized over the expected customer service period.

**(b) Advances from customers**

Advances from customers are amounts paid by customers for prepaid cards, other calling cards and prepaid service fees, which cover future telecommunications services (over a period of one to twelve months). Advances from customers are stated at the amount of proceeds received less the amount already recognized as revenues upon the rendering of services.

**(c) Subscriber point rewards program**

The fair value of providing telecommunications services and the subscriber points reward are allocated based on their relative fair values. The allocated portion of fair value for the subscriber points reward is recorded as deferred revenue when the rewards are granted and recognized as revenue when the points are redeemed or expired. The fair value of deferred revenue is estimated based on (i) the value of each bonus point awarded to subscribers, (ii) the number of bonus points related to subscribers who are qualified or expected to be qualified to exercise their redemption right at each balance sheet date, and (iii) the expected bonus points redemption rate. The fair value of the outstanding subscriber points reward is subject to review by management on a periodic basis.

**2.19 Borrowings**

Borrowings are recognized initially at fair value, net of transaction costs incurred. Borrowings are subsequently stated at amortized cost, any difference between the proceeds (net of transaction costs) and the redemption value is recognized in the statement of income over the period of the borrowings using the effective interest method.

Borrowings are classified as current liabilities unless the Group has an unconditional right to defer settlement of the liability for at least 12 months after the balance sheet date.

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**2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)**

**2.20 Share Capital**

Ordinary shares are classified as equity.

Incremental costs directly attributable to the issuance of new shares or options are shown in equity as a deduction, net of tax, from the proceeds.

Where any group company purchases the Company's equity share capital (treasury shares), the consideration paid, including any directly attributable incremental costs (net of tax) is deducted from equity attributable to the Company's equity holders and no gain or loss shall be recognized in the statement of income.

**2.21 Employee Benefits**

**(a) Retirement benefits**

The Group participates in defined contribution pension schemes. For defined contribution plans, the Group pays contributions to publicly or privately administered pension insurance plans on a mandatory, contractual or voluntary basis. The Group has no further payment obligations once the contributions have been paid. The contributions are recognized as employee benefit expenses when they are due. Prepaid contributions are recognized as an asset to the extent that a reduction in the future payments is available.

**(b) Early retirement benefits**

Early retirement benefits are recognized as expenses when the Group reaches agreement with the relevant employees for early retirement.

**(c) Housing benefits**

One-off cash housing subsidies paid to PRC employees are charged to the statement of income in the year in which it is determined that the payment of such subsidies is probable and the amounts can be reasonably estimated.

The Group's contributions to the housing fund, special monetary housing benefits and other housing benefits are expensed as incurred. The Group has no further payment obligations once the contributions have been paid.

**(d) Share-based compensation costs**

The Group operates an equity-settled, share-based compensation plan. The fair value of the employee services received in exchange for the grant of the share options is recognized as an expense. The total amount to be expensed over the vesting period is determined by reference to the fair value of the share options granted at the granted date excluding the impact of any non-market vesting conditions (for example, revenue and profit targets) and is not subsequently remeasured. However, non-market vesting conditions are considered in determining the number of options that are expected to vest. At each balance sheet date, the Group revises its estimates of the number of share options that are expected to vest. The Group recognizes the impact of the revision of original estimates, if any, in the statement of income of the period in which the revision occurs, with a corresponding adjustment to equity.

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**2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)**

**2.21 Employee Benefits (Continued)**

The proceeds received net of any directly attributable transaction costs are credited to share capital (nominal value) and share premium when the share options are exercised. The corresponding employee share-based compensation reserve is transferred to share premium.

In connection with the 2008 Business Combination (Note 1), the exchange of China Netcom's options to the Company's options was accounted for as a modification in accordance with IFRS/HKFRS 2 "Share-based payment" issued by the IASB/HKICPA (IFRS/HKFRS 2). The incremental fair value of the exchanged options measured before and after the modification is to be recognized as follows:

For vested options, the incremental share-based compensation costs are recognized in the statement of income immediately;

For non-vested options, the incremental share-based compensation costs are recognized in the statement of income over the remaining vesting period.

**2.22 Accounts Payable**

Accounts payable are obligations to pay for goods or services that have been acquired in the ordinary course of business from suppliers. Accounts payable are classified as current liabilities if payment is due within one year or less (or in the normal operating cycle of the business if longer). If not, they are presented as non-current liabilities.

Accounts payable are recognized initially at fair value and subsequently measured at amortized cost using the effective interest method.

**2.23 Provisions**

Provisions are recognized when the Group has present legal or constructive obligations as a result of past events, it is probable that an outflow of resources will be required to settle the obligation, and the amount has been reliably estimated. Where there are a number of similar obligations, the likelihood that an outflow will be required in settlement is determined by considering the class of obligations as a whole. A provision is recognized even if the likelihood of an outflow with respect to any one item included in the same class of obligations may be small.

Provisions are measured at the present value of the pre-tax amount of expenditures expected to be required to settle the obligation that reflects current market assessments of the time value of money and the risks specific to the obligation. The increase in the provision due to passage of time is recognized as interest expense.

**Table of Contents****2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)****2.24 Discontinued Operations**

A discontinued operation is a component of the Group that may be a major line of business or geographical area of operations that has been disposed of or is held for sale. The results and cash flows of that component are separately reported as discontinued operations in the statement of income and statement of cash flows, respectively. The difference between the consideration received and receivable and the book value of net assets disposed of is recorded as gain/loss on disposal in the consolidated statement of income in the year of disposal. The comparative statement of income and statement of cash flows are also reclassified as discontinued operations. The assets and liabilities of such component classified as held for sale is presented separately in assets and liabilities, respectively, of the consolidated balance sheet, from the date it is first determined to be discontinued operations or assets/liabilities held for sale, and are de-recognized upon the completion of the disposal.

**2.25 Revenue Recognition**

Revenue comprises the fair value of the consideration received or receivable for the services and sales of goods or telecommunications products in the ordinary course of the Group's activities. Revenue is shown net of business tax, government surcharges, returns and discounts and after eliminating sales within the Group.

The Group recognizes revenue when the amount of revenue can be reliably measured, it is probable that future economic benefits will flow to the entity and specific criteria have been met for each of the Group's activities as described below. The amount of revenue is not considered to be reliably measurable until all contingencies relating to the sale have been resolved. The Group bases its estimates on historical results, taking into consideration of the type of customer, the type of transaction and the specifics of each arrangement.

**(a) Sales of services and goods**

Usage fees and monthly fees are recognized when the service are rendered;

Revenues from the provision of broadband and other Internet-related services and managed data services are recognized when the services are provided to customers;

Revenue from telephone cards, which represents service fees received from customers for telephone services, is recognized when the related service is rendered upon actual usage of the telephone cards by customers;

Lease income from leasing of lines and customer-end equipment are treated as operating leases with rental income recognized on a straight-line basis over the lease term;

Value-added services revenue, which mainly represents revenue from the provision of services such as short message, cool ringtone, personalized ring, caller number display and secretarial services to subscribers, is recognized when service is rendered;

Standalone sales of telecommunications products, which mainly represent handsets and accessories, are recognized when title has been passed to the buyers;

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**2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)**

**2.25 Revenue Recognition (Continued)**

**(a) Sales of services and goods (Continued)**

For offerings which include the sale of mobile handset and provision of service, the amount of revenue allocated to the handset sale is determined using the residual value method. Under such method, the Group determines the revenue from the sale of the mobile handset by deducting the fair value of the service element from the total contract consideration. The Group recognizes revenues related to the sale of the handset when the title is passed to the customer whereas service revenues are recognized based upon the actual usage of mobile services. The cost of the mobile handset is expensed immediately to the statement of income.

Revenue from information communications technology services are recognized when goods are delivered to the customers (which generally coincides with the time when the customers have accepted the goods and the related risks and rewards of ownership have been transferred to the customers) or when services are rendered to the customers using the percentage of completion method when the outcome of the services provided can be estimated reliably. If the outcome of the services provided cannot be estimated reliably, the treatment should be as follows: (i) if it is probable that the costs incurred for the services provided is recoverable, services revenue should be recognized only to the extent of recoverable costs incurred, and costs should be recognized as current expenses in the period in which they are incurred; (ii) if it is probable that costs incurred will not be recoverable, costs should be recognized as current expenses immediately and services revenue should not be recognized.

**(b) Interest income**

Interest income from deposits in banks or other financial institutions is recognized on a time proportion basis, using the effective interest method.

**(c) Dividend income**

Dividend income is recognized when the right to receive payment is established.



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**2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)**

2.26 Leases (as the lessee)

(a) Operating lease

Leases in which a significant portion of the risks and rewards of ownership are retained by the lessor are classified as operating leases. Payments made under operating leases (net of any incentives received from the lessor), including long-term prepayment for land use rights, are expensed in the statement of income on a straight-line basis over the period of the lease.

(b) Finance lease

Leases of assets where the Group has substantially all the risks and rewards of ownership are classified as finance leases. Finance leases are capitalized at the commencement of the lease at the lower of the fair value of the leased property and the present value of the minimum lease payments. Each lease payment is allocated between the liability and finance charges so as to achieve a constant rate of interest on the liability balance outstanding. The corresponding liabilities, net of finance charges, are recorded as obligations under finance leases. The interest element implicit in the lease payment is recognized in the statement of income over the lease period so as to produce a constant periodic rate of interest on the remaining balance of the liability for each period.

2.27 Borrowing Costs

Borrowing costs are expensed as incurred, except for interest directly attributable to the acquisition, construction or production of an asset that necessarily takes a substantial period of time to get ready for its intended use, in which case they are capitalized as part of the cost of that asset. Capitalization of borrowing costs commences when expenditures for the asset and borrowing costs are being incurred and the activities to prepare the asset for its intended use are in progress. Borrowing costs are capitalized up to the date when the project is completed and ready for its intended use.

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**2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)**

**2.27 Borrowing Costs (Continued)**

To the extent that funds are borrowed specifically for the purpose of obtaining a qualifying asset, the amount of borrowing costs eligible for capitalization is determined at the actual borrowing costs incurred on that borrowing during the period less any investment income on the temporary investment of those borrowings.

To the extent that funds are borrowed generally and used for the purpose of obtaining a qualifying asset, the amount of borrowing costs eligible for capitalization is determined by applying a capitalization rate to the expenditures on that asset. The capitalization rate is the weighted average of the borrowing costs applicable to the borrowings of the Group that are outstanding during the period, other than borrowings made specifically for the purpose of obtaining a qualifying asset. The amount of borrowing costs capitalized during a period should not exceed the amount of borrowing cost incurred during that period. Other borrowing costs are recognized as expenses when incurred.

**2.28 Taxation**

**(a) Current income tax**

The current income tax charge is calculated on the basis of the tax laws enacted or substantially enacted at the balance sheet date in the countries where the Company and its subsidiaries operate and generate taxable income. Management periodically evaluates positions taken in tax returns with respect to situations in which applicable tax regulation is subject to interpretation and establishes provisions where appropriate on the basis of the amount expected to be paid to the tax authorities.

**(b) Deferred income tax**

Deferred income tax is provided in full, using the liability method, on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the consolidated financial statements. However, if the deferred income tax arises from initial recognition of an asset or liability in a transaction other than a business combination that at the time of the transaction affects neither accounting nor taxable income or loss, it is not accounted for. Deferred income tax is determined using tax rates (and laws) that have been enacted or substantially enacted by the balance sheet date and are expected to apply when the related deferred income tax asset is realized or the deferred income tax liability is settled.

Deferred income tax assets are recognized only to the extent that it is probable that future taxable profit will be available against which the temporary differences can be utilized.

Deferred income tax assets and liabilities are offset when there is a legally enforceable right to offset current tax assets against current tax liabilities and when the deferred income taxes assets and liabilities relate to income taxes levied by the same taxation authority on either the taxable entity or different taxable entities where there is an intention to settle the balances on a net basis.

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**2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)**

**2.29 Government Grant**

Government grants are recognized at their fair values where there is a reasonable assurance that the grant will be received and the Group will comply with all attached conditions. Grants relating to assets are included in non-current liabilities, which are credited to the statement of income on a straight-line basis over the expected lives of the related assets. Grants relating to costs are deferred and recognized in the statement of income over the period necessary to match them with the costs that they are intended to compensate.

**2.30 Dividend Distribution**

Dividend distribution to the Company's shareholders is recognized as a liability in the Company's financial statements in the period in which the dividends are approved by the Company's shareholders.

**2.31 Contingent Liabilities and Contingent Assets**

A contingent liability is a possible obligation that arises from past events and whose existence will only be confirmed by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the Group. It can also be a present obligation arising from past events that is not recognized because it is not probable that outflow of economic resources will be required or the amount of obligation cannot be measured reliably.

A contingent liability is not recognized but is disclosed in the notes to the financial statements. When a change in the probability of an outflow occurs so that outflow is probable, the liability will then be recognized as a provision.

A contingent asset is a possible asset that arises from past events and whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the Group.

Contingent assets are not recognized but are disclosed in the notes to the financial statements when an inflow of economic benefits is probable. When an inflow is virtually certain, an asset is recognized.

**2.32 Earnings per Share and per American Depositary Share ( ADS )**

Basic earnings per share is computed by dividing the profit attributable to equity holders by the weighted average number of ordinary shares outstanding during the year.

Diluted earnings per share is computed by dividing the profit attributable to equity holders by the weighted average number of ordinary shares, after adjusting for the effects of the dilutive potential ordinary shares.

Basic and diluted earnings per ADS are computed by multiplying earnings per share by 10, which is the number of shares represented by each ADS.

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**3. FINANCIAL RISK MANAGEMENT**

3.1 Financial risk factors

The Group's activities expose it to a variety of financial risks: market risk (including currency risk, price risk, cash flow interest rate risk and fair value interest rate risk), credit risk and liquidity risk. The Group's overall risk management program focuses on the unpredictability of financial markets and seeks to minimize potential adverse effects on the Group's financial performance.

Financial risk management is carried out by the Group's finance department at its headquarters, following the overall direction determined by the Board of Directors. The Group's finance department identifies and evaluates financial risks in close co-operation with the Group's operating units.

(a) Market risk

(i) Foreign exchange risk

The Group's major operational activities are carried out in Mainland China and a majority of the transactions are denominated in RMB. The Group is exposed to foreign exchange risk arising from various currency exposures, primarily with respect to US dollars, HK dollars and Euro. Exchange risk mainly exists with respect to the repayment of indebtedness to foreign lenders and payables to equipment suppliers and contractors.

The Group's finance department at its headquarters is responsible for monitoring the amount of monetary assets and liabilities denominated in foreign currencies. From time to time, the Group may consider entering into forward exchange contracts or currency swap contracts to mitigate the foreign exchange risk. During the year, the Group had not entered into any forward exchange contracts or currency swap contracts.

As of December 31, 2009 and 2008, the Group had cash and cash equivalents and short-term bank deposits denominated in foreign currencies amounting to RMB1,545 million and RMB1,315 million, respectively. As of December 31, 2009 and 2008, the Group had borrowings denominated in foreign currencies amounting to RMB11,730 million and RMB1,099 million, respectively.

As of December 31, 2009, if the RMB had strengthened/weakened by 10% against foreign currencies, primarily with respect to US dollars, HK dollars and Euro, while all other variables are held constant, the Group would have recognized additional exchange gains/losses of approximately RMB1,019 million (2008: exchange losses/gains of approximately RMB22 million) for cash and cash equivalents, short-term bank deposits and borrowings denominated in foreign currencies.

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**3. FINANCIAL RISK MANAGEMENT (Continued)**

3.1 Financial risk factors (Continued)

(a) Market risk (Continued)

(ii) Price risk

The Group is exposed to equity securities price risk because investments held by the Group are classified in the consolidated balance sheet as available-for-sale financial assets.

The available-for-sale financial assets comprise primarily equity securities of Telefónica. As of December 31, 2009, if the share price of Telefónica had increased/decreased by 10%, while all other variables are held constant, the Group would have reversed the recognized losses or recognized additional losses of approximately RMB584 million in available-for-sale fair value reserve.

(ii) Cash flow and fair value interest rate risk

The Group's interest-bearing assets are mainly represented by bank deposits, management does not expect the changes in market deposit interest rates will have significant impact on the financial statements as the deposits are all short-term in nature and the interest involved will not be significant.

The Group's interest rate risk arises from interest bearing borrowings including bank loans, corporate bonds, commercial paper and related party loan. Borrowings issued at floating rates expose the Group to cash flow interest rate risk. Borrowings issued at fixed rates expose the Group to fair value interest rate risk. The Group determines the amount of its fixed rate or floating rate borrowings depending on the prevailing market conditions. During 2009 and 2008, the Group's borrowings were mainly at fixed rates and were mainly denominated in RMB.

Increases in interest rates will increase the cost of new borrowing and the interest expense with respect to the Group's outstanding floating rate borrowings, and therefore could have a material adverse effect on the Group's financial position. Management continuously monitors the interest rate position of the Group and makes decisions with reference to the latest market conditions. From time to time, the Group may enter into interest rate swap agreements designed to mitigate its exposure to interest rate risks in connection with the floating rate borrowings, although the Group did not consider it was necessary to do so in 2009 and 2008.

As of December 31, 2009, the Group had approximately RMB62,925 million (2008: approximately RMB64,531 million) of bank loans, commercial paper, corporate bonds and related party loans at fixed rates and approximately RMB10,909 million (2008: approximately RMB1,114 million) of bank loans and related party loan at floating rates.

For the year ended December 31, 2009, if interest rates on the floating rate borrowings had been 10% higher/lower while all other variables are held constant, the interest expenses would have increased/decreased by approximately RMB3 million (2008: approximately RMB125 million).

**Table of Contents****3. FINANCIAL RISK MANAGEMENT (Continued)**

## 3.1 Financial risk factors (Continued)

## (b) Credit risk

Credit risk is managed on a group basis. Credit risk arises from cash and cash equivalents and short-term bank deposits with banks, as well as credit exposures to corporate customers, individual subscribers, related parties and other operators.

The table below shows the bank deposits and cash and cash equivalents balances held at the major banks by the Group as of December 31, 2008 and 2009:

|                              | <b>2008</b><br><b>(As restated)</b> | <b>2009</b> |
|------------------------------|-------------------------------------|-------------|
| Short-term bank deposits     |                                     |             |
| State-owned banks in the PRC | 337                                 | 861         |
| Other banks                  |                                     | 135         |
|                              | 337                                 | 996         |
| Cash and cash equivalents    |                                     |             |
| State-owned banks in the PRC | 9,671                               | 7,485       |
| Other banks                  | 566                                 | 335         |
|                              | 10,237                              | 7,820       |

The Group expects that there is no significant credit risk associated with the bank deposits and cash and cash equivalents since the state-owned banks have support from the government and other banks are medium or large size listed banks. Management does not expect that there will be any significant losses from non-performance by these counterparties.

In addition, the Group has no significant concentrations of credit risk with respect to corporate customers and individual subscribers. The extent of the Group's credit exposure is mainly represented by the fair value of accounts receivable for services. The Group has policies to limit the credit exposure on accounts receivable for services. The Group assesses the credit quality of and sets credit limits on all its customers by taking into account their financial position, the availability of guarantee from third parties, their credit history and other factors such as current market conditions. The normal credit period granted by the Group is on average between 30 days to 90 days from the date of billing. The utilization of credit limits and the settlement pattern of the customers are regularly monitored by the Group.

Credit risk relating to amounts due from related parties and other operators is not considered to be significant as these companies are reputable and their receivables are settled on a regular basis.

## (c) Liquidity risk

Prudent liquidity risk management includes maintaining sufficient cash and availability of funds including short-term bank loans, commercial paper and the issuance of bonds. Due to the dynamic nature of the underlying businesses, the Group's finance department at its headquarters maintains flexibility in funding through having adequate amount of cash and cash equivalents and utilizing

different sources of financing when necessary.

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**Table of Contents****3. FINANCIAL RISK MANAGEMENT (Continued)**

## 3.1 Financial risk factors (Continued)

## (c) Liquidity risk (Continued)

The following tables show the undiscounted balances of the financial liabilities (including interest expense) categorized by time period from the balance sheet date to the contractual maturity date.

|  | Less than 1<br>year | Between 1<br>and 2<br>years | Between 2<br>and 5<br>years | Over 5<br>years |
|--|---------------------|-----------------------------|-----------------------------|-----------------|
| <b>At December 31, 2008 (As restated)</b>                |                     |                             |                             |                 |
| Long-term bank loans                                     | 1,299               | 108                         | 315                         | 635             |
| Long-term loans due to ultimate holding company          | 1,016               | 35,652                      |                             |                 |
| Corporate bonds  | 355                 | 355                         | 6,064                       | 2,360           |
| Other obligations  | 3,012               | 400                         | 1,052                       | 924             |
| Accounts payable and accrued liabilities                 | 71,593              |                             |                             |                 |
| Amounts due to related parties                           | 1,658               |                             |                             |                 |
| Amounts due to domestic carriers                         | 956                 |                             |                             |                 |
| Payables in relation to disposal of the CDMA<br>business | 4,232               |                             |                             |                 |
| Commercial paper   | 10,447              |                             |                             |                 |
| Short-term bank loans                                    | 11,013              |                             |                             |                 |
|  | 105,581             | 36,515                      | 7,431                       | 3,919           |
| <b>At December 31, 2009</b>                              |                     |                             |                             |                 |
| Long-term bank loans                                     | 72                  | 62                          | 185                         | 562             |
| Corporate bonds  | 355                 | 355                         | 5,726                       | 2,229           |
| Other obligations  | 2,537               | 111                         | 18                          | 60              |
| Accounts payable and accrued liabilities                 | 101,551             |                             |                             |                 |
| Amounts due to related parties                           | 5,448               |                             |                             |                 |
| Amounts due to ultimate holding company                  | 308                 |                             |                             |                 |
| Amounts due to domestic carriers                         | 1,136               |                             |                             |                 |
| Payables in relation to disposal of the CDMA<br>business | 7                   |                             |                             |                 |
| Short-term bank loans                                    | 64,752              |                             |                             |                 |
|  | 176,166             | 528                         | 5,929                       | 2,851           |

Regarding the Group's use of the going concern basis for the preparation of its financial statements, please refer to Note 2.2(e) for details.



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**3. FINANCIAL RISK MANAGEMENT (Continued)**

**3.2 Capital risk management**

The Group's objectives when managing capital are:

To safeguard the Group's ability to continue as a going concern in order to provide returns for shareholders and benefits for other stakeholders.

To support the Group's stability and growth.

To provide capital for the purpose of strengthening the Group's risk management capability. In order to maintain or adjust the capital structure, the Group reviews and manages its capital structure actively and regularly to ensure optimal capital structure and shareholder returns, taking into account the future capital requirements of the Group and capital efficiency, prevailing and projected profitability, projected operating cash flows, projected capital expenditures and projected strategic investment opportunities.

The Group monitors capital on the basis of the debt-to-capitalization ratio. This ratio is calculated as interest bearing debts plus minority interest over interest bearing debts plus total equity. Interest bearing debts represent commercial paper, short-term bank loans, long-term bank loans, obligations under finance lease (included in other obligations), notes payables (included in accounts payable and accrued liabilities), certain amounts due to related parties and corporate bonds, as shown in the consolidated balance sheet. Total equity represents capital and reserves attributable to the Company's equity holders plus minority interest as shown in the consolidated balance sheet.

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**Table of Contents****3. FINANCIAL RISK MANAGEMENT (Continued)**

## 3.2 Capital risk management (Continued)

The Group's debt-to-capitalization ratios at December 31, 2008 and 2009 are as follows:

|   | <b>2008</b><br><b>(As restated)</b> | <b>2009</b> |
|---|-------------------------------------|-------------|
| Interest bearing debts:   |                                     |             |
| - Commercial paper  | 10,000                              |             |
| - Short-term bank loans   | 10,780                              | 63,909      |
| - Long-term bank loans  | 997                                 | 759         |
| - Long-term loans due to ultimate holding company                     | 35,652                              |             |
| - Obligation under finance lease included in other obligations        |                                     | 103         |
| - Amounts due to related parties                                      |                                     | 2,104       |
| - Notes payables included in accounts payable and accrued liabilities |                                     | 500         |
| - Corporate bonds   | 7,000                               | 7,000       |
| - Current portion of long-term bank loans                             | 1,216                               | 62          |
| - Current portion of obligation under finance lease                   |                                     | 26          |
|   | 65,645                              | 74,463      |
| Minority interest   | 2                                   | 2           |
| Interest bearing debts plus minority interest                         | 65,647                              | 74,465      |
| Total equity:   |                                     |             |
| - Capital and reserves attributable to the Company's equity holders   | 197,231                             | 206,465     |
| - Minority interest   | 2                                   | 2           |
|   | 197,233                             | 206,467     |
| Interest bearing debts plus total equity                              | 262,878                             | 280,930     |
| Debt-to-capitalization ratio  | 25.0%                               | 26.5%       |

**Table of Contents****3. FINANCIAL RISK MANAGEMENT (Continued)**

## 3.3 Fair value estimation

Effective from January 1, 2009, the Group adopted the amendment to IFRS/HKFRS 7 for financial instruments that are measured in the balance sheet at fair value, this requires disclosure of fair value measurements by level of the following fair value measurement hierarchy:

Quoted prices (unadjusted) in active markets for identical assets or liabilities (level 1).

Inputs other than quoted prices included within level 1 that are observable for the asset or liability, either directly (that is, as prices) or indirectly (that is, derived from prices) (level 2).

Inputs for the asset or liability that are not based on observable market data (that is, unobservable inputs) (level 3).

The following table presents the Group's assets that are measured at fair value at December 31, 2009:

|   | Level 1 | Level 2 | Level 3 | Total |
|---|---------|---------|---------|-------|
| Available-for-sale financial assets – Equity securities | 7,977   |         |         | 7,977 |

The fair value of financial instruments traded in active markets is based on quoted market prices at the balance sheet date. A market is regarded as active if quoted prices are readily and regularly available from an exchange, dealer, broker, industry group, pricing service, or regulatory agency, and those prices represent actual and regularly occurring market transactions on an arm's length basis. The quoted market price used for financial assets held by the Group is the current bid price. These instruments are included in level 1 and comprise primarily equity securities of Telefónica which are classified as available-for-sale.

During the year ended December 31, 2009, there were no transfers of financial instruments between Level 1 and Level 2 of the fair value hierarchy.

In addition, the estimate of fair value of the Company's options is determined by using valuation techniques. The Group selects an appropriate valuation method and makes assumptions with reference to market conditions existing at each valuation date. For details, please refer to Note 34.

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**4. CRITICAL ACCOUNTING ESTIMATES AND JUDGMENTS**

Estimates and judgments are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances.

**4.1 Critical accounting estimates and assumptions**

The Group makes estimates and assumptions concerning the future. The resulting accounting estimates may not be equal to the related actual results. The estimates and assumptions that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year are discussed below.

**(a) Depreciation on property, plant and equipment**

Depreciation on the Group's property, plant and equipment is calculated using the straight-line method to allocate cost or revalued amounts up to residual values over the estimated useful lives of the assets. The Group reviews the useful lives and residual values periodically to ensure that the method and rates of depreciation are consistent with the expected pattern of realization of economic benefits from property, plant and equipment. The Group estimates the useful lives of property, plant and equipment based on historical experience, taking into account anticipated technological changes. If there are significant changes from previously estimated useful lives, the amount of depreciation expenses may change.

**(b) Revaluation of property, plant and equipment**

Property, plant and equipment other than buildings and telecommunications equipment of the Mobile business (Note 2.6 (c)) is carried at revalued amounts, being the fair value at the date of revaluation, less subsequent accumulated depreciation and accumulated impairment losses. Such equipment is revalued on a depreciated replacement cost or open market value approach, as appropriate, by an independent valuer on a regular basis.

During the intervals of independent revaluations, management performs the analysis and assessment annually to determine whether the fair value of property, plant and equipment carried at revalued amounts are materially different from their carrying amount. If the revalued amounts differ significantly from the carrying amounts of such property, plant and equipment in the future, the carrying amounts will be adjusted to the revalued amounts. The key assumptions made to determine the revalued amounts include the estimated replacement costs and the estimated useful lives of the property, plant and equipment. This will have an impact on the Group's future results, since any subsequent decreases in valuation are first set off against increases on earlier valuations in respect of the same item and thereafter are charged as an expense to the statement of income and any subsequent increases are credited as income to the statement of income up to the amount previously charged to the statement of income and thereafter are credited to equity. In addition, the depreciation expenses in future periods will change as the carrying amounts of such property, plant and equipment change as a result of the revaluation.

Most of the Group's property, plant and equipment which are carried at revalued amounts were revalued as of December 31, 2006 by an independent valuation firm. The directors of the Company consider the fair values of these revalued property, plant and equipment were not materially different from their carrying values as of December 31, 2009.

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**4. CRITICAL ACCOUNTING ESTIMATES AND JUDGMENTS (Continued)**

4.1 Critical accounting estimates and assumptions (Continued)

(c) Impairment of non-current assets

The Group tests whether non-current assets have suffered from any impairment, in accordance with the accounting policy stated in Note 2.11. The recoverable amount of an asset is the higher of its fair value less costs to sell and its value in use. Management estimates value in use based on estimated discounted pre-tax future cash flows of the cash generating unit at the lowest level to which the asset belongs. If there is any significant change in management's assumptions, including discount rates or growth rates in the future cash flow projection, the estimated recoverable amounts of the non-current assets and the Group's results would be significantly affected. Such impairment losses are recognized in the statement of income, except where the asset is carried at valuation and the impairment loss does not exceed the revaluation surplus for that same asset, in which case the impairment loss is treated as a revaluation decrease and charged to the revaluation reserve. Accordingly, there will be an impact to the future results if there is a significant change in the recoverable amounts of the non-current assets.

Impairment loss on property, plant and equipment of RMB323 million, RMB12,494 million and nil was recognized for the years ended December 31, 2007, 2008 and 2009, respectively. For details, please refer to Note 6.

(d) Provision for doubtful debts

Accounts receivables are recognized initially at fair value and subsequently measured at amortized cost using the effective interest method, less provision for impairment. The Group evaluates specific accounts receivable where there are indications that the receivable may be doubtful or is not collectible. The Group records a provision based on its best estimates to reduce the receivable balance to the amount that is expected to be collected. For the remaining receivable balances as of each reporting date, the Group makes a provision based on observable data indicating that there is a measurable decrease in the estimated future cash flows from the remaining balances. The Group makes such estimates based on its past experience, historical collection patterns, subscribers' creditworthiness and collection trends. For general subscribers, the Group makes a full provision for receivables aged over 3 months, which is consistent with its credit policy with respect to the relevant subscribers.

The Group's estimates described above are based on past experience, historical collection patterns, subscribers' creditworthiness and collection trends. If circumstances change (e.g. due to factors including developments in the Group's business and the external market environment), the Group may need to re-evaluate its policies on doubtful debts, and make additional provisions in the future.

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**4. CRITICAL ACCOUNTING ESTIMATES AND JUDGMENTS (Continued)**

4.1 Critical accounting estimates and assumptions (Continued)

(e) Income tax and deferred taxation

The Group estimates its income tax provision and deferred taxation in accordance with the prevailing tax rules and regulations, taking into account any special approvals obtained from relevant tax authorities and any preferential tax treatment to which it is entitled in each location or jurisdiction in which the Group operates. There are many transactions and calculations for which the ultimate tax determination is uncertain during the ordinary course of business. The Group recognizes liabilities for anticipated tax audit issues based on estimates of whether additional taxes will be due. Where the final tax outcome of these matters is different from the amounts that were initially recorded, such differences will impact the income tax and deferred tax provisions in the period in which such determination is made.

For temporary differences which give rise to deferred tax assets, the Group has assessed the likelihood that the deferred tax assets could be recovered. Major deferred tax assets relate to impairment loss on property, plant and equipment, unrecognized revaluation surplus on property, plant and equipment under PRC tax regulations, and provision for doubtful debts. Due to the effects of these temporary differences on income tax, the Group has recorded deferred tax assets amounting to approximately RMB5,202 million as of December 31, 2009 (2008: approximately RMB5,334 million). Deferred tax assets are recognized based on the Group's estimates and assumptions that they will be recovered from taxable income arising from continuing operations in the foreseeable future.

The Group believes it has recorded adequate income tax provision and deferred taxes based on the prevailing tax rules and regulations and its current best estimates and assumptions. In the event that future tax rules and regulations or related circumstances change, adjustments to income tax and deferred taxation may be necessary which would impact the Group's results or financial position.

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**4. CRITICAL ACCOUNTING ESTIMATES AND JUDGMENTS (Continued)**

4.2 Critical judgments in applying the Group's accounting policies

(a) Recognition of upfront non-refundable revenue and direct incremental costs

The Group defers and amortizes upfront activation fees of SIM/USIM cards of the Mobile business over the expected customer service period of 3 years (2007: approximately 3 years; 2008: approximately 3 years). The related direct incremental costs of acquiring and activating mobile subscribers, including costs of SIM/USIM cards and commissions, are also capitalized and amortized over the same expected customer service period of 3 years.

The Group defers and amortizes upfront customer connection and installation fees of the Fixed-line business over the expected customer service period of 10 years (2007: approximately 10 years; 2008: approximately 10 years). The related direct incremental installation costs are deferred and amortized over the same expected customer service period of 10 years.

The Group only capitalizes costs to the extent that they will generate future economic benefits. The excess of the direct incremental costs over the corresponding upfront non-refundable revenue, if any, are expensed to the statement of income immediately.

The Group estimates the expected customer service period based on the historical customer retention experience and after factoring in the expected level of future competition, the risk of technological or functional obsolescence to the Group's services, technological innovation, and the expected changes in the regulatory and social environment. If the Group's estimate of the expected customer service period changes as a result of increased competition, changes in telecommunications technology or other factors, the amount and timing of recognition of the deferred revenues and direct incremental costs may change for future periods.

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**4. CRITICAL ACCOUNTING ESTIMATES AND JUDGMENTS (Continued)**

4.2 Critical judgments in applying the Group's accounting policies (Continued)

(b) 2009 Business Combination

The 2009 Business Combination was considered as a business combination of entities and business under common control, and has been accounted for using merger accounting under HKFRS, which is consistent with the predecessor values method under IFRS.

When applying the merger accounting/predecessor values method to restate the historical financial statements prior to the effective date of the 2009 Business Combination, the Group included all the assets and liabilities, revenue and expenses associated with the Acquired Business and the Telecommunications Networks in Southern China in the consolidated balance sheets and the consolidated statements of income throughout the periods presented, including those assets not acquired and liabilities not assumed as well as the related costs and expenses. Pursuant to the agreement dated December 16, 2008, the 2009 Business Combination excluded the Telecommunications Networks in Southern China, which are retained by Unicom New Horizon and are leased from Unicom New Horizon to CUCL effective from January 2009. To reflect the economic substance that the Group has not taken on the risks and rewards associated with the property, plant and equipment and related assets and liabilities relating to the Fixed-line business in Southern China, the Group is deemed to have disposed of the Excluded Assets and Liabilities and has recorded the deemed disposal of these assets and liabilities as a distribution from reserves by the Group to Unicom Group upon the completion of the 2009 Business Combination effective from January 2009.

As of December 31, 2008, the total assets and liabilities associated with the Telecommunications Networks in Southern China were approximately RMB31,566 million and RMB42,060 million, respectively (Note 2.2(b)), which have been included in the consolidated balance sheet as of December 31, 2008 and have been subsequently recorded as a distribution from reserves to Unicom Group in January 2009 upon the completion of 2009 Business Combination. In addition, the depreciation and amortization, impairment loss, other operating expenses, and finance costs associated with the Excluded Assets and Liabilities for the year ended December 31, 2008 were approximately RMB3,886 million, RMB657 million, RMB249 million, and RMB846 million, respectively (2007: approximately RMB3,650 million, RMB323 million, RMB171 million, and RMB499 million) (Note 2.2(b)).

Subsequent to the completion of the 2009 Business Combination, the Group recorded leasing fees amounting to approximately RMB2.0 billion charged by Unicom New Horizon for the lease of the Telecommunications Networks in Southern China for the year ended December 31, 2009 (2007:Nil; 2008:Nil) (Note 4.2(c)).



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**4. CRITICAL ACCOUNTING ESTIMATES AND JUDGMENTS (Continued)**

4.2 Critical judgments in applying the Group's accounting policies (Continued)

(c) Lease of Telecommunications Networks in Southern China

Pursuant to the Network Lease Agreement (Note 1(b)), Unicom New Horizon has the legal ownership of the Telecommunications Networks in Southern China. The Group believes it only bears the risks associated with the operation of the Fixed-line business in Southern China during the relevant leasing periods and is free from any ownership risks of the telecommunications networks, and the risks and rewards of ownership of the leased assets rest substantially with the lessor. Accordingly, the Group has accounted for the leasing of the aforementioned telecommunications networks as an operating lease.

(d) PRC tax resident enterprise

Pursuant to the PRC enterprise income tax law, a 10% withholding income tax is levied on dividends declared on or after January 1, 2008 by foreign investment enterprises to their foreign enterprise shareholders unless the enterprise investor is deemed as a PRC Tax Resident Enterprise ( TRE ). On April 22, 2009, the PRC State Administration of Taxation issued a notice regarding the determination of PRC TRE status and provided implementation guidance in withholding income tax for non-TRE enterprise shareholders. The Company performed an assessment and concluded that it meets the definition of PRC TRE. Therefore, as of December 31, 2008 and 2009, the Company's subsidiaries in the PRC did not accrue for withholding tax on dividends distributed to the Company and there has been no deferred tax liability accrued in the Group's consolidated financial statements for the undistributed income of the Company's subsidiaries in the PRC.

If the results of the Company's assessment change, the amount of current income tax and deferred income tax will change in future periods.

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**5. SEGMENT INFORMATION**

The CODM has been identified as the Board of Directors ( the BOD ) of the Company which regularly reviews the Group s internal reporting in order to assess performance and allocate resources; and determines the operating segments based on these reports. The BOD considers the business from the provision of services perspective instead of the geographic perspective. Accordingly, the Group s continuing operations comprise two operating segments based on the various types of telecommunications services, mainly provided to customers in Mainland China.

The major operating segments of the Group are classified as follows:

Continuing operations:

Mobile business the provision of GSM and WCDMA cellular and related services in all 31 provinces, municipalities and autonomous regions in Mainland China;

Fixed-line business the provision of fixed-line telecommunications and related services, domestic and international data and Internet related services, and domestic and international long distance and related services in all 31 provinces, municipalities and autonomous regions in Mainland China.

Discontinued operations:

CDMA business the provision of the CDMA telephone and related services, through a leasing arrangement for the CDMA network capacity from Unicom New Horizon. The CDMA business was disposed of in October 2008.

Starting from 2009, the CODM evaluates results of each operating segment based on revenue and costs that are directly attributable to the operating segments. The unallocated amounts primarily represent corporate and shared service expenses that are not directly allocated to one of the aforementioned operating segments. The unallocated amounts also included other statement of income items such as employee benefit expenses, interest income, income tax expenses, finance costs and other income, which cannot be directly identified to specific operating segments. Segment assets primarily comprise property, plant and equipment, other assets, inventories and receivables. Segment liabilities primarily comprise operating liabilities. The 2007 and 2008 comparative financial information has been restated to conform to current year s presentation.

Revenues between segments are carried out on terms comparable to those that prevail in arm s length transactions or at standards promulgated by relevant government authorities. Revenue from external customers reported to the CODM is measured in a manner consistent with that in the consolidated statement of income.

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**Table of Contents****5. SEGMENT INFORMATION (Continued)**

## 5.1 Operating Segments (Continued)

|   | 2007 (As restated) |                        |                       |                        |                   |                                   | Discontinued<br>operations<br>CDMA<br>business | Total    |
|---|--------------------|------------------------|-----------------------|------------------------|-------------------|-----------------------------------|--|----------|
|   | Mobile<br>business | Fixed-line<br>business | Continuing operations |                        | Reconciling items |                                   |  |          |
|   |                    |                        | Subtotal              | Unallocated<br>amounts | Eliminations      | Total<br>continuing<br>operations |  |          |
| Telecommunications<br>service revenue   | 62,236             | 91,093                 | 153,329               | 420                    |                   | 153,749                           | 25,943   | 179,692  |
| Information<br>communication<br>technology services<br>and other revenue                        | 187                | 4,782                  | 4,969                 | 228                    |                   | 5,197                             | 318  | 5,515    |
| Sales of<br>telecommunications<br>products  | 14                 | 980                    | 994                   |                        |                   | 994                               | 4,888  | 5,882    |
| Total revenue from<br>external customers  | 62,437             | 96,855                 | 159,292               | 648                    |                   | 159,940                           | 31,149   | 191,089  |
| Intersegment revenue  | 276                | 3,779                  | 4,055                 | 980                    | (5,035)           |                                   |  |          |
| Total revenue   | 62,713             | 100,634                | 163,347               | 1,628                  | (5,035)           | 159,940                           | 31,149   | 191,089  |
| Interconnection<br>charges  | (10,022)           | (6,152)                | (16,174)              |                        | 3,976             | (12,198)                          | (2,116)  | (14,314) |
| Depreciation and<br>amortization  | (18,843)           | (31,049)               | (49,892)              | (1,383)                |                   | (51,275)                          | (632)  | (51,907) |
| Networks, operations<br>and support expenses  | (2,905)            | (6,228)                | (9,133)               | (8,817)                | 73                | (17,877)                          | (10,203)                                       | (28,080) |
| Employee benefit<br>expenses  |                    |                        |                       | (19,549)               | 151               | (19,398)                          | (1,823)  | (21,221) |
| Other operating<br>expenses   | (6,779)            | (15,389)               | (22,168)              | (15,159)               | 803               | (36,524)                          | (15,227)                                       | (51,751) |
| Finance costs   |                    |                        |                       | (4,396)                | 656               | (3,740)                           | (15)   | (3,755)  |
| Interest income   |                    |                        |                       | 961                    | (656)             | 305                               | 15   | 320      |
| Impairment loss on<br>property, plant and<br>equipment  |                    | (323)                  | (323)                 |                        |                   | (323)                             |  | (323)    |
| Realized loss on<br>changes in fair value<br>of derivative<br>component of<br>convertible bonds |                    |                        |                       | (569)                  |                   | (569)                             |  | (569)    |
| Other income net  |                    |                        |                       | 5,102                  |                   | 5,102                             | 7  | 5,109    |

|   |         |        |         |          |      |         |       |         |
|---|---------|--------|---------|----------|------|---------|-------|---------|
| Segment<br>income/(loss) before<br>income tax         | 24,164  | 41,493 | 65,657  | (42,182) | (32) | 23,443  | 1,155 | 24,598  |
| Income tax expenses                                   |         |        |         |          |      | (7,175) | (499) | (7,674) |
| Net income  |         |        |         |          |      | 16,268  | 656   | 16,924  |
| Attributable to:<br>Equity holders of the<br>Company  |         |        |         |          |      | 16,268  | 656   | 16,924  |
| Minority interest                                     |         |        |         |          |      |         |       |         |
|   |         |        |         |          |      | 16,268  | 656   | 16,924  |
| Other information:<br>Provision for<br>doubtful debts | (1,258) | (994)  | (2,252) | (8)      |      | (2,260) | (395) | (2,655) |
| Capital expenditures<br>for segment assets<br>(a)     | 16,332  | 28,954 | 45,286  | 9,812    |      | 55,098  |       | 55,098  |

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**Table of Contents****5. SEGMENT INFORMATION (Continued)**

## 5.1 Operating Segments (Continued)

|   | 2008 (As restated)    |                     |          |                     |              |                             | Discontinued operations<br>(up to effective date of disposal)<br>CDMA business | Total    |
|---|-----------------------|---------------------|----------|---------------------|--------------|-----------------------------|--|----------|
|   | Continuing operations |                     |          | Reconciling items   |              | Total continuing operations |  |          |
|   | Mobile business       | Fixed-line business | Subtotal | Unallocated amounts | Eliminations |                             |  |          |
| Telecommunications service revenue                              | 64,240                | 88,254              | 152,494  | 337                 |              | 152,831                     | 18,951   | 171,782  |
| Information communication technology services and other revenue | 359                   | 4,339               | 4,698    | 364                 |              | 5,062                       | 92   | 5,154    |
| Sales of telecommunications products                            | 532                   | 1,362               | 1,894    | 5                   |              | 1,899                       | 3,253  | 5,152    |
| Total revenue from external customers                           | 65,131                | 93,955              | 159,086  | 706                 |              | 159,792                     | 22,296   | 182,088  |
| Intersegment revenue  | 265                   | 3,407               | 3,672    | 1,214               | (4,886)      |                             |  |          |
| Total revenue   | 65,396                | 97,362              | 162,758  | 1,920               | (4,886)      | 159,792                     | 22,296   | 182,088  |
| Interconnection charges   | (10,753)              | (5,776)             | (16,529) |                     | 3,491        | (13,038)                    | (1,661)  | (14,699) |
| Depreciation and amortization                                   | (18,551)              | (31,668)            | (50,219) | (1,628)             |              | (51,847)                    | (411)  | (52,258) |
| Networks, operations and support expenses                       | (2,279)               | (5,757)             | (8,036)  | (10,873)            | 173          | (18,736)                    | (7,777)  | (26,513) |
| Employee benefit expenses                                       |                       |                     |          | (20,967)            | 209          | (20,758)                    | (1,600)  | (22,358) |
| Other operating expenses  | (9,054)               | (14,150)            | (23,204) | (15,746)            | 953          | (37,997)                    | (8,966)  | (46,963) |
| Finance costs   |                       |                     |          | (3,983)             | 714          | (3,269)                     | (6)  | (3,275)  |
| Interest income   |                       |                     |          | 979                 | (714)        | 265                         | 10   | 275      |
| Impairment loss on property, plant and equipment                |                       | (12,494)            | (12,494) |                     |              | (12,494)                    |  | (12,494) |
| Other income net  |                       |                     |          | 2,141               |              | 2,141                       | 22   | 2,163    |
|   | 24,759                | 27,517              | 52,276   | (48,157)            | (60)         | 4,059                       | 1,907  | 5,966    |

|   |         |         |         |       |         |        |         |  |
|---|---------|---------|---------|-------|---------|--------|---------|--|
| Segment<br>income/(loss) before<br>income tax     |         |         |         |       |         |        |         |  |
| Income tax expenses                               |         |         |         |       | (1,828) | (469)  | (2,297) |  |
| Gain on disposal of<br>the CDMA business          |         |         |         |       |         | 26,135 | 26,135  |  |
| Net income  |         |         |         |       | 2,231   | 27,573 | 29,804  |  |
| Attributable to:                                  |         |         |         |       |         |        |         |  |
| Equity holders of the<br>Company                  |         |         |         |       | 2,232   | 27,572 | 29,804  |  |
| Minority interest                                 |         |         |         |       | (1)     | 1      |         |  |
|   |         |         |         |       | 2,231   | 27,573 | 29,804  |  |
| Other information:                                |         |         |         |       |         |        |         |  |
| Provision for<br>doubtful debts                   | (1,371) | (1,639) | (3,010) | (15)  | (3,025) | (383)  | (3,408) |  |
| Capital expenditures<br>for segment assets<br>(a) | 33,852  | 37,774  | 71,626  | 5,471 | 77,097  |        | 77,097  |  |

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**Table of Contents****5. SEGMENT INFORMATION (Continued)**

## 5.1 Operating Segments (Continued)

|  | Mobile<br>business | Fixed-line<br>business | 2009<br>Continuing operations |  | Total<br>continuing<br>operations |
|--|--------------------|------------------------|-------------------------------|--|-----------------------------------|
|  |                    |                        | Subtotal                      | Reconciling items<br>Unallocated<br>amounts Eliminations |                                   |
| Telecommunications service revenue   | 69,769             | 79,549                 | 149,318                       | 275  | 149,593                           |
| Information communication technology<br>services and other revenue           | 252                | 1,611                  | 1,863                         | 326  | 2,189                             |
| Sales of telecommunications products   | 1,970              | 193                    | 2,163                         |  | 2,163                             |
| Total revenue from external customers  | 71,991             | 81,353                 | 153,344                       | 601  | 153,945                           |
| Intersegment revenue   | 219                | 4,237                  | 4,456                         | 1,587  | (6,043)                           |
| Total revenue  | 72,210             | 85,590                 | 157,800                       | 2,188  | (6,043)                           |
| Interconnection charges  | (13,104)           | (4,292)                | (17,396)                      |  | 4,441                             |
| Depreciation and amortization  | (17,847)           | (28,264)               | (46,111)                      | (1,505)  | 29                                |
| Networks, operations and support expenses                                    | (2,496)            | (5,780)                | (8,276)                       | (13,471)   | 19                                |
| Leasing fee for telecommunications<br>networks in Southern China             |                    | (2,000)                | (2,000)                       |  |                                   |
| Employee benefit expenses  |                    |                        |                               | (22,104)   | 173                               |
| Other operating expenses   | (11,671)           | (8,783)                | (20,454)                      | (17,465)   | 1,196                             |
| Finance costs  |                    |                        |                               | (1,214)  | 178                               |
| Interest income  |                    |                        |                               | 269  | (178)                             |
| Realised gain on changes in fair value of<br>derivative financial instrument |                    |                        |                               | 1,239  |                                   |
| Other income net   |                    |                        |                               | 962  |                                   |
| Segment income/(loss) before income tax                                      | 27,092             | 36,471                 | 63,563                        | (51,101)   | (185)                             |
| Income tax expenses  |                    |                        |                               |  |                                   |
| Net income   |                    |                        |                               |  | 9,556                             |
| Attributable to:   |                    |                        |                               |  |                                   |
| Equity holders of the Company  |                    |                        |                               |  | 9,556                             |
| Minority interest  |                    |                        |                               |  |                                   |
|  |                    |                        |                               |  | 9,556                             |

Other information:

|   |         |        |         |       |         |
|---|---------|--------|---------|-------|---------|
| Provision for doubtful debts                | (1,494) | (858)  | (2,352) | (3)   | (2,355) |
| Capital expenditures for segment assets (a) | 56,984  | 46,494 | 103,478 | 8,996 | 112,474 |

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**Table of Contents****5. SEGMENT INFORMATION (Continued)**

## 5.1 Operating Segments

|                           | Mobile<br>business | Fixed-<br>line<br>business | December 31, 2008<br>(As restated) |                        |                                   | Total   |
|---------------------------|--------------------|----------------------------|------------------------------------|------------------------|-----------------------------------|---------|
|                           |                    |                            | Subtotal                           | Unallocated<br>amounts | Reconciling items<br>Eliminations |         |
| Total segment assets      | 130,041            | 215,693                    | 345,734                            | 35,071                 | (487)                             | 380,318 |
| Total segment liabilities | 53,496             | 76,544                     | 130,040                            | 53,390                 | (345)                             | 183,085 |

|                           | Mobile<br>business | Fixed-<br>line<br>business | December 31, 2009 |                        |                                   | Total   |
|---------------------------|--------------------|----------------------------|-------------------|------------------------|-----------------------------------|---------|
|                           |                    |                            | Subtotal          | Unallocated<br>amounts | Reconciling items<br>Eliminations |         |
| Total segment assets      | 170,577            | 213,172                    | 383,749           | 34,470                 | (1,174)                           | 417,045 |
| Total segment liabilities | 74,411             | 51,066                     | 125,477           | 85,948                 | (847)                             | 210,578 |

(a) Capital expenditures under unallocated amounts represent capital expenditures on common facilities, which benefit all operating segments.

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**Table of Contents****6. PROPERTY, PLANT AND EQUIPMENT**

The movement of property, plant and equipment for the years ended December 31, 2008 and 2009 is as follows:

|   | 2008 (As restated) |   |   |   |                        |                          | Total     |
|---|--------------------|---|---|---|------------------------|--------------------------|-----------|
|   | Buildings          | Telecommunications equipment of Mobile business | Telecommunications equipment of Fixed-line business | Office furniture, fixtures, motor vehicles and other improvements | Leasehold improvements | Construction-in-progress |           |
| Cost or valuation:                                      |                    |   |   |   |                        |                          |           |
| Beginning of year (As previously reported)              | 44,094             | 151,660   | 327,711   | 32,418  | 1,657                  | 18,966                   | 576,506   |
| 2009 Business Combination under common control (Note 1) | 2,400              |   | 29,705  | 8,591   | 284                    | 7,019                    | 47,999    |
| Beginning of year (As restated)                         | 46,494             | 151,660   | 357,416   | 41,009  | 1,941                  | 25,985                   | 624,505   |
| Additions   | 258                | 234   | 1,467   | 1,096   | 77                     | 73,965                   | 77,097    |
| Transfer from CIP                                       | 2,995              | 17,931  | 29,292  | 4,122   | 362                    | (54,702)                 |           |
| Disposals   | (510)              | (3,077)   | (6,084)   | (6,908)   | (399)                  | (230)                    | (17,208)  |
| Disposal of discontinued operations                     | (1,077)            | (3,469)   |   | (284)   | (6)                    | (23)                     | (4,859)   |
| End of year (As restated)                               | 48,160             | 163,279   | 382,091   | 39,035  | 1,975                  | 44,995                   | 679,535   |
| Representing:   |                    |   |   |   |                        |                          |           |
| At cost   | 48,160             | 163,279   |   |   |                        | 44,995                   | 256,434   |
| At valuation  |                    |   | 382,091   | 39,035  | 1,975                  |                          | 423,101   |
|   | 48,160             | 163,279   | 382,091   | 39,035  | 1,975                  | 44,995                   | 679,535   |
| Accumulated depreciation and impairment:                |                    |   |   |   |                        |                          |           |
|   | (11,809)           | (85,446)  | (184,801)   | (17,423)  | (893)                  | (24)                     | (300,396) |

|  |          |          |           |          |         |        |           |
|--|----------|----------|-----------|----------|---------|--------|-----------|
| Beginning of year<br>(As previously<br>reported)<br>2009 Business<br>Combination<br>under common<br>control (Note 1) | (472)    |          | (9,711)   | (7,309)  | (155)   | (42)   | (17,689)  |
| Beginning of year<br>(As restated)   | (12,281) | (85,446) | (194,512) | (24,732) | (1,048) | (66)   | (318,085) |
| Charge for the<br>year   | (1,740)  | (15,110) | (29,001)  | (4,534)  | (321)   |        | (50,706)  |
| Disposals  | 274      | 3,068    | 4,999     | 6,741    | 348     | 4      | 15,434    |
| Disposal of<br>discontinued<br>operations  | 190      | 1,546    |           | 126      |         |        | 1,862     |
| Impairment loss<br>for the year  | (4)      |          | (12,435)  | (7)      |         | (48)   | (12,494)  |
| End of year (As<br>restated)   | (13,561) | (95,942) | (230,949) | (22,406) | (1,021) | (110)  | (363,989) |
| Net book value:<br>End of year (As<br>restated)  | 34,599   | 67,337   | 151,142   | 16,629   | 954     | 44,885 | 315,546   |
| Beginning of year<br>(As restated)   | 34,213   | 66,214   | 162,904   | 16,277   | 893     | 25,919 | 306,420   |

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**Table of Contents****6. PROPERTY, PLANT AND EQUIPMENT (Continued)**

|   | <b>Buildings</b> | <b>Telecommunications equipment of Mobile business</b> | <b>Telecommunications equipment of Fixed-line business</b> | <b>2009 Office furniture, fixtures, motor vehicles and other improvements</b> | <b>Leasehold improvements</b> | <b>Construction-in-progress</b> | <b>Total</b> |
|---|------------------|--|--|---|-------------------------------|---------------------------------|--------------|
| Cost or valuation:                                      |                  |  |  |   |                               |                                 |              |
| Beginning of year<br>(As previously reported)           | 44,950           | 163,279  | 345,143  | 36,086  | 1,627                         | 40,783                          | 631,868      |
| 2009 Business Combination under common control (Note 1) | 3,210            |  | 36,948   | 2,949   | 348                           | 4,212                           | 47,667       |
| Beginning of year<br>(As restated)                      | 48,160           | 163,279  | 382,091  | 39,035  | 1,975                         | 44,995                          | 679,535      |
| Additions   | 644              | 430  | 1,518  | 503   | 208                           | 109,171                         | 112,474      |
| Transfer from CIP                                       | 3,329            | 54,031   | 24,565   | 3,674   | 271                           | (85,870)                        |              |
| Disposals   | (297)            | (10,817)   | (2,203)  | (957)   | (251)                         |                                 | (14,525)     |
| Effect of 2009 business combination                     | (2,472)          |  | (36,948)   | (841)   | (317)                         | (4,124)                         | (44,702)     |
| End of year   | 49,364           | 206,923  | 369,023  | 41,414  | 1,886                         | 64,172                          | 732,782      |
| Representing:   |                  |  |  |   |                               |                                 |              |
| At cost   | 49,364           | 206,923  |  |   |                               | 64,172                          | 320,459      |
| At valuation  |                  |  | 369,023  | 41,414  | 1,886                         |                                 | 412,323      |
|   | 49,364           | 206,923  | 369,023  | 41,414  | 1,886                         | 64,172                          | 732,782      |
| Accumulated depreciation and impairment:                |                  |  |  |   |                               |                                 |              |
| Beginning of year<br>(As previously reported)           | (13,019)         | (95,942)   | (217,482)  | (20,668)  | (813)                         | (32)                            | (347,956)    |

|   |          |          |           |          |         |        |           |
|---|----------|----------|-----------|----------|---------|--------|-----------|
| 2009 Business Combination under common control (Note 1) | (542)    |          | (13,467)  | (1,738)  | (208)   | (78)   | (16,033)  |
| Beginning of year (As restated)                         | (13,561) | (95,942) | (230,949) | (22,406) | (1,021) | (110)  | (363,989) |
| Charge for the year                                     | (1,859)  | (12,286) | (27,693)  | (4,077)  | (327)   |        | (46,242)  |
| Disposals   | 286      | 10,387   | 1,969     | 930      | 251     |        | 13,823    |
| Effect of 2009 business combination                     | 476      |          | 13,467    | 416      | 188     | 78     | 14,625    |
| Impairment transfer out                                 |          |          | 151       |          |         | 7      | 158       |
| End of year   | (14,658) | (97,841) | (243,055) | (25,137) | (909)   | (25)   | (381,625) |
| Net book value: End of year                             | 34,706   | 109,082  | 125,968   | 16,277   | 977     | 64,147 | 351,157   |
| Beginning of year (As restated)                         | 34,599   | 67,337   | 151,142   | 16,629   | 954     | 44,885 | 315,546   |

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**6. PROPERTY, PLANT AND EQUIPMENT (Continued)**

As of December 31, 2009, the net book value of all the revalued property, plant and equipment would have been approximately RMB149,960 million (2008: approximately RMB188,841 million) had they been stated at cost less accumulated depreciation and accumulated impairment losses.

As of December 31, 2009, the net book value of assets held under finance leases was approximately RMB128 million (2008: approximately RMB52 million).

For the year ended December 31, 2009, interest expense of approximately RMB806 million (2007: approximately RMB581 million; 2008: approximately RMB430 million) was capitalized to construction-in-progress. The capitalized borrowing rate represents the cost of capital for raising the related borrowings externally and varied from 4.27% to 4.80% for the year ended December 31, 2009 (2007: 3.60% to 5.80%; 2008: 3.51% to 6.80%).

For the year ended December 31, 2009, the Group recognized a gain on disposal of property, plant and equipment of approximately RMB79 million (2007: a loss of approximately RMB294 million; 2008: a loss of approximately RMB273 million).

After the completion of the merger with China Netcom (Note 1) in 2008, management reconsidered the Group's strategy regarding the PHS services business at the end of 2008 and expected to gradually phase out this operation over the subsequent 3 years. Accordingly, it was expected that the economic performance of PHS services business would deteriorate significantly. The test for impairment was conducted for the PHS services related equipment, after considering the expected significant decline in revenue and profitability in 2009 and onwards. The impaired PHS services related equipment was written down to their recoverable values, which was determined based on their estimated value in use. Estimated value in use was determined based on the present value of estimated future net cash flows expected to arise from the continuing use of the PHS services related equipment. In estimating the future net cash flows, the Group has made key assumptions and estimates on the appropriate discount rate of 15%, the period covered by the cash flow forecast of 3 years, the future loss of customers at an annual rate of decline ranging from 60% to 80%, and the decrease in average revenue per subscriber at an annual rate of decline of 15%.

These assumptions and estimates are made after considering the historical trends, the prevailing market trends, expected remaining life of the PHS services business and the physical conditions of the PHS services related equipment. Based on the above, the Group recognized an impairment loss on PHS services related equipment of approximately RMB11,837 million for the year ended December 31, 2008.

As of December 31, 2009, management updated the impairment analysis for the PHS services related equipment and concluded there was no need for additional recognition or reversal of the impairment provision on PHS services related equipment.

As of December 31, 2007 and 2008, the property, plant and equipment associated with the Telecommunications Networks in Southern China amounted to approximately RMB28,633 million and RMB30,077 million, respectively, which have been subsequently recorded as a distribution from reserves to Unicom Group in January 2009 upon the completion of 2009 Business Combination. For the year ended December 31, 2008, the depreciation expenses and impairment loss related to such property, plant and equipment amounted to approximately RMB3,678 million and RMB657 million, respectively (2007: RMB3,559 and RMB323 million, respectively), which have been recorded in the restated consolidated statement of income of the Company. For details, please refer to Note 2.2(b). Upon the commencement of leasing agreement, the Group will lease such Telecommunications Networks in Southern China and record the related leasing fees instead of depreciation

expenses.

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**Table of Contents****7. LEASE PREPAYMENTS**

The Group's long-term prepayment for land use rights represents prepaid operating lease payments for land use rights in Mainland China and their net book value is analyzed as follows:

|                                  | <b>2008</b><br>(As<br>restated) | <b>2009</b> |
|----------------------------------|---------------------------------|-------------|
| Held on:                         |                                 |             |
| Leases of between 10 to 50 years | 8,673                           | 7,653       |
| Leases of less than 10 years     | 65                              | 76          |
|                                  | 8,738                           | 7,729       |

For the year ended December 31, 2009, the long-term prepayment for land use rights expensed in the statement of income amounted to approximately RMB224 million (2007: approximately 284 million; 2008: approximately RMB253 million).

**8. GOODWILL**

|                           | <b>2008</b> | <b>2009</b> |
|---------------------------|-------------|-------------|
| Cost:                     |             |             |
| Beginning of year         | 3,144       | 2,771       |
| Disposal of CDMA business | (373)       |             |
| End of year               | 2,771       | 2,771       |

Goodwill arising from the acquisitions of Unicom New Century Telecommunications Co., Ltd. and Unicom New World Telecommunications Co., Ltd. by the Group in 2002 and 2003, respectively, represented the excess of the purchase consideration over the Group's shares of the fair values of the separately identifiable net assets acquired prior to the adoption of HKFRS and AG 5 in 2005 (refer to Note 2.3(a)).

Goodwill is allocated to the Group's cash-generating units (CGU). As of December 31, 2008 and 2009, all the carrying value of goodwill was attributable to the Mobile business. The recoverable amount of goodwill is determined based on value in use calculations. These calculations use pre-tax cash flow projections for 5 years based on financial budgets approved by management, including revenue annual growth rate of 6% and the applicable discount rate of 12%. Management determined expected operation results based on past performance and its expectations in relation to market developments. The expected growth rates used are consistent with the forecasts of the business segments. The discount rate used is pre-tax and reflects specific risks relating to the CGU. Based on management's assessment results, there was no impairment of goodwill as of December 31, 2008 and 2009 and no reasonable change to the assumptions would lead to an impairment.

Upon disposal of the CDMA business effective on October 1, 2008, goodwill of approximately RMB373 million attributable to the CDMA business arising from the above acquisitions was derecognized.



**Table of Contents****9. TAXATION**

Hong Kong income tax has been provided at the rate of 16.5% (2007: 17.5%; 2008: 16.5%) on the estimated assessable income for the year. Taxation on income from outside Hong Kong has been calculated on the estimated assessable income for the year at the rates of taxation prevailing in the countries in which the Group operates, the Company's subsidiaries mainly operated in the PRC and the applicable standard enterprise income tax rate is 25% (2007: 33%; 2008: 25%).

|  | <b>2007</b><br><b>(As</b><br><b>restated)</b> | <b>2008</b><br><b>(As</b><br><b>restated)</b> | <b>2009</b> |
|--|---|---|-------------|
| Provision for enterprise income tax on the estimated taxable income for the year |   |   |             |
| - Hong Kong  | 18  | 24  | 45          |
| - Outside Hong Kong  | 7,229   | 4,661   | 2,282       |
|  | 7,247   | 4,685   | 2,327       |
| Deferred taxation  | (72)  | (2,857)                                       | 394         |
| Income tax expense   | 7,175   | 1,828   | 2,721       |

Reconciliation between applicable statutory tax rate and the effective tax rate:

|   | <b>Note</b> | <b>2007</b><br><b>(As</b><br><b>restated)</b> | <b>2008</b><br><b>(As</b><br><b>restated)</b> | <b>2009</b> |
|---|-------------|---|---|-------------|
| Applicable PRC statutory tax rate   |             | 33.0%   | 25.0%   | 25.0%       |
| Non-deductible expenses   |             | 0.7%  | 5.2%  | 1.7%        |
| Tax effect of 2009 Business Combination   | (a)         | 5.2%  | 26.1%   |             |
| Non-taxable income  |             |   |   |             |
| - Upfront connection and installation fees arising from Fixed-line business         |             | (3.2%)  | (7.8%)  | (1.4%)      |
| - Tax refund on reinvestment in subsidiaries  |             | (5.6%)  |   |             |
| Impact of PRC preferential tax rates and tax holiday                                |             | (1.0%)  | (2.1%)  | (1.1%)      |
| Utilization of previously unrecognized tax losses                                   |             |   |   | (0.6%)      |
| Effect of change of tax rate under the new PRC enterprise income tax law            |             | 0.9%  |   |             |
| Realized loss on changes in fair value of derivative component of convertible bonds |             | 0.8%  |   |             |
| Others  |             | (0.2%)  | (1.4%)  | (1.4%)      |
| Effective tax rate  |             | 30.6%   | 45.0%   | 22.2%       |

- (a): The income tax of Fixed-line business in Southern China, local access telephone business in Tianjin Municipality and New Guoxin was reported on a consolidated basis with Netcom Group and Unicom Group prior to the 2009 Business Combination and no separate tax returns were prepared. No income tax expenses/benefits were therefore recorded for the Fixed-line Business in Southern China, local access telephone business in Tianjin Municipality and New Guoxin in 2008 or prior years in accounting for the Fixed-line business in Southern China, local access telephone business in Tianjin Municipality and New Guoxin using merger accounting/predecessor values method.

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**Table of Contents****9. TAXATION (Continued)**

The analysis of deferred tax assets and deferred tax liabilities are as follow:

|   | <b>2008</b><br>(As<br>restated) | <b>2009</b> |
|---|---------------------------------|-------------|
| Deferred tax assets:                                      |                                 |             |
| - Deferred tax asset to be recovered after 12 months      | 4,903                           | 3,254       |
| - Deferred tax asset to be recovered within 12 months     | 1,601                           | 2,913       |
|   | 6,504                           | 6,167       |
| Deferred tax liabilities:                                 |                                 |             |
| - Deferred tax liabilities to be settled after 12 months  | (931)                           | (699)       |
| - Deferred tax liabilities to be settled within 12 months | (239)                           | (266)       |
|   | (1,170)                         | (965)       |
| Net deferred tax assets after offsetting                  | 5,334                           | 5,202       |
| Deferred tax assets:                                      |                                 |             |
| - Deferred tax asset to be recovered after 12 months      | 16                              | 6           |
| - Deferred tax asset to be recovered within 12 months     | 10                              | 59          |
|   | 26                              | 65          |
| Deferred tax liabilities:                                 |                                 |             |
| - Deferred tax liabilities to be settled after 12 months  | (23)                            | (16)        |
| - Deferred tax liabilities to be settled within 12 months | (19)                            | (294)       |
|   | (42)                            | (310)       |
| Net deferred tax liabilities after offsetting             | (16)                            | (245)       |

There were no material unrecognized deferred tax assets as of December 31, 2008 and 2009.

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**Table of Contents****9. TAXATION (Continued)**

The movement of the net deferred tax assets/liabilities is as follows:

|  | <b>2007</b><br><b>(As</b><br><b>restated)</b> | <b>2008</b><br><b>(As</b><br><b>restated)</b> | <b>2009</b> |
|--|---|---|-------------|
| Net deferred tax assets after offsetting:                    |   |   |             |
| - Beginning of year  | 3,018   | 2,473   | 5,334       |
| - Deferred tax credited/(charged) to the statement of income |   |   |             |
| - Continuing operations                                      | 74  | 2,856   | (132)       |
| - Discontinued operations                                    | (28)  | (35)  |             |
| - Deferred tax (charged)/credited to equity                  | (591)   | 46  |             |
| - Disposal of discontinued operation                         |   | (6)   |             |
| <br>   |   |   |             |
| - End of year  | 2,473   | 5,334   | 5,202       |
| <br>   |   |   |             |
| Net deferred tax liabilities after offsetting:               |   |   |             |
| - Beginning of year  | (16)  | (18)  | (16)        |
| - Deferred tax (charged)/credited to the statement of income | (2)   | 1   | (262)       |
| - Deferred tax credited to equity                            |   | 1   | 33          |
| <br>   |   |   |             |
| - End of year  | (18)  | (16)  | (245)       |

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**Table of Contents****9. TAXATION (Continued)**

Deferred taxation as of year-end represents the taxation effect of the following temporary differences, taking into consideration the offsetting of balances related to the same tax authority:

|   | Note | 2008<br>(As<br>restated) | 2009  |
|---|------|--------------------------|-------|
| <b>Net deferred tax assets after offsetting:</b>  |      |                          |       |
| Deferred tax assets:  |      |                          |       |
| Provision for doubtful debts  |      | 789                      | 1,064 |
| Impairment loss on property, plant and equipment  | 6    | 2,924                    | 2,034 |
| Unrecognized revaluation surplus on property, plant and equipment under PRC regulations                 | i    | 1,991                    | 1,917 |
| Revaluation deficit on property, plant and equipment  | ii   | 170                      | 116   |
| Accruals of expenses not yet deductible for tax purpose   |      | 179                      | 418   |
| Deferral and amortisation of upfront non-refundable revenue   |      | 177                      | 142   |
| Deferred revenue on subscriber points reward program  |      | 43                       | 48    |
| Deferred revenue in relation to the provision of supporting services upon disposal of the CDMA business |      | 102                      | 32    |
| Accruals of retirement benefits   |      | 55                       | 25    |
| Unrealized profit for the inter-company transactions  |      | 43                       | 214   |
| Others  |      | 31                       | 157   |
|   |      | 6,504                    | 6,167 |
| Deferred tax liabilities:   |      |                          |       |
| Capitalization and amortization of direct incremental costs   |      | (124)                    | (108) |
| Capitalized interest already deducted for tax purpose   |      | (703)                    | (528) |
| Revaluation surplus on property, plant and equipment  | ii   | (343)                    | (299) |
| Others  |      |                          | (30)  |
|   |      | (1,170)                  | (965) |
|   |      | 5,334                    | 5,202 |
| <b>Net deferred tax liabilities after offsetting:</b>   |      |                          |       |
| Deferred tax assets:  |      |                          |       |
| Accumulated tax loss carried forward  |      |                          | 37    |
| Fair value losses on available-for-sale financial assets  |      |                          | 41    |
| Others  |      | 26                       | 28    |
|   |      | 26                       | 106   |

Deferred tax liabilities:

|   |      |       |
|---|------|-------|
| Realized gain on changes in fair value of derivative financial instrument |      | (310) |
| Fair value gains on available-for-sale financial assets                   | (15) | (23)  |
| Accelerated depreciation for tax purpose                                  | (27) | (18)  |
|   | (42) | (351) |
|   | (16) | (245) |

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**Table of Contents****9. TAXATION (Continued)**

- (i) Prior to the merger, the prepayments for the leasehold land and buildings held by China Netcom were revalued for PRC tax purposes as of December 31, 2003 and 2004. However, the resulting revaluations of the prepayments for the leasehold land and buildings were not recognized under IFRSs/HKFRSs. Accordingly, deferred tax assets were recorded by the Group under IFRSs/HKFRSs.
- (ii) The property, plant and equipment other than buildings and telecommunications equipment of Mobile business are carried at revalued amount under IFRSs/HKFRSs, which are not used for PRC tax reporting purposes. As a result, the Group recorded the deferred tax assets or liabilities arising from the revaluation deficit or surplus under IFRSs/HKFRSs.

**10. OTHER ASSETS**

|  | <b>2008<br/>(As<br/>restated)</b> | <b>2009</b> |
|--|-----------------------------------|-------------|
| Direct incremental costs for activating mobile subscribers | 499                               | 433         |
| Installation costs of Fixed-line business                  | 2,251                             | 1,732       |
| Prepaid rental for premises and leased lines               | 2,203                             | 3,454       |
| Purchased software   | 3,193                             | 3,954       |
| Others   | 1,339                             | 2,023       |
|  | 9,485                             | 11,596      |

**11. SUBSIDIARIES**

As of December 31, 2009, the details of the Company's subsidiaries are as follows:

| Name   | Place and date of incorporation and nature of legal entity | Percentage of equity interests held |          | Particulars of issued share capital | Principal activities and place of operation |
|--|--|-------------------------------------|----------|-------------------------------------|---|
|  |  | Direct                              | Indirect |                                     |   |
| China United Network Communications Corporation Limited (merged with CNC China on January 1, 2009) | The PRC, April 21, 2000, limited liability company         | 100%                                |          | RMB 138,091,677,828                 | Telecommunications operation in the PRC     |
| China Netcom Group Corporation (Hong Kong) Limited   | Hong Kong, October 22, 1999, limited company               | 100%                                |          | 6,699,197,200 shares, USD0.04 each  | Investment holding in Hong Kong             |

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**Table of Contents****11. SUBSIDIARIES (Continued)**

| Name   | Place and date of incorporation and nature of legal entity             | Percentage of equity interests held |          | Particulars of issued share capital | Principal activities and place of operation                            |
|--|--|-------------------------------------|----------|-------------------------------------|--|
|  |  | Direct                              | Indirect |                                     |  |
| Unicom New World (BVI) Limited   | British Virgin Islands ( BVI ), November 5, 2003, limited company      | 100%                                |          | 1,000 shares, HKD1 each             | Investment holding in BVI  |
| China Unicom (Hong Kong) Operations Limited (formerly known as China Unicom International Limited)   | Hong Kong, May 24, 2000, limited company                               | 100%                                |          | 60,100,000 shares, HKD1 each        | Telecommunications service in Hong Kong                                |
| China Netcom (Hong Kong) Operations Limited  | Hong Kong, May 2, 2001, limited company                                |                                     | 100%     | 1,000 shares, HKD1 each             | Telecommunications service in Hong Kong                                |
| China Unicom (Americas) Operations Limited (formerly known as China Unicom USA Corporation and merged with China Netcom (USA) Operations Limited on August 31, 2009) | The United States of America (the USA ), May 24, 2002, limited company | 100%                                |          | 5,000 shares, USD100 each           | Telecommunications service in USA                                      |
| China Unicom (Europe) Operations Limited   | United Kingdom, November 8, 2006, limited company                      | 100%                                |          | 4,861,000 shares, GBP1 each         | Telecommunications operation in the United Kingdom                     |
| China Unicom (Japan) Operations Corporation  | Japan, January 25, 2007, limited company                               | 100%                                |          | 1,000 shares, JPY366,000 each       | Telecommunications operation in Japan                                  |
| China Unicom (Singapore) Operations Pte Limited  | Singapore, August 5, 2009, limited company                             | 100%                                |          | 1 share, USD1 each                  | Telecommunications operation in Singapore (Business not yet commenced) |

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**Table of Contents****11. SUBSIDIARIES (Continued)**

| Name  | Place and date of incorporation and nature of legal entity | Percentage of equity interests held |          | Particulars of issued share capital | Principal activities and place of operation   |
|---|--|-------------------------------------|----------|-------------------------------------|---|
|   |  | Direct                              | Indirect |                                     |   |
| Billion Express Investments Limited   | British Virgin Islands, August 15, 2007, limited company   | 100%                                |          | 1 share, USD1 each                  | Investment holding in BVI   |
| China Unicom Limited  | Hong Kong, August 31, 2007, limited company                |                                     | 100%     | 2 shares, HKD1 each                 | Dormant   |
| Unicom Vsens Telecommunications Company Limited                                 | The PRC, August 19, 2008, limited liability company        |                                     | 100%     | RMB 500,000,000                     | Sales of handsets, telecommunication equipment and provision of technical services in the PRC     |
| China Unicom Mobile Network Company Limited                                     | The PRC, December 31, 2008, limited liability company      |                                     | 100%     | RMB 500,000,000                     | Construction and maintenance of the network in the PRC  |
| China Netcom Corporation International Limited                                  | Bermuda, October 15, 2002, limited company                 |                                     | 100%     | USD 12,000                          | Provision of investing service in Bermuda   |
| China Unicom System Integration Limited Corporation                             | The PRC, April 30, 2006, limited liability company         |                                     | 100%     | RMB 550,000,000                     | Provision of information communications technology services in the PRC                            |
| China Unicom Broadband Online Limited Corporation                               | The PRC, March 29, 2006, limited liability company         |                                     | 100%     | RMB 30,000,000                      | Provision of internet information services and value-added telecommunications services in the PRC |
| Beijing Telecommunications Planning and Designing Institute Corporation Limited | The PRC, June 1, 2007 limited liability company            |                                     | 100%     | RMB 264,227,115                     | Provision of telecommunications network construction, planning and                                |



**Table of Contents****11. SUBSIDIARIES (Continued)**

| Name  | Place and date of incorporation and nature of legal entity | Percentage of equity interests held |          | Particulars of issued share capital | Principal activities and place of operation   |
|---|--|-------------------------------------|----------|-------------------------------------|---|
|   |  | Direct                              | Indirect |                                     |   |
| Zhongrong Information Service Limited Corporation                             | The PRC, March 31, 2008 limited liability company          |                                     | 100%     | RMB 50,000,000                      | Provision of information consulting and technology development outsourcing services in the PRC  |
| China Information Technology Designing & Consulting Institute Company Limited | The PRC, September 27, 2008 limited liability company      |                                     | 100%     | RMB 60,000,000                      | Provision of consultancy, survey, design and contract services relating to information projects and construction projects in the telecommunications industry in the PRC |
| Unicom Xingye Science and Technology Trade Company Limited                    | The PRC, October 30, 2000, limited liability company       |                                     | 100%     | RMB 30,000,000                      | Provision of technical support, manufacturing, research and design services for SIM/USIM cards and other telecommunication cards in the PRC                             |
| New Guoxin Telecom Corporation of China Unicom                                | The PRC, September 17, 1998, limited liability company     |                                     | 100%     | RMB 6,825,087,800                   | Provision of customer services and hotline businesses in the PRC  |

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**Table of Contents****11. SUBSIDIARIES (Continued)**

| Name   | Place and date of incorporation and nature of legal entity | Percentage of equity interests held |          | Particulars of issued share capital | Principal activities and place of operation                          |
|--|--|-------------------------------------|----------|-------------------------------------|--|
|  |  | Direct                              | Indirect |                                     |  |
| Huaxia P&T Project Consultation and Management Company Limited     | The PRC, March 5, 1998, limited liability company          |                                     | 100%     | RMB<br>10,000,000                   | Provision of project consultation and management services in the PRC |
| Zhengzhou Kaicheng Industrial Company Limited                      | The PRC, December 21, 2005, limited liability company      |                                     | 100%     | RMB<br>2,200,000                    | Provision of property management services in the PRC                 |
| Zhengzhou Information and Design Technology Publication Company    | The PRC, February 17, 2003, limited liability company      |                                     | 100%     | RMB<br>300,000                      | Provision of magazine publishing services in the PRC                 |
| Beijing Tonghexing Telecommunications Technologies Company Limited | The PRC, December 28, 2000, limited liability company      |                                     | 51%      | RMB<br>7,000,000                    | Provision of technical support in the PRC                            |

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**Table of Contents****12. AVAILABLE-FOR-SALE FINANCIAL ASSETS**

|  | <b>Note</b> | <b>2008<br/>(As<br/>restated)</b> | <b>2009</b> |
|--|-------------|-----------------------------------|-------------|
| Equity securities issued by corporates |             | 95                                | 7,977       |
| Analyzed by place of listing:          |             |                                   |             |
| Listed in the PRC                      |             | 95                                | 188         |
| Listed outside the PRC                 | 32          |                                   | 7,789       |
|  |             | 95                                | 7,977       |

For the year ended December 31, 2009, losses on changes in fair value of available-for-sale financial assets amounted to approximately RMB71 million (2007: gains of approximately RMB246 million; 2008: losses of approximately RMB188 million). The losses, net of tax impact of approximately RMB33 million (2007: gains of approximately RMB81 million; 2008: losses of approximately RMB47 million) were recorded in the consolidated statement of comprehensive income.

**13. INVENTORIES AND CONSUMABLES**

|  | <b>2008<br/>(As<br/>restated)</b> | <b>2009</b> |
|--|-----------------------------------|-------------|
| Handsets and other customer end products | 329                               | 1,637       |
| Telephone cards                          | 317                               | 264         |
| Consumables                              | 457                               | 449         |
| Others                                   | 44                                | 62          |
|  | 1,147                             | 2,412       |

**Table of Contents****14. ACCOUNTS RECEIVABLE, NET**

|  | <b>2008</b><br><b>(As</b><br><b>restated)</b> | <b>2009</b> |
|--|---|-------------|
| Accounts receivable for Mobile business                | 3,100   | 3,850       |
| Accounts receivable for Fixed-line business            | 9,494   | 8,783       |
| Accounts receivable for other business                 | 209   | 262         |
| Sub-total  | 12,803  | 12,895      |
| Less: Provision for doubtful debts for Mobile business | (1,347)                                       | (1,874)     |
| Provision for doubtful debts for Fixed-line business   | (2,037)                                       | (2,115)     |
| Provision for doubtful debts for other business        | (78)  | (81)        |
|  | 9,341   | 8,825       |

The aging analysis of accounts receivable is as follows:

|                                     | <b>2008</b><br><b>(As</b><br><b>restated)</b> | <b>2009</b> |
|-------------------------------------|---|-------------|
| Within one month                    | 6,750   | 6,384       |
| More than one month to three months | 1,560   | 1,235       |
| More than three months to one year  | 2,944   | 2,936       |
| More than one year                  | 1,549   | 2,340       |
|                                     | 12,803  | 12,895      |

The normal credit period granted by the Group is on average between 30 days to 90 days from the date of billing. There is no significant concentration of credit risk with respect to customer receivables, as the Group has a large number of customers.

As of December 31, 2009, accounts receivable of approximately RMB2,441 million (2008: approximately RMB2,591 million) were past due but not impaired. These relate to customers for which there is no recent history of default. The aged analysis of these receivables was as follows:

|                                     | <b>2008</b><br><b>(As</b><br><b>restated)</b> | <b>2009</b> |
|-------------------------------------|---|-------------|
| More than one month to three months | 1,560   | 1,235       |
| More than three months to one year  | 736   | 882         |
| More than one year                  | 295   | 324         |



**Table of Contents****14. ACCOUNTS RECEIVABLE, NET (Continued)**

As of December 31, 2009, accounts receivable of approximately RMB4,070 million (2008: approximately RMB3,462 million) were impaired. The individually impaired receivables mainly relate to subscriber service fees. The aging of these receivables is as follows:

|                                    | <b>2008</b><br><b>(As</b><br><b>restated)</b> | <b>2009</b> |
|------------------------------------|---|-------------|
| More than three months to one year | 2,208   | 2,054       |
| More than one year                 | 1,254   | 2,016       |
|                                    | 3,462   | 4,070       |

Provision for doubtful debts is analyzed as follows:

|                                     | <b>2008</b><br><b>(As</b><br><b>restated)</b> | <b>2009</b> |
|-------------------------------------|---|-------------|
| Balance, beginning of year          | 3,206   | 3,462       |
| Provision for the year:             |   |             |
| -Continuing operations              | 3,016   | 2,334       |
| -Discontinued operations            | 383   |             |
| Written-off during the year         | (2,483)                                       | (1,726)     |
| Disposal of discontinued operations | (660)   |             |
| Balance, end of year                | 3,462   | 4,070       |

The creation and release of provisions for impaired receivables have been recognized in the statement of income. Amounts charged to the allowance account are generally written-off when there is reliable evidence to indicate no expectation of recovering additional cash.

The maximum exposure to credit risk at the reporting date is the carrying value of accounts receivable mentioned above. The Group does not hold any collateral as security.

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**Table of Contents****15. PREPAYMENTS AND OTHER CURRENT ASSETS**

|                          | <b>2008</b><br>(As<br>restated) | <b>2009</b> |
|--------------------------|---------------------------------|-------------|
| Prepaid rental           | 816                             | 845         |
| Deposits and prepayments | 857                             | 1,379       |
| Prepaid income taxes     |                                 | 1,060       |
| Advances to employees    | 241                             | 274         |
| Others                   | 962                             | 694         |
|                          | 2,876                           | 4,252       |

The aging analysis of prepayments and other current assets is as follows:

|                    | <b>2008</b><br>(As<br>restated) | <b>2009</b> |
|--------------------|---------------------------------|-------------|
| Within one year    | 2,522                           | 3,806       |
| More than one year | 354                             | 446         |
|                    | 2,876                           | 4,252       |

As of December 31, 2009, there was no impairment for the prepayments and other current assets.

**16. SHORT-TERM BANK DEPOSITS**

|  | <b>2008</b><br>(As<br>restated) | <b>2009</b> |
|--|---------------------------------|-------------|
| Bank deposits with maturity exceeding three months | 307                             | 970         |
| Restricted bank deposits                           | 30                              | 26          |
|  | 337                             | 996         |

As of December 31, 2009, restricted bank deposits primarily represented deposits that were subject to externally imposed restrictions as requested by a contractor in relation to construction payables owed to the contractor.

**Table of Contents****17. CASH AND CASH EQUIVALENTS**

|  | <b>2008</b> | <b>2009</b> |
|--|-------------|-------------|
| Cash at bank and in hand                                       | 9,720       | 7,210       |
| Bank deposits with original maturities of three months or less | 517         | 610         |
|  | 10,237      | 7,820       |

**18. SHARE CAPITAL**

|  | <b>2008<br/>HKD<br/>millions</b> | <b>2009<br/>HKD<br/>millions</b> |
|--|----------------------------------|----------------------------------|
| <b>Authorized:</b>                             |                                  |                                  |
| 30,000,000,000 ordinary shares of HKD0.10 each | 3,000                            | 3,000                            |

|   | <b>Number of<br/>shares<br/>millions</b> | <b>Ordinary<br/>shares ,<br/>par<br/>value of<br/>HKD0.1<br/>each<br/>HKD<br/>millions</b> | <b>Share<br/>capital</b> | <b>Share<br/>premium</b> | <b>Total</b> |
|---|--|--|--------------------------|--------------------------|--------------|
| <b>Issued and fully paid:</b>   |  |  |                          |                          |              |
| <b>At January 1, 2008</b>   | 13,635                                   | 1,363  | 1,437                    | 64,320                   | 65,757       |
| Issuance of shares upon exercise of options (Note 34)                           | 31                                       | 3  | 3                        | 252                      | 255          |
| Issuance of shares in connection with 2008 Business Combination (Note a)        | 10,102                                   | 1,010  | 889                      | 102,212                  | 103,101      |
| <b>At December 31, 2008</b>   | 23,768                                   | 2,376  | 2,329                    | 166,784                  | 169,113      |
| Issuance of shares for mutual investment by the Company and Telefónica (Note b) | 694                                      | 69   | 60                       | 6,651                    | 6,711        |
| Off-market share repurchase (Note c)  | (900)                                    | (90)   | (79)                     |                          | (79)         |
| <b>At December 31, 2009</b>   | 23,562                                   | 2,355  | 2,310                    | 173,435                  | 175,745      |

Note a : Pursuant to an ordinary resolution passed at the extraordinary general meeting held on September 16, 2008, the Company issued 10,102,389,377 ordinary shares of HKD0.10 each at a price of HKD11.60 per share with fair value or total price of approximately RMB103.1 billion on October 15, 2008 in exchange for the entire issued share capital of China Netcom.

Note b : On October 21, 2009, the Company issued 693,912,264 ordinary shares of HKD0.10 each at a price of HKD11.17 per share in exchange for 40,730,735 Telefónica treasury shares at a price of Euro17.24 each. Please refer to Note 32 for details.

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**18. SHARE CAPITAL (Continued)**

Note c: Pursuant to a special resolution passed at the extraordinary general meeting held on November 3, 2009, the Company repurchased 899,745,075 shares, being all the shares owned by SK Telecom Co., Ltd, by way of an off-market share repurchase. The total consideration of HKD9,991,669,058, being HKD11.105 for each share, was satisfied in cash upon completion. The total consideration of HKD9,991,669,058 (equivalent to RMB8,801,661,273) was charged to retained profits. The repurchased shares were cancelled subsequently.

In addition, pursuant to Section 49H of the Hong Kong Companies Ordinance, an amount equivalent to the par value of the shares cancelled of HKD89,974,508 (equivalent to RMB79,258,544) was transferred from share capital to the capital redemption reserve.

**19. RESERVES**

(i) Statutory reserves

CUCL and CNC China are registered as foreign investment enterprises in the PRC. In accordance with the respective Articles of Association, they are required to provide for certain statutory reserves, namely, general reserve fund and staff bonus and welfare fund, which are appropriated from income after tax and minority interests but before dividend distribution.

CUCL and CNC China are required to allocate at least 10% of their income after tax and minority interests determined under the PRC Company Law to the general reserve fund until the cumulative amounts reach 50% of the registered capital. The statutory reserve can only be used, upon approval obtained from the relevant authority, to offset accumulated losses or increase capital.

Accordingly, CUCL appropriated approximately RMB769 million (2007: approximately RMB718 million and RMB868 million by CUCL and CNC China, respectively; 2008: approximately RMB3,523 million and RMB19 million by CUCL and CNC China, respectively) to the general reserve fund for the year ended December 31, 2009.

Appropriation to the staff bonus and welfare fund is at the discretion of the directors. The staff bonus and welfare fund can only be used for special bonuses or the collective welfare of the employees and cannot be distributed as cash dividends. Under IFRSs/HKFRSs, the appropriations to the staff bonus and welfare fund will be charged to the statement of income as expenses incurred since any assets acquired through this fund belong to the employees. For the years ended December 31, 2007, 2008 and 2009, no appropriation to staff bonus and welfare fund has been made by CUCL nor CNC China.

According to the PRC tax approval document issued by the Ministry of Finance and State Administration of Taxation to the Group, the Group's upfront connection fees in respect of the Fixed-line business are not subject to the PRC enterprise income tax and an amount equal to the upfront connection fees recognized in the retained profits should be transferred from retained profits to the statutory reserve. Up to December 31, 2009, the Group has made an accumulated appropriation of approximately RMB12,082 million to the statutory reserve (Up to December 31, 2007: approximately RMB10,706 million; up to December 31, 2008 : approximately RMB11,592 million).

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**19. RESERVES (Continued)**

(ii) Share premium and capital redemption reserve

The application of the share premium account and the capital redemption reserve is governed by Sections 48B and 49H, respectively, of the Hong Kong Companies Ordinance and these reserves cannot be distributed to shareholders by way of dividend.

(iii) Available-for-sale fair value reserve

The available-for-sale fair value reserve represents the changes in the fair value of available-for-sale financial assets, net of tax, until the financial assets are derecognized or impaired.

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**Table of Contents****20. LONG-TERM BANK LOANS**

|   |  | <b>2008</b> | <b>2009</b> |
|---|--|-------------|-------------|
|   | <b>Interest rates and final maturity</b>   |             |             |
| RMB denominated bank loans<br>- unsecured                         | Floating interest rates ranging from 4.86% to 6.80% per annum with maturity through 2009   | 1,114       |             |
| USD denominated bank loans<br>- secured<br>- unsecured            | Fixed interest rates ranging from Nil to 5.00% (2008: Nil to 5.65%) per annum with maturity through 2039 (2008: maturity through 2039)     | 146<br>377  | 137<br>357  |
|   |  | 523         | 494         |
| Japanese Yen denominated bank loans<br>- unsecured                | Fixed interest rates of 2.12% per annum with maturity through 2014   | 234         |             |
| Euro denominated bank loans                                       | Fixed interest rates ranging from 1.10% to 2.50% (2008: 0.50% to 2.50%) per annum with maturity through 2034 (2008: maturity through 2034) |             |             |
| The repayment schedule of the long-term bank loans is as follows: |  |             |             |
|   |  | <b>2008</b> | <b>2009</b> |
| Balances due:   |  |             |             |
| - not later than one year   |  | 1,216       | 62          |
| - later than one year and not later than two years                |  | 96          | 54          |
| - later than two years and not later than five years              |  | 287         | 165         |
| - later than five years   |  | 614         | 540         |
|   |  | 2,213       | 821         |
| Less: Portion classified as current liabilities                   |  | (1,216)     | (62)        |
|   |  | 997         | 759         |

**Table of Contents****20. LONG-TERM BANK LOANS (Continued)**

- (a) The fair values of the Group's non-current portion of long-term bank loans at December 31, 2008 and 2009 were as follows:

|                      | <b>2008</b> | <b>2009</b> |
|----------------------|-------------|-------------|
| Long-term bank loans | 690         | 552         |

The fair value is based on cash flows discounted using rates based on the market rates ranging from 4.48% to 4.72% (December 31, 2008: 4.59% to 6.56%).

- (b) As of December 31, 2009, bank loans of approximately RMB137 million (2008: approximately RMB146 million) were secured by corporate guarantees granted by third parties.

**21. CORPORATE BONDS**

On June 8, 2007, the Group issued RMB2 billion 10-year corporate bonds, bearing interest at 4.5% per annum. The corporate bonds are secured by a corporate guarantee granted by Bank of China Limited.

On September 3, 2008, the Group issued another RMB5 billion 5-year corporate bonds, bearing interest at 5.29% per annum. The corporate bonds are secured by a corporate guarantee granted by State Grid Corporation of China.

The fair values of the Group's corporate bonds at December 31, 2008 and 2009 were as follows:

|                 | <b>2008</b> | <b>2009</b> |
|-----------------|-------------|-------------|
| Corporate bonds | 7,494       | 7,143       |

The fair value is based on cash flows discounted using rates based on the market rates ranging from 4.18% to 4.86% (December 31, 2008: 3.32% to 3.98%).

**22. CONVERTIBLE BONDS**

On August 20, 2007, the Company received a notice delivered by SK Telecom Co., Ltd. (SK Telecom), the sole holder of outstanding zero coupon convertible bonds of USD1 billion, pursuant to the terms and conditions of the convertible bonds for the conversion in full of the convertible bonds into the Company's shares. Accordingly, on August 31, 2007, the Company allotted and issued 899,745,075 ordinary shares of HKD0.10 each of the Company to SK Telecom.

Prior to the conversion, the change in the fair value of the conversion option from December 31, 2006 to August 20, 2007 resulted in a fair value loss of approximately RMB569 million, which has been recorded in the Realized loss on changes in fair value of derivative component of convertible bonds in the statement of income for the year ended December 31, 2007.

The convertible bonds with carrying value of approximately RMB10,819 million as of August 20, 2007 were fully converted into 899,745,075 ordinary shares of HKD0.10 each of the Company. The share conversion resulted in an increase in share capital and share premium by approximately RMB88 million and RMB10,731 million, respectively.

**Table of Contents****23. OTHER OBLIGATIONS**

|                                 | Note | 2008<br>(As<br>restated) | 2009    |
|---------------------------------|------|--------------------------|---------|
| Early retirement benefits       | (a)  | 2,109                    |         |
| One-off cash housing subsidies  | (a)  | 2,502                    | 2,502   |
| Obligations under finance lease | (b)  |                          | 129     |
| Others                          |      | 82                       | 90      |
| Sub-total                       |      | 4,693                    | 2,721   |
| Less: Current portion           |      | (3,012)                  | (2,534) |
|                                 |      | 1,681                    | 187     |

(a) The movement of early retirement benefits and one-off cash housing subsidies is as follows:

|                           | Early retirement<br>benefits<br>Note (ii) | One-off cash housing<br>subsidies<br>Note (i) & (ii) |
|---------------------------|---|--|
| As of January 1, 2008     | 2,532                                     | 2,856  |
| Additions during the year |   |  |
| Payments during the year  | (423)                                     | (354)  |
| As of December 31, 2008   | 2,109                                     | 2,502  |
| As of January 1, 2009     | 2,109                                     | 2,502  |
| Additions during the year |   |  |
| Payments during the year  | (2,109)                                   |  |
| As of December 31, 2009   |   | 2,502  |

(i) Certain staff quarters, prior to 1998, have been sold to certain of the Group's employees at preferential prices, subject to a number of eligibility requirements. In 1998, the State Council issued a circular which stipulated that the sale of quarters to employees at preferential prices should be terminated. In 2000, the State Council issued a further circular stating that cash subsidies should be made to certain eligible employees following the withdrawal of the allocation of staff quarters. However, the specific timetable and procedures for the implementation of these policies were to be determined by individual provincial or municipal governments based on the particular situation of the provinces or municipality.



Based on the relevant detailed local government regulations promulgated, certain entities within the Group have adopted cash housing subsidy plans. In accordance with these plans, for those eligible employees who had not been allocated with quarters or who had not been allocated with quarters up to the prescribed standards before the discounted sales of quarters were terminated, the Group is required to pay them one-off cash housing subsidies based on their years of service, positions and other criteria. Based on the available information, the Group estimated the required provision for these cash housing subsidies amounted to RMB4,142 million, which was charged to the statement of income for the year ended December 31, 2000 (the year in which the Council circular in respect of cash subsidies was issued).

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**Table of Contents****23. OTHER OBLIGATIONS (Continued)**

- (ii) Pursuant to the reorganization undertaken on June 30, 2004 between China Netcom, China Netcom (Holding) Company Limited and Netcom Group and the acquisition of the principal telecommunications operations, assets and liabilities in the four Northern provinces/autonomous region, namely Shanxi province, Neimenggu autonomous region, Jilin province and Heilongjiang province from Netcom Group (the Acquisition of New Horizon ) in 2005, if the actual payments required for housing subsidies and early retirement benefits differ from the amount provided as of June 30, 2004 and June 30, 2005, Netcom Group would bear any additional payments required or would be paid the difference if the actual payments are lower than the amount provided. Upon the completion of the Parent Merger, Unicom Group has assumed all the rights and obligations of Netcom Group. In 2009, the Group fully repaid the amount in relation to early retirement benefits to Unicom Group.
- (b) Obligations under finance lease

The obligations under finance lease represent the payables for the finance lease of telecommunications equipment. The lease payments under finance lease are analyzed as follows:

|  | <b>2008</b> | <b>2009</b> |
|--|-------------|-------------|
| Total minimum lease payments under finance lease:  |             |             |
| - not later than one year                          |             | 29          |
| - later than one year and not later than two years |             | 105         |
|  |             | 134         |
| Less: Future finance charges                       |             | (5)         |
| Present value of minimum obligations               |             | 129         |
| Representing obligations under finance lease:      |             |             |
| - current liabilities                              |             | 26          |
| - non-current liabilities                          |             | 103         |

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**Table of Contents****24. ACCOUNTS PAYABLE AND ACCRUED LIABILITIES**

|   | <b>January 1,<br/>2008</b> | <b>2008<br/>(As<br/>restated)</b> | <b>2009</b> |
|---|----------------------------|-----------------------------------|-------------|
|   | <b>(As restated)</b>       | <b>restated)</b>                  |             |
| Payables to contractors and equipment suppliers       | 44,719                     | 58,817                            | 85,941      |
| Payables to telecommunications product suppliers      | 2,949                      | 1,848                             | 3,193       |
| Customer/contractor deposits                          | 2,826                      | 2,261                             | 2,522       |
| Repair and maintenance expense payables               | 1,774                      | 1,807                             | 1,900       |
| Salary and welfare payables                           | 1,311                      | 1,129                             | 1,364       |
| Interest payable                                      | 468                        | 263                               | 212         |
| Amounts due to services providers / content providers | 1,256                      | 984                               | 1,069       |
| Accrued expenses                                      | 3,534                      | 3,298                             | 4,268       |
| Others  | 2,494                      | 3,447                             | 3,603       |
|   | 61,331                     | 73,854                            | 104,072     |

The aging analysis of payables and accrued liabilities is as follows:

|                        | <b>January 1,<br/>2008</b> | <b>2008<br/>(As<br/>restated)</b> | <b>2009</b> |
|------------------------|----------------------------|-----------------------------------|-------------|
|                        | <b>(As restated)</b>       | <b>restated)</b>                  |             |
| Less than six months   | 48,521                     | 62,583                            | 90,983      |
| Six months to one year | 6,754                      | 4,232                             | 4,031       |
| More than one year     | 6,056                      | 7,039                             | 9,058       |
|                        | 61,331                     | 73,854                            | 104,072     |

**Table of Contents****25. COMMERCIAL PAPER**

CNC China issued RMB10 billion unsecured commercial paper with repayment periods of 365 days on October 6, 2008 in the PRC capital market. The effective interest rate is 4.47% per annum. The net cash proceeds raised in the PRC capital market were RMB10 billion. The commercial paper was fully repaid on October 8, 2009.

**26. SHORT-TERM BANK LOANS**

|                            | <b>Interest rates and final maturity</b>   | <b>2008</b> | <b>2009</b> |
|----------------------------|--|-------------|-------------|
| RMB denominated bank loans | Fixed interest rates ranging from 3.50% to 4.37% (2008: 4.54% to 6.80%) per annum with maturity through 2010 (2008: maturity through 2009) |             |             |
| - unsecured                |  | 10,780      | 55,104      |
| HKD denominated bank loans | Floating interest rates of HKD HIBOR plus interest margin  |             |             |
| - unsecured                | 0.42% per annum with maturity through 2010   |             | 8,805       |
| Total                      |  | 10,780      | 63,909      |

(i) The carrying values of short-term bank loans approximate their fair values as of the balance sheet date.

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**Table of Contents****27. REVENUE**

The tariffs for the services provided by the Group are subject to regulations by various government authorities, including the NDRC, the MIIT and the provincial price regulatory authorities.

Revenue from continuing operations is presented net of business tax and government surcharges. Relevant business tax and government surcharges amounted to approximately RMB4,487 million for the year ended December 31, 2009 (2007: approximately RMB4,549 million; 2008: approximately RMB4,598 million).

The major components of revenue for continuing operations are as follows:

|   | <b>2007</b><br><b>(As restated)</b> | <b>2008</b><br><b>(As restated)</b> | <b>2009</b>    |
|---|-------------------------------------|-------------------------------------|----------------|
| <b>Continuing operations:</b>                                       |                                     |                                     |                |
| Mobile business   |                                     |                                     |                |
| - Usage and monthly fees  | 42,077                              | 40,462                              | 42,297         |
| - Value-added services revenue                                      | 13,528                              | 16,263                              | 19,070         |
| - Interconnection fee   | 5,767                               | 6,775                               | 8,220          |
| - Other service revenue   | 864                                 | 740                                 | 182            |
| <b>Total mobile telecommunications service revenue</b>              | <b>62,236</b>                       | <b>64,240</b>                       | <b>69,769</b>  |
| Fixed-line business   |                                     |                                     |                |
| - Usage and monthly fees  | 48,905                              | 41,489                              | 34,369         |
| - Broadband services revenue  | 16,450                              | 20,962                              | 23,898         |
| - Interconnection fees  | 7,799                               | 7,342                               | 5,599          |
| - Value-added services revenue                                      | 7,084                               | 7,074                               | 5,238          |
| - Leased line income  | 4,433                               | 5,492                               | 5,683          |
| - Other Internet-related services and managed data services revenue | 2,363                               | 2,662                               | 2,466          |
| - Upfront connection fees   | 1,517                               | 886                                 | 490            |
| - Other service revenue   | 2,542                               | 2,347                               | 1,806          |
| <b>Total fixed-line telecommunications service revenue</b>          | <b>91,093</b>                       | <b>88,254</b>                       | <b>79,549</b>  |
| Unallocated telecommunications service revenue                      | 420                                 | 337                                 | 275            |
| <b>Total telecommunications service revenue</b>                     | <b>153,749</b>                      | <b>152,831</b>                      | <b>149,593</b> |
| Information communication technology services and other revenue     | 5,197                               | 5,062                               | 2,189          |
| Sales of telecommunications products                                | 994                                 | 1,899                               | 2,163          |
| <b>Total revenue from external customers</b>                        | <b>159,940</b>                      | <b>159,792</b>                      | <b>153,945</b> |



**Table of Contents****28. NETWORKS, OPERATIONS AND SUPPORT EXPENSES**

|   | Note | 2007<br>(As<br>restated) | 2008<br>(As<br>restated) | 2009   |
|---|------|--------------------------|--------------------------|--------|
| <b>Continuing operations:</b>                   |      |                          |                          |        |
| Repair and maintenance                          |      | 6,183                    | 6,373                    | 7,093  |
| Power and water charges                         |      | 5,307                    | 5,901                    | 7,414  |
| Operating leases                                | (a)  | 4,119                    | 4,362                    | 4,778  |
| Consumables                                     |      | 1,629                    | 1,388                    | 1,513  |
| Others  |      | 639                      | 712                      | 930    |
| <br>  |      |                          |                          |        |
| Total networks, operations and support expenses |      | 17,877                   | 18,736                   | 21,728 |

(a): The operating lease expenses represent the rental charges for premises, equipment and facilities.

**29. EMPLOYEE BENEFIT EXPENSES**

|   | Note | 2007<br>(As<br>restated) | 2008<br>(As<br>restated) | 2009   |
|---|------|--------------------------|--------------------------|--------|
| <b>Continuing operations:</b>                         |      |                          |                          |        |
| Salaries and wages                                    |      | 15,755                   | 17,115                   | 17,842 |
| Contributions to defined contribution pension schemes |      | 2,010                    | 2,288                    | 2,558  |
| Contributions to housing fund                         |      | 1,004                    | 1,099                    | 1,321  |
| Other housing benefits                                |      | 459                      | 172                      | 183    |
| Share-based compensation                              | 34   | 170                      | 84                       | 27     |
| <br>  |      |                          |                          |        |
| Total employee benefit expenses                       |      | 19,398                   | 20,758                   | 21,931 |

**30. OTHER OPERATING EXPENSES**

|  | 2007<br>(As<br>restated) | 2008<br>(As<br>restated) | 2009   |
|--|--------------------------|--------------------------|--------|
| <b>Continuing operations:</b>                                      |                          |                          |        |
| Provision for doubtful debts                                       | 2,260                    | 3,025                    | 2,355  |
| Cost of telecommunications products sold                           | 1,109                    | 2,156                    | 2,689  |
| Cost in relation to information communications technology services | 3,808                    | 3,010                    | 839    |
| Commission expenses  | 11,396                   | 11,773                   | 11,994 |
| Advertising and promotion expenses                                 | 2,799                    | 3,036                    | 4,290  |
| Customer installation cost   | 2,243                    | 2,256                    | 2,449  |
| Customer acquisition and retention cost                            | 3,222                    | 2,549                    | 2,287  |
| Auditors remuneration  | 123                      | 131                      | 73     |
| Property management fee  | 1,010                    | 1,186                    | 1,434  |

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|                                    |        |        |        |
|------------------------------------|--------|--------|--------|
| Office and administrative expenses | 3,013  | 2,831  | 2,915  |
| Transportation expense             | 1,594  | 1,892  | 1,825  |
| Miscellaneous taxes and fees       | 565    | 607    | 583    |
| Others                             | 3,382  | 3,545  | 2,990  |
| <br>                               |        |        |        |
| Total other operating expenses     | 36,524 | 37,997 | 36,723 |

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**Table of Contents****31. FINANCE COSTS**

|   | Note    | 2007<br>(As<br>restated) | 2008<br>(As<br>restated) | 2009  |
|---|---------|--------------------------|--------------------------|-------|
| <b>Continuing operations:</b>   |         |                          |                          |       |
| Finance costs:  |         |                          |                          |       |
| - Interest on bank loans repayable within 5 years                           |         | 2,766                    | 1,787                    | 927   |
| - Interest on long-term loans due to ultimate holding company               | 39.1(c) | 641                      | 1,016                    |       |
| - Interest on corporate bonds and commercial paper repayable within 5 years |         | 226                      | 580                      | 607   |
| - Interest on bank loans repayable over 5 years                             |         | 147                      | 54                       | 5     |
| - Interest on corporate bonds repayable over 5 years                        |         | 51                       | 90                       | 90    |
| - Interest on convertible bonds   |         | 242                      |                          |       |
| - Interest on deferred consideration  | (a)     | 375                      | 224                      |       |
| - Less: Amounts capitalized in construction-in-progress                     | 6       | (581)                    | (430)                    | (806) |
| <br>  |         |                          |                          |       |
| Total interest expense  |         | 3,867                    | 3,321                    | 823   |
| - Exchange (gain)/loss, net   |         | (457)                    | (270)                    | 15    |
| - Others  |         | 330                      | 218                      | 198   |
| <br>  |         |                          |                          |       |
| Total finance costs   |         | 3,740                    | 3,269                    | 1,036 |

(a): In 2005, China Netcom completed the Acquisition of New Horizon. The consideration for the Acquisition of New Horizon was RMB12,800 million which consisted of an initial cash payment of RMB3,000 million and deferred payments of RMB9,800 million. The deferred payments were being settled in half-yearly installments over five years. The interest charged on the deferred payments was calculated at 5.265% per annum. In 2008, the Group fully repaid the amount.

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**Table of Contents****32. MUTUAL INVESTMENT OF US\$1 BILLION BY THE COMPANY AND TELEFÓNICA IN EACH OTHER**

On September 6, 2009, the Company announced that in order to strengthen the cooperation between the Company and Telefónica, the parties entered into a subscription agreement ( Subscription Agreement ), pursuant to which each party conditionally agreed to invest an equivalent of USD1 billion in each other through an acquisition of each other's shares. On October 21, 2009 ( Completion Date ), the Company and Telefónica completed the mutual investment of the equivalent of USD1 billion in each other, which was implemented by way of the subscription by Telefónica for 693,912,264 new shares of the Company at a price of HKD11.17 each, satisfied by the contribution by Telefónica of 40,730,735 Telefónica treasury shares at a price of Euro17.24 each to the Company.

At the inception of the subscription agreement on September 6, 2009, the Company's agreement to undertake the above mutual investment with Telefónica is treated as a derivative financial instrument in accordance with IAS/HKAS 39 Financial instrument: Recognition and measurement as it represents a forward contract for the purchase of shares by the Company and Telefónica in each other at predetermined fixed prices and is denominated in a foreign currency. The derivative financial instrument would be remeasured at fair value at each balance sheet date with all subsequent changes in fair value being charged or credited to the statement of income in the period when the change occurs until the completion of the mutual investment by the Company and Telefónica in each other. Upon settlement of the derivative financial instrument on completion of the mutual investment by the Company and Telefónica in each other at the Completion Date, October 21, 2009, the derivative financial instrument was derecognized and an available-for-sale financial asset, representing the investment in the Telefónica shares, was recognized correspondingly at the then fair value of the Telefónica shares.

As of the Completion Date, October 21, 2009, the fair value of the Telefónica shares was determined to be approximately RMB7,952 million and the changes in the fair value of the derivative financial instrument during the period from September 6, 2009 to October 21, 2009 resulted in a fair value gain of approximately RMB1,239 million, which has been recorded as Realized gain on changes in fair value of derivative financial instrument in the consolidated statement of income for the year ended December 31, 2009.

As of December 31, 2009, the related available-for-sale financial asset amounted to approximately RMB7,789 million. For the period from October 21, 2009 to December 31, 2009, loss on changes in fair value of available-for-sale financial asset amounted to approximately RMB163 million. The loss, net of tax impact of approximately RMB41 million, was recorded in the consolidated statement of comprehensive income.

**33. OTHER INCOME NET**

|  | Note | 2007<br>(As<br>restated) | 2008<br>(As<br>restated) | 2009 |
|--|------|--------------------------|--------------------------|------|
| <b>Continuing operations:</b>                            |      |                          |                          |      |
| Tax refund on reinvestment in subsidiaries               | (a)  | 4,001                    |                          |      |
| Dividend income from available-for-sale financial assets |      | 2                        | 3                        | 215  |
| Gain on the non-monetary assets exchange                 | (b)  | 386                      | 1,305                    | 38   |
| Others   |      | 713                      | 833                      | 709  |
|  |      | 5,102                    | 2,141                    | 962  |

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**33. OTHER INCOME NET (Continued)**

Note (a): During 2007, the Company and China Netcom reinvested the undistributed profits of certain PRC subsidiaries into these subsidiaries and were granted a refund of a portion of the taxes previously paid by these subsidiaries as permitted under the tax law effective until December 31, 2007. This tax refund on reinvestment in subsidiaries was recorded as other income .

Note (b): Please refer to Note (b)(v) to the consolidated statement of cash flows for details.

**34. EQUITY-SETTLED SHARE OPTION SCHEMES**

**34.1 Fixed Award Pre-global Offering Share Option Scheme (the Pre-Global Offering Share Option Scheme )**

Pursuant to the resolution passed by the Board of Directors in June 2000, the Company adopted the Pre-Global Offering Share Option Scheme on June 1, 2000 for the granting of share options to qualified employees on the following terms:

- (i) the exercise price is equivalent to the share issue price of the Global Offering of HKD15.42 per share (excluding the brokerage fee and SEHK transaction levy); and
- (ii) the share options are vested and exercisable after 2 years from the grant date and expire 10 years from the date of grant.

No further options can be granted under the Pre-Global Offering Option Scheme.

The Pre-Global Offering Option Scheme had been amended in conjunction with the amended terms of the share option scheme (Note 34.2) on May 13, 2002, May 11, 2007 and May 26, 2009, respectively. Apart from the above two terms, the principal terms are substantially the same as the amended Share Option Scheme in all material aspects.

**34.2 Share Option Scheme (the Share Option Scheme )**

On June 1, 2000, the Company adopted the Share Option Scheme pursuant to which the directors of the Company may, at their discretion, invite employees, including executive directors, of the Company or any of its subsidiaries, to take up share options to subscribe for shares up to a maximum aggregate number of shares (including those that could be subscribed for under the Pre-Global Offering Share Option Scheme as described above) not exceeding 10% of the total issued share capital of the Company. Pursuant to the Share Option Scheme, the nominal consideration payable by a participant for the grant of share options will be HKD1.00. The exercise price payable by a participant upon the exercise of an option will be determined by the directors at their discretion at the date of grant, except that such price may not be set below a minimum price which is the higher of:

- (i) the nominal value of the share; and
- (ii) 80% of the average of the closing prices of shares on the SEHK on the five trading days immediately preceding the date of grant of the option on which there were dealings in the shares on the SEHK.

The period during which an option may be exercised will be determined by the Board of Directors at their discretion, except that no option may be exercised later than 10 years from June 22, 2000.

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**34. EQUITY-SETTLED SHARE OPTION SCHEMES (Continued)**

34.2 Share Option Scheme (the Share Option Scheme ) (Continued)

The terms of the Share Option Scheme were amended on May 13, 2002 to comply with the requirements set out in the Chapter 17 of the Listing Rules which came into effect on September 1, 2001 with the following major amendments:

- (i) share options may be granted to employees including executive directors of the Group or any of the non-executive directors;
- (ii) the option period commences on a day after the date on which an option is offered but not later than 10 years from the offer date; and
- (iii) minimum subscription price shall not be less than the higher of:
  - the nominal value of the shares;
  - the closing price of the shares of the stock exchange as stated in the stock exchange's quotation sheets on the offer date in respect of the share options; and
  - the average closing price of the shares on the stock exchange's quotation sheets for the five trading days immediately preceding the offer date.

On May 11, 2007, the Company further amended the Share Option Scheme with major amendments related to the exercise of options upon cessation of employment. These amendments are made in order to reduce the administrative burden on the Company to monitor outstanding options for grantees whose employment has been terminated.

All of the share options granted under Note 34.1 and 34.2 are governed by the amended terms of the Pre-Global Share Option Scheme and the Share Option Scheme as mentioned above.

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**34. EQUITY-SETTLED SHARE OPTION SCHEMES (Continued)**

34.3 Special Purpose Unicom Share Option Scheme (the Special Purpose Share Option Scheme )

Prior to the 2008 Business Combination, China Netcom granted share options to its directors and employees (including employees of its subsidiaries) in years 2004 ( First Grant ) and 2005 ( Second Grant ) pursuant to a shareholders resolution passed on September 30, 2004.

Pursuant to the ordinary resolution passed by the shareholders on September 16, 2008, the Company adopted the Special Purpose Share Option Scheme in connection with the merger of the Company and China Netcom by way of a scheme of arrangement of China Netcom under Section 166 of the Companies Ordinance for the granting of options to holders of China Netcom options outstanding at October 14, 2008 ( Eligible Participants ). Pursuant to this scheme, no fractional options can be granted and the maximum number of shares which may be issued upon the exercise of all options granted under this scheme and any other share options schemes of the Company must not in aggregate exceed 10% of the issued share capital of the Company as of the date of approval of this scheme.

The number of options and exercise price of options granted under the Special Purpose Share Option Scheme are as follows:

- (i) The exercise price of options under this scheme is equal to (a) the exercise price of an outstanding China Netcom option held by the Eligible Participants divided by (b) the share exchange ratio 1.508.
- (ii) The total number of options granted by the Company to all Eligible Participants under this scheme shall be equal to the product of (a) the share exchange ratio and (b) the number of China Netcom options outstanding as of October 14, 2008.

The above formula ensures that the value of options granted under this scheme received by a holder of China Netcom options is equivalent to the see-through price of that holder s outstanding China Netcom options. The period during which an option may be exercised will be determined by the directors at their discretion, except that no option may be exercised later than September 30, 2014.

No further options can be granted under the Special Purpose Share Option Scheme.

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**Table of Contents****34. EQUITY-SETTLED SHARE OPTION SCHEMES (Continued)**

## 34.3 Special Purpose Unicom Share Option Scheme (the Special Purpose Share Option Scheme ) (Continued)

Details of share options granted and outstanding by China Netcom, immediately prior to the merger between the Company and China Netcom (i.e. October 14, 2008) are as follows:

|   | <b>2007</b>                                    |   | <b>For the period from January 1, 2008 to October 14, 2008</b> |   |
|---|--|---|--|---|
|   | <b>Average exercise price in HKD per share</b> | <b>Number of share options involved</b> | <b>Average exercise price in HKD per share</b>                 | <b>Number of share options involved</b> |
| Balance, beginning of year/period               | 10.21  | 176,646,900                             | 10.32  | 150,844,560                             |
| Granted   |  |   |  |   |
| Forfeited/cancelled                             | 8.40   | (2,117,440)                             | 9.55   | (139,620)                               |
| Cancelled in exchange for the Company's options |  |   | 10.30  | (125,836,140)                           |
| Exercised                                       | 9.67   | (23,684,900)                            | 10.45  | (24,868,800)                            |
| Balance, end of year/period                     | 10.32  | 150,844,560                             |  |   |
| Representing:                                   |  |   |  |   |
| First Grant                                     |  | 79,263,860                              |  |   |
| Second Grant                                    |  | 71,580,700                              |  |   |
| Balance, end of year/period                     |  | 150,844,560                             |  |   |
| Exercisable at end of year/period               | 10.59  | 45,218,610                              |  |   |

Details of share options of China Netcom exercised during 2007 and the period from January 1, 2008 to October 14, 2008 are as follows:

For the year ended December 31, 2007:

**Weighted  
average  
closing price  
per  
share at  
respective**

| <b>Grant</b> | <b>Exercise price</b> | <b>days immediately before date of exercise of options</b> | <b>Proceeds received</b> | <b>Number of shares involved</b> |
|--------------|-----------------------|--|--------------------------|----------------------------------|
|              | <b>HKD</b>            | <b>HKD</b>   | <b>HKD</b>               |                                  |
| First Grant  | 8.40                  | 22.23  | 136,343,760              | 16,231,400                       |
| Second Grant | 12.45                 | 23.92  | 92,796,075               | 7,453,500                        |
|              |                       |  | 229,139,835              | 23,684,900                       |

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**Table of Contents****34. EQUITY-SETTLED SHARE OPTION SCHEMES (Continued)**

For the period from January 1, 2008 to October 14, 2008:

| <b>Grant</b> | <b>Exercise price</b> | <b>Weighted average closing price per share at respective days immediately before date of exercise of options</b> | <b>Proceeds received</b> | <b>Number of shares involved</b> |
|--------------|-----------------------|---|--------------------------|----------------------------------|
|              | <b>HKD</b>            | <b>HKD</b>  | <b>HKD</b>               |                                  |
| First Grant  | 8.40                  | 26.17   | 103,316,640              | 12,299,600                       |
| Second Grant | 12.45                 | 25.46   | 156,486,540              | 12,569,200                       |
|              |                       |   | 259,803,180              | 24,868,800                       |

The Group accounted for the exchange of options based on the estimated fair value of share options at the modification date by using the Black-Scholes valuation model. Because the Black-Scholes valuation model requires the input of subjective assumptions, including the volatility of share price, change in subjective input assumptions can materially affect the fair value estimate. Accordingly, the weighted average fair values of 2004 and 2005 Special Purpose Share Options granted under the Special Purpose Share Option Scheme was HKD6.01 and HKD4.00, respectively. The significant assumptions used and the numbers of options granted are as follows:

|                               | <b>2004<br/>Special Purpose<br/>Share Option</b> | <b>2005<br/>Special Purpose<br/>Share Option</b> |
|-------------------------------|--|--|
| Stock price                   | HKD 11.60  | HKD 11.60  |
| Exercise price                | HKD 5.57   | HKD 8.26   |
| Volatility                    | 55%  | 49%  |
| Dividend yield                | 2%   | 2%   |
| Risk-free rate                | 0.24-1.06%                                       | 0.28-1.54%                                       |
| Expected life                 | 0.30-1.09 years                                  | 0.32-2.32 years                                  |
| Weighted average option value | HKD 6.01   | HKD 4.00   |
| Number of options granted     | 100,831,432                                      | 88,929,468                                       |

The volatility measured at the standard deviation of expected share price returns was based on statistical analysis of daily share prices over the last 2 to 3 years. Expected dividends were based on historical dividends. Risk-free rate was by reference to the yield of Hong Kong Exchange Fund Notes with a term similar to the expected option life.

The total incremental fair value of the exchanged options was determined to be RMB21 million which was measured by reference to the incremental fair value of the options granted under the Special Purpose Share Option Scheme as of October 15, 2008 (the modification date) over the fair value of China Netcom options as of October 15, 2008. For the year ended December 31, 2009, share-based compensation expense of approximately RMB10 million (2008:



approximately RMB9 million) was recorded by the Group as a result of this modification.

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**Table of Contents****34. EQUITY-SETTLED SHARE OPTION SCHEMES (Continued)**

## 34.4 Share Option Information

Movements in the number of share options outstanding and their related weighted average exercise prices are as follows:

|                            | 2007                                    |                                  | 2008                                    |                                  | 2009                                    |                                  |
|----------------------------|---|----------------------------------|---|----------------------------------|---|----------------------------------|
|                            | Average exercise price in HKD per share | Number of share options involved | Average exercise price in HKD per share | Number of share options involved | Average exercise price in HKD per share | Number of share options involved |
| Balance, beginning of year | 6.95                                    | 314,256,000                      | 7.12                                    | 257,279,600                      | 6.95                                    | 413,074,166                      |
| Granted                    |   |                                  | 6.83                                    | 189,760,900                      |   |                                  |
| Forfeited                  | 8.43                                    | (3,420,800)                      | 6.37                                    | (2,720,334)                      |   |                                  |
| Exercised                  | 6.03                                    | (53,555,600)                     | 7.62                                    | (31,246,000)                     |   |                                  |
| Balance, end of year       | 7.12                                    | 257,279,600                      | 6.95                                    | 413,074,166                      | 6.95                                    | 413,074,166                      |
| Exercisable at end of year | 8.48                                    | 92,713,600                       | 7.14                                    | 245,359,027                      | 6.88                                    | 390,841,799                      |

No options were exercised during the year ended December 31, 2009. Exercise of share options during the year ended December 31, 2008 resulted in 31,246,000 shares being issued (2007: 53,555,600 shares), with exercise proceeds of approximately RMB216 million (2007: approximately RMB313 million).

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**Table of Contents****34. EQUITY-SETTLED SHARE OPTION SCHEME (Continued)**

## 34.4 Share Option Information (Continued)

As of balance sheet date, information of outstanding share options is summarized as follows:

| <b>Date of options grant</b>  | <b>Vesting period</b>                           | <b>Exercisable period</b>                       | <b>The price per share to be paid on exercise of options</b> | <b>Number of share options outstanding as of December 31, 2008</b> | <b>Number of share options outstanding as of December 31, 2009</b> |
|---|---|---|--|--|--|
| Share options granted under the Pre-Global Offering Share Option Scheme (Note i): |   |   |  |  |  |
| June 22, 2000   | June 22, 2000<br>to<br>June 21, 2002            | June 22, 2002<br>to<br>June 21, 2010            | HKD<br>15.42   | 16,977,600   | 16,977,600   |
| Share options granted under the Share Option Scheme (Note i and Note iii):        |   |   |  |  |  |
| June 30, 2001   | June 30, 2001                                   | June 30, 2001<br>to<br>June 22, 2010            | HKD<br>15.42   | 4,350,000  | 4,350,000  |
| May 21, 2003 (Note ii)  | May 21, 2003<br>to<br>May 21, 2006              | May 21, 2004<br>to<br>May 20, 2010              | HKD 4.30   | 8,956,000  | 8,956,000  |
| July 20, 2004   | July 20, 2004<br>to<br>July 20, 2007            | July 20, 2005<br>to<br>July 19, 2010            | HKD 5.92   | 41,024,000   | 41,024,000   |
| December 21, 2004   | December 21,<br>2004 to<br>December 21,<br>2007 | December 21,<br>2005 to<br>December 20,<br>2010 | HKD 6.20   | 654,000  | 654,000  |
| February 15, 2006   | February 15,<br>2006 to<br>February 15,<br>2009 | February 15,<br>2008 to<br>February 14,<br>2012 | HKD 6.35   | 151,556,000  | 151,556,000  |

Share options granted under the Special Purpose Share Option Scheme:

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|   |   |  |          |             |             |
|---|---|--|----------|-------------|-------------|
| October 15, 2008<br>( 2004 Special Purpose<br>Share Options ) (Note<br>iii) | October 15,<br>2008 to<br>May 17, 2009        | October 15,<br>2008 to<br>November 16,<br>2010 | HKD 5.57 | 100,627,098 | 100,627,098 |
| October 15, 2008<br>( 2005 Special Purpose<br>Share Options )               | October 15,<br>2008 to<br>December 6,<br>2010 | October 15,<br>2008 to<br>December 5,<br>2011  | HKD 8.26 | 88,929,468  | 88,929,468  |
|   |   |  |          | 413,074,166 | 413,074,166 |

The options outstanding as of December 31, 2009 had a weighted average remaining contractual life of 1.50 years (2008: 2.47 years).

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**34. EQUITY-SETTLED SHARE OPTION SCHEME (Continued)**

34.4 Share Option Information (Continued)

- Note i: The exercise periods of approximately 25,000,000 options were extended by one year by the Board of Directors pursuant to the amended terms of each of the Pre-Global Offering Share Option Scheme and the Share Option Scheme as approved by shareholders on May 26, 2009. The main reasons for such extension were (i) that the holders of those options were determined by the Board of Directors as Transferred Personnel under the respective terms of the Pre-Global Offering Share Option Scheme and the Share Option Scheme due to the transfers of those option holders to other telecommunications operators as part of the 2008 industry restructuring, and (ii) that those options were not exercisable due to a Mandatory Moratorium under the respective terms of each of the Pre-Global Offering Share Option Scheme and the Share Option Scheme. The modifications did not have significant impact on the consolidated financial statements for the year ended December 31, 2009. In March 2010, due to the Mandatory Moratorium continuing to be in force, the Board of Directors further extended the exercise periods of such options by another year on March 24, 2010. This modification did not have significant impact on the Group's consolidated financial statements.
- Note ii: The original expiration date for these options was May 20, 2009. As these options were not exercisable due to a Mandatory Moratorium as set forth in the Share Option Scheme, they were extended to May 20, 2010 pursuant to amendment of the Share Option Scheme approved by the shareholders of the Company on May 26, 2009. The modifications did not have significant impact on the consolidated financial statements for the year ended December 31, 2009.
- Note iii: The exercise period of these options were extended by one year by the Board of Directors on March 24, 2010 pursuant to the amended terms of each of the Share Option Scheme and the Special Purpose Share Option Scheme as they were not exercisable due to a Mandatory Moratorium under the respective terms of each of the Share Option Scheme and the Special Purpose Share Option Scheme. This modification did not have significant impact on the Group's consolidated financial statements.

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**Table of Contents****34. EQUITY-SETTLED SHARE OPTION SCHEME (Continued)**

No option was exercised for the year ended December 31, 2009.

Details of share options exercised for the years ended December 31, 2007 and 2008 are as follows:

For the year ended December 31, 2007:

| <b>Grant</b>  | <b>Exercise price<br/>HKD</b> | <b>Weighted average closing price per share at respective days immediately before date of exercise of options<br/>HKD</b> | <b>Proceeds received<br/>HKD</b> | <b>Number of shares involved</b> |
|---------------|-------------------------------|---|----------------------------------|----------------------------------|
| June 22, 2000 | 15.42                         | 17.56   | 34,657,992                       | 2,247,600                        |
| June 30, 2001 | 15.42                         | 17.62   | 8,450,160                        | 548,000                          |
| July 10, 2002 | 6.18                          | 12.96   | 49,793,496                       | 8,057,200                        |
| May 21, 2003  | 4.30                          | 12.95   | 60,057,240                       | 13,966,800                       |
| July 20, 2004 | 5.92                          | 13.77   | 170,117,120                      | 28,736,000                       |
|               |                               |   | 323,076,008                      | 53,555,600                       |

For the year ended December 31, 2008:

| <b>Grant date</b> | <b>Exercise price<br/>HKD</b> | <b>Weighted average closing price per share at respective days immediately before days of exercise of options<br/>HKD</b> | <b>Proceeds received<br/>HKD</b> | <b>Number of shares involved</b> |
|-------------------|-------------------------------|---|----------------------------------|----------------------------------|
| June 22, 2000     | 15.42                         | 18.73   | 63,980,664                       | 4,149,200                        |
| June 30, 2001     | 15.42                         | 18.38   | 18,781,560                       | 1,218,000                        |
| July 10, 2002     | 6.18                          | 15.88   | 20,443,440                       | 3,308,000                        |

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|                   |      |       |             |            |
|-------------------|------|-------|-------------|------------|
| May 21, 2003      | 4.30 | 16.90 | 8,947,440   | 2,080,800  |
| July 20, 2004     | 5.92 | 17.81 | 58,240,960  | 9,838,000  |
| February 15, 2006 | 6.35 | 17.62 | 67,640,200  | 10,652,000 |
|                   |      |       | 238,034,264 | 31,246,000 |

For the year ended December 31, 2009, employee share-based compensation expense recorded for continuing operations amounted to approximately RMB27 million (2007: approximately RMB170 million; 2008: approximately RMB84 million).

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**Table of Contents****35 DISPOSAL GROUP AND DISCONTINUED OPERATIONS**

On June 2, 2008 and on July 27, 2008, the Company, CUCL and China Telecom entered into the Framework Agreement and the Disposal Agreement, respectively, to sell the CDMA business to China Telecom. The disposal was completed on October 1, 2008. The gain on disposal, net of corresponding income tax of approximately RMB9.0 billion, amounted to approximately RMB26.1 billion.

The net assets of the CDMA business as of the effective date of disposal of the CDMA business were as listed below:

| <b>Net assets disposed of:</b>  | <b>Note</b> | <b>As of<br/>October 1,<br/>2008</b> |
|---|-------------|--------------------------------------|
| Cash and cash equivalents   | (a)         | 4,612                                |
| Property, plant and equipment   |             | 2,997                                |
| Goodwill  |             | 373                                  |
| Deferred tax assets   |             | 6                                    |
| Other assets  |             | 3,958                                |
| Inventories   |             | 525                                  |
| Accounts receivable, net  |             | 690                                  |
| Prepayments and other current assets  |             | 808                                  |
| Deferred revenue  |             | (444)                                |
| Accounts payable and accrued liabilities                                    |             | (1,144)                              |
| Advances from customers   |             | (4,428)                              |
| Minority interest   |             | (5)                                  |
|   |             | 7,948                                |
| Fair value of future service agreed in the Disposal Agreement               | 39.2(c)     | 517                                  |
| Transaction cost and taxation   |             | 184                                  |
| Income tax expense arising from the disposal of the CDMA business           |             | 9,016                                |
| Gain on disposal of the CDMA business recognized in the statement of income |             | 26,135                               |
| Cash consideration on disposal of the CDMA business                         |             | 43,800                               |
| Less: Cash consideration receivable from disposal of the CDMA business      |             | (13,140)                             |
| Cash and cash equivalents transferred                                       |             | (1,148)                              |
| Net cash inflow   |             | 29,512                               |

Note a: The balance represents cash and cash equivalent of approximately RMB1,148 million transferred and RMB3,464 million to be transferred to China Telecom in accordance with the Disposal Agreement. For details, please refer to Note 39.2(c).



**Table of Contents****35 DISPOSAL GROUP AND DISCONTINUED OPERATIONS (Continued)**

## Discontinued operations

The results and cash flows of the CDMA business for the year ended December 31, 2007 and for the period ended September 30, 2008 are presented as discontinued operations as follows:

|   | <b>For the year<br/>ended<br/>December<br/>31, 2007<br/>(As restated)</b> | <b>For the period<br/>from January<br/>1,<br/>2008 to<br/>September<br/>30, 2008<br/>(As restated)</b> |
|---|---|--|
| Revenue   | 31,149  | 22,296   |
| Expenses  | (29,994)  | (20,389)   |
| Income from discontinued operations before income tax         | 1,155   | 1,907  |
| Income tax expenses   | (499)   | (469)  |
| Income for the year/period from discontinued operations       | 656   | 1,438  |
| Gain on disposal of discontinued operations before income tax |   | 35,151   |
| Income tax expenses   |   | (9,016)  |
| Gain on disposal of discontinued operations after income tax  |   | 26,135   |
| Income for the year/period from discontinued operations       | 656   | 27,573   |

**Table of Contents****35 DISPOSAL GROUP AND DISCONTINUED OPERATIONS (Continued)**

## Discontinued operations (Continued)

|  | <b>For the<br/>year<br/>ended<br/>December<br/>31, 2007<br/>(As<br/>restated)</b> | <b>For the period<br/>from<br/>January 1,<br/>2008<br/>to September<br/>30, 2008</b> |
|--|---|--|
| Net cash inflow from operating activities            | 837   | 656  |
| Net cash outflow from investing activities           | (25)  | (23)   |
| Cash inflow from disposal of discontinued operations |   | 29,512   |
| Net cash inflow from investing activities            | (25)  | 29,489   |
| Net cash inflow from financing activities            |   |  |
| Net cash inflow from discontinued operations         | 812   | 30,145   |

The net cash outflow of approximately RMB5,039 million for discontinued operations for the year ended December 31, 2009 represents the income tax paid on the gain on disposal of the CDMA business in 2008 and related professional service fees paid totaling RMB9,329 million, offset by proceeds received of approximately RMB4,290 million from the disposal of the CDMA business.

In addition, for the year ended December 31, 2009, proceeds receivable from disposal of the CDMA business of approximately RMB3,729 million was offset against payables in relation to disposal of the CDMA business in accordance with a settlement agreement entered into in 2009.

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**Table of Contents****36. DIVIDENDS**

At the annual general meeting held on May 26, 2009, the shareholders of the Company approved the payment of a final dividend of RMB0.20 per ordinary share for the year ended December 31, 2008 totaling approximately RMB4,754 million which has been reflected as a reduction of retained profits for the year ended December 31, 2009. As of December 31, 2009, such dividends have been paid by the Company, except for dividends payable of approximately RMB307 million and RMB24 million due to Unicom BVI and Netcom BVI, respectively.

At a meeting held on March 24, 2010, the Board of Directors of the Company proposed the payment of a final dividend of RMB0.16 per ordinary share to the shareholders for the year ended December 31, 2009 totaling approximately RMB3,770 million. This proposed dividend has not been reflected as a dividend payable in the financial statements as of December 31, 2009, but will be reflected as an appropriation of retained profits in the financial statements for the year ending December 31, 2010.

|   | <b>2007</b> | <b>2008</b> | <b>2009</b> |
|---|-------------|-------------|-------------|
| Proposed final dividend:  |             |             |             |
| RMB0.16 (2007:RMB0.20; 2008: RMB0.20) per ordinary share by the Company           | 2,727       | 4,754       | 3,770       |
| HKD nil (2007:HKD0.592; 2008:HKD nil) per ordinary share by China Netcom (Note a) | 3,700       |             |             |
|   | 6,427       | 4,754       | 3,770       |
| Dividend paid:  |             |             |             |
| By the Company  | 2,285       | 2,732       | 4,754       |
| By China Netcom (Note a)  | 3,600       | 3,499       |             |
|   | 5,885       | 6,231       | 4,754       |

Note a : Since the 2008 Business Combination is accounted for as a business combination of entities under common control, accordingly, the proposed final dividend and dividend paid include the proposed final dividend and dividend paid by China Netcom as if it had always been part of the Group.

For the Company's non-TRE enterprise shareholders, the Company would distribute dividends after deducting the amount of enterprise income tax payable by these non-TRE enterprise shareholders thereon and reclassify the related dividend payable to withholding tax payable upon the declaration of such dividends. The requirement to withhold tax does not apply to the Company's shareholders appearing as individuals in its share register.

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**37. EARNINGS PER SHARE AND ADS**

Basic earnings per share for the years ended December 31, 2007, 2008 and 2009 were computed by dividing the income attributable to equity holders by the weighted average number of ordinary shares outstanding during the years, as adjusted by the number of ordinary shares in issue had the merger with China Netcom been completed on January 1, 2007.

Diluted earnings per share for the years ended December 31, 2007, 2008 and 2009 were computed by dividing the income attributable to equity holders by the weighted average number of ordinary shares outstanding during the years, as adjusted by the number of ordinary shares in issue had the merger with China Netcom been completed on January 1, 2007, after adjusting for the effects of the dilutive potential ordinary shares. All potential ordinary shares arose from (i) share options granted under the amended Pre-Global Offering Share Option Scheme; (ii) share options granted under the amended Share Option Scheme, (iii) share options granted under the amended Special Purpose Share Option Scheme and (iv) the Convertible Bonds (for the year ended December 31, 2007 only).

The potential ordinary shares which are not dilutive for the year ended December 31, 2007 arose from share options with exercise price of HKD15.42 granted under the amended Pre-Global Offering Share Option Scheme and amended Share Option Scheme and the Convertible Bonds while the potential ordinary shares which are not dilutive for the years ended December 31, 2008 and 2009 arose from share options with exercise price of HKD15.42 granted under the amended Pre-Global Offering Share Option Scheme and amended Share Option Scheme, which are excluded from the weighted average number of ordinary shares for the purpose of computation of diluted earnings per share.

**Table of Contents****37. EARNINGS PER SHARE AND ADS (Continued)**

The following table sets forth the computation of basic and diluted earnings per share and ADS:

|   | <b>2007</b><br><b>(As</b><br><b>restated)</b> | <b>2008</b><br><b>(As</b><br><b>restated)</b> | <b>2009</b> |
|---|---|---|-------------|
| Numerator (in RMB millions):  |   |   |             |
| Income attributable to equity holders of the Company  |   |   |             |
| - Continuing operations   | 16,268  | 2,231   | 9,556       |
| - Discontinued operations   | 656   | 27,573  |             |
|   | 16,924  | 29,804  | 9,556       |
| Denominator (in millions):  |   |   |             |
| Weighted average number of ordinary shares outstanding used in computing basic earnings per share | 23,075  | 23,751  | 23,767      |
| Dilutive equivalent shares arising from share options   | 246   | 190   | 128         |
| Shares used in computing diluted earnings per share   | 23,321  | 23,941  | 23,895      |
| Basic earnings per share (in RMB)   |   |   |             |
| - Continuing operations   | 0.70  | 0.09  | 0.40        |
| - Discontinued operations   | 0.03  | 1.16  |             |
|   | 0.73  | 1.25  | 0.40        |
| Basic earnings per ADS (in RMB)   |   |   |             |
| - Continuing operations   | 7.04  | 0.94  | 4.02        |
| - Discontinued operations   | 0.29  | 11.61   |             |
|   | 7.33  | 12.55   | 4.02        |
| Diluted earnings per share (in RMB)   |   |   |             |
| - Continuing operations   | 0.70  | 0.09  | 0.40        |
| - Discontinued operations   | 0.03  | 1.15  |             |
|   | 0.73  | 1.24  | 0.40        |
| Diluted earnings per ADS (in RMB)   |   |   |             |
| - Continuing operations   | 6.98  | 0.93  | 4.00        |
| - Discontinued operations   | 0.28  | 11.52   |             |

7.26

12.45

4.00

Basic and diluted earnings per ADS have been computed by multiplying the earnings per share by 10, which is the number of shares represented by each ADS.

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**Table of Contents****38. FAIR VALUE OF FINANCIAL INSTRUMENTS**

Financial assets of the Group mainly include cash and cash equivalents, short-term bank deposits, available-for-sale financial assets, accounts receivable, amounts due from ultimate holding company, related parties and domestic carriers. Financial liabilities of the Group mainly include accounts payable and accrued liabilities, short-term bank loans, commercial paper, corporate bonds, long-term bank loans, long-term loans due to ultimate holding company, other obligations and amounts due to ultimate holding company, related parties and domestic carriers.

Cash and cash equivalents, short-term bank deposits and available-for-sale financial assets denominated in foreign currencies, as summarized below, have been translated to RMB at the applicable rates quoted by the People's Bank of China as of December 31, 2008 and 2009.

|   | 2008             |                               | 2009                 |                  |                               |       |
|---|------------------|-------------------------------|----------------------|------------------|-------------------------------|-------|
| Original<br>currency                        | Exchange<br>rate | RMB<br>equivalent<br>millions | Original<br>currency | Exchange<br>rate | RMB<br>equivalent<br>millions |       |
| <b>Cash and cash equivalents:</b>           |                  |                               |                      |                  |                               |       |
| - denominated in HK dollars                 | 223              | 0.88                          | 197                  | 324              | 0.88                          | 285   |
| - denominated in US dollars                 | 134              | 6.83                          | 914                  | 86               | 6.83                          | 585   |
| - denominated in Euro                       | 4                | 9.66                          | 43                   | 26               | 9.80                          | 258   |
| - denominated in Japanese Yen               | 50               | 0.08                          | 4                    | 14               | 0.07                          | 1     |
| - denominated in GBP                        | 2                | 9.88                          | 20                   | 0.4              | 10.98                         | 4     |
| Sub-total                                   |                  |                               | 1,178                |                  |                               | 1,133 |
| <b>Short-term bank deposits:</b>            |                  |                               |                      |                  |                               |       |
| - denominated in HK dollars                 |                  | 0.88                          |                      | 86               | 0.88                          | 76    |
| - denominated in US dollars                 | 20               | 6.83                          | 137                  | 49               | 6.83                          | 336   |
| Sub-total                                   |                  |                               | 137                  |                  |                               | 412   |
| <b>Available-for-sale financial assets:</b> |                  |                               |                      |                  |                               |       |
| - denominated in Euro                       |                  | 9.66                          |                      | 795              | 9.80                          | 7,789 |
| Total                                       |                  |                               | 1,315                |                  |                               | 9,334 |





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**38. FAIR VALUE OF FINANCIAL INSTRUMENTS (Continued)**

The Group did not have and does not believe it will have any difficulties in exchanging its foreign currency cash into RMB at the exchange rates quoted by the People's Bank of China. The carrying amounts of the Group's cash and cash equivalents, short-term bank deposits, available-for-sale financial assets, other current financial assets and liabilities approximated their fair values as of December 31, 2008 and 2009 due to the nature or short maturity of those instruments.

The carrying amounts of receivables and payables which are all subject to normal trade credit terms approximated their fair value as of the balance sheet date.

In connection with the fair value of the Group's non-current portion of long-term bank loans and corporate bonds, please refer to Note 20 (a) and Note 21 respectively for details.

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**39. RELATED PARTY TRANSACTIONS**

Unicom Group and Netcom Group are state-owned enterprises directly controlled by the PRC government. The PRC government is the Company's ultimate controlling party. Neither Unicom Group and Netcom Group nor the PRC government publishes financial statements available for public use.

The PRC government controls a significant portion of the productive assets and entities in the PRC. The Group provides telecommunications services as part of its retail transactions, thus, is likely to have extensive transactions with the employees of other state-controlled entities, including their key management personnel and their close family members. These transactions are carried out on commercial terms that are consistently applied to all customers.

Management considers other state-owned enterprises, which mainly include other telecommunications service operators, have material transactions with the Group in its ordinary course of business. These transactions are carried out on terms that are the same as similar arm's length transactions or at standards promulgated by relevant government authorities and have been reflected in the financial statements. The Group's telecommunications networks depend, in large part, on interconnection with the network and on transmission lines leased from other domestic carriers. Management believes that meaningful information relating to related party transactions has been disclosed below.

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**Table of Contents****39. RELATED PARTY TRANSACTIONS (Continued)**

## 39.1 Transactions with Unicom Group, Netcom Group and their subsidiaries

## (a) Significant recurring transactions

The following is a summary of significant recurring transactions carried out by the Group with Unicom Group, Netcom Group and their subsidiaries. In the directors' opinion, these transactions were carried out in the ordinary course of business.

|   | Note              | 2007<br>(As<br>restated) | 2008<br>(As<br>restated) | 2009  |
|---|-------------------|--------------------------|--------------------------|-------|
| <b>Transactions with Unicom Group, Netcom Group and their subsidiaries:</b> |                   |                          |                          |       |
| <b>Continuing operations:</b>   |                   |                          |                          |       |
| Leasing fee of Telecommunications Networks in Southern China                | (ii)              |                          |                          | 2,000 |
| Charges for mobile subscriber value-added service                           | (i), (iii)        | 37                       | 153                      | 122   |
| Rental charges for premises, equipment and facilities                       | (i), (iv), (viii) | 678                      | 678                      | 820   |
| Charges for the international gateway services                              | (i), (v)          | 15                       | 7                        | 5     |
| Agency fee incurred for procurement of telecommunications equipment         | (i), (vi)         | 19                       | 21                       | 12    |
| Charge for engineering and information technology-related services          | (i), (vii)        | 1,946                    | 2,603                    | 2,786 |
| Common corporate services income  | (ix)              | 121                      | 140                      | 3     |
| Charges for common corporate services                                       | (ix)              | 477                      | 563                      | 266   |
| Rental income from properties   | (viii)            | 1                        | 10                       | 1     |
| Purchases of materials  | (x)               | 668                      | 516                      | 375   |
| Charges for ancillary telecommunications support services                   | (xi)              | 448                      | 558                      | 689   |
| Charges for support services  | (xii)             | 536                      | 461                      | 273   |
| Charges for lease of telecommunications facilities                          | (xiii)            | 309                      | 306                      | 148   |
| Income from information communication technologies services                 | (i), (xiv)        | 130                      | 118                      | 70    |
| Income for engineering design and technical services                        | (i), (xv)         | 23                       | 40                       | 15    |
| Interest expenses for long-term loans due to ultimate holding company       | 39.1(c)<br>F-118  | 641                      | 1,016                    |       |

**Table of Contents****39. RELATED PARTY TRANSACTIONS (Continued)**

## 39.1 Transactions with Unicom Group, Netcom Group and their subsidiaries (Continued)

## (a) Significant recurring transactions (Continued)

|   | <b>Note</b> | <b>2007<br/>(As<br/>restated)</b> | <b>2008<br/>(As<br/>restated)</b> | <b>2009</b> |
|---|-------------|-----------------------------------|-----------------------------------|-------------|
| <b>Transactions with Unicom Group, Netcom Group<br/>and their subsidiaries:</b> |             |                                   |                                   |             |
| <b>Discontinued operations:</b>   |             |                                   |                                   |             |
| Charges for mobile subscriber value-added services                              | (i), (iii)  | 17                                | 46                                |             |
| CDMA network capacity lease rental charges                                      | (xvi)       | 8,382                             | 6,009                             |             |
| Constructed capacity related cost of the CDMA<br>network                        | (xvii)      | 215                               | 234                               |             |
|   | F-119       |                                   |                                   |             |

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**39. RELATED PARTY TRANSACTIONS (Continued)**

39.1 Transactions with Unicom Group, Netcom Group and their subsidiaries (Continued)

(a) Significant recurring transactions (Continued)

- (i) On October 26, 2006, CUCL entered into a new agreement 2006 Comprehensive Services Agreement to continue to carry out related party transactions. The new agreement was approved by the independent shareholders of the Company on December 1, 2006, and become effective from January 1, 2007.

Pursuant to the ordinary resolution passed at the extraordinary general meeting held on September 16, 2008, the independent shareholders of the Company approved the amendment of the 2006 Comprehensive Services Agreement with effect from October 15, 2008 to include CNC China as a party ( the Second 2006 Comprehensive Services Agreement ).

Also, the independent shareholders of the Company approved the following agreements:  
Framework Agreement for Engineering and Information Technology Services dated August 12, 2008

Engineering and Information Technology Services Agreement 2008-2010

Domestic Interconnection Settlement Agreement 2008-2010

International Long Distance Voice Services Settlement Agreement 2008-2010

Framework Agreement for Interconnection Settlement dated August 12, 2008

As mentioned in Note 1, as a result of the merger between CUCL and CNC China and the Parent Merger on January 1, 2009 and January 6, 2009, respectively, the continuing connected transactions (and all associated rights and obligations thereunder) of CNC China and Netcom Group were assumed by CUCL and Unicom Group, respectively.

Under HKFRSs and IFRSs, the 2009 Business Combination has been accounted for using merger accounting/predecessor values method. Accordingly, the transactions between the Target Business (See Note 1) and the Group were eliminated and not disclosed as related party transactions in the consolidated financial statements.

- (ii) On December 16, 2008, CUCL, Unicom Group, Netcom Group and Unicom New Horizon entered into the Network Lease Agreement in relation to the Lease of the Telecommunications Networks in Southern China by CUCL from Unicom New Horizon on an exclusive basis immediately following and subject to the completion of the 2009 Business Combination. Under the Network Lease Agreement, CUCL shall pay annual leasing fees of RMB2.0 billion and RMB2.2 billion for the years ended December 31, 2009 and 2010, respectively. The Lease was effective in January 2009.

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**39. RELATED PARTY TRANSACTIONS (Continued)**

39.1 Transactions with Unicom Group, Netcom Group and their subsidiaries (Continued)

(a) Significant recurring transactions (Continued)

- (iii) Pursuant to 2006 Comprehensive Services Agreement and the Second 2006 Comprehensive Services Agreement, UNISK (Beijing) Information Technology Corporation Limited ( UNISK ) and Unicom NewSpace Corporation Limited ( Unicom NewSpace ) agreed to provide the mobile subscribers of CUCL with various types of value-added services through its cellular communication network and data platform. The Group retains a portion of the revenue generated from the value-added services provided to the Group's subscribers (and actually received by the Group) and allocates a portion of such fees to UNISK and Unicom NewSpace for settlement, on the condition that such proportion allocated to UNISK and Unicom NewSpace does not exceed the average proportion allocated to independent value-added telecommunications content providers who provide value-added telecommunications content to the Group in the same region. The percentage of revenue to be allocated to UNISK and Unicom NewSpace by the Group varies depending on the types of value-added service provided to the Group.
- (iv) Pursuant to 2006 Comprehensive Services Agreement and the Second 2006 Comprehensive Services Agreement, CUCL and Unicom Group agreed to mutually lease premises, equipment and facilities from each other. Rentals are based on the lower of depreciation costs and market rates.
- (v) Pursuant to 2006 Comprehensive Services Agreement and the Second 2006 Comprehensive Services Agreement, charges for international gateway services represent the amounts paid or payable to Unicom Group for international gateway services provided for the Group's international long distance networks. The charge for this service is based on the cost of operation and maintenance of the international gateway facilities incurred by Unicom Group, including depreciation, together with a margin of 10% over cost.
- (vi) Pursuant to 2006 Comprehensive Services Agreement and the Second 2006 Comprehensive Services Agreement, Unicom Import and Export Company Limited ( Unicom I/E Co ) agreed to provide equipment procurement services to the Group. Unicom I/E Co. charges the Group 0.55% (for contracts up to an amount of USD30 million (inclusive)) and 0.35% (for contracts with an amount of more than USD30 million) of the value of imported equipment, and 0.25% (for contracts up to an amount of RMB200 million (inclusive)) and 0.15% (for contracts with an amount of more than RMB200 million) of the value of domestic equipment for such services.

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**39. RELATED PARTY TRANSACTIONS (Continued)**

39.1 Transactions with Unicom Group, Netcom Group and their subsidiaries (Continued)

(a) Significant recurring transactions (Continued)

- (vii) Pursuant to Framework Agreement for Engineering and Information Technology Services dated August 12, 2008 entered between CUCL and Netcom Group and Engineering and Information Technology Services Agreement 2008-2010 entered between CNC China and Netcom Group, the charges payable by CUCL and CNC China for the above services are determined with reference to market rates and are settled when the relevant services are provided.
- (viii) Pursuant to Property Leasing Agreement 2008-2010 entered between CNC China and Netcom Group and the Framework Agreement for Property Leasing dated August 12, 2008 entered between CUCL and Netcom Group, the charges payable by CNC China, CUCL and Netcom Group are based on market rates or the depreciation charges and taxes (only not higher than the market rates) in respect of each property. The charges are subject to review every year.
- (ix) Pursuant to Master Sharing Agreement 2008-2010 entered between CNC China and Netcom Group, expenses associated with common corporate services is allocated between CNC China and Netcom Group based on total assets as appropriate.
- (x) Pursuant to Materials Procurement Agreement 2008-2010 entered between CNC China and Netcom Group, the charges payable by CNC China to Netcom Group are based on market rates or cost-plus basis.
- (xi) Pursuant to Ancillary Telecommunications Services Agreement 2008-2010 entered between CNC China and Netcom Group, and the Framework Agreement for Ancillary Telecommunications Services dated August 12, 2008 entered between CUCL and Netcom Group, Netcom Group agreed to provide services including certain telecommunications pre-sale, on-sale and after-sale services, certain sales agency services, the printing and delivery of invoice services, the maintenance of certain air-conditioning, fire alarm equipment and telephone booths and other customer services. The charges are based on market rates and are settled as and when the relevant services are provided.
- (xii) Pursuant to Support Services Agreement 2008-2010 entered between CNC China and Netcom Group and the Framework Agreement for Support Services dated August 12, 2008 entered between CUCL and Netcom Group, Netcom Group agreed to provide services including equipment leasing services, motor vehicles services, safety and security services, conference services, basic construction agency services, equipment maintenance services, employee training services, advertising services, printing services and other support services. The charges are based on market rates and are settled as and when the relevant services are provided.
- (xiii) Pursuant to Telecommunications Facilities Leasing Agreement 2008-2010 entered between CNC China and Netcom Group and the Framework Agreement for Telecommunications Facilities Leasing dated August 12, 2008 entered between CUCL and Netcom Group, CNC China agreed to lease the international telecommunications facilities and inter-provincial transmission optic fibers from Netcom Group. The lease payment is based on the depreciation charge of the leased assets.

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**39. RELATED PARTY TRANSACTIONS (Continued)**

39.1 Transactions with Unicom Group, Netcom Group and their subsidiaries (Continued)

(a) Significant recurring transactions (Continued)

- (xiv) Pursuant to Information and Communications Technology Agreement 2008-2010 entered between System Integration Corporation and Netcom Group, System Integration Corporation, agreed to provide information communications technology services to Netcom Group and also to subcontract services ancillary to the provision of information communications technology services, namely, the system installation and configuration services, to the subsidiaries and branches of Netcom Group in Netcom Group's southern service region in the PRC. The charges payable by Netcom Group are based on market value.
- (xv) The service fee standards for the engineering design and technical services provided to Unicom Group are determined based on standards promulgated by the relevant government authorities.
- (xvi) On October 26, 2006, CUCL entered into the new agreement 2006 CDMA Lease Agreement with Unicom Group and Unicom New Horizon to continue to lease the CDMA networks. The new agreement was approved by the independent shareholders of the Company on December 1, 2006, and became effective from January 1, 2007. As disclosed in the announcement dated July 28, 2008, the Company, CUCL and China Telecom agreed on the CDMA business disposal and the Company agreed to waive the CDMA network purchase option and terminate the 2006 CDMA Lease Agreement, in each case with effect from the completion of the CDMA business disposal. During the Company's extraordinary general meeting of shareholders held on September 16, 2008, the Company's independent shareholders approved the waiver of the CDMA network purchase option and the termination of the 2006 CDMA Lease Agreement. Upon the completion of the CDMA business disposal on October 1, 2008, the 2006 CDMA Lease Agreement was terminated.
- (xvii) Pursuant to 2006 CDMA Lease Agreement, the constructed capacity related costs in connection with the CDMA network capacity used by the Group, including the rentals for the exchange centers and the base stations, water and electricity charges, heating charges and fuel charges for the relevant equipment etc., as well as the maintenance costs of a non-capital nature, are charged to the Group. The proportion of the constructed capacity related costs to be borne by the Group is calculated on a monthly basis by reference to the actual number of cumulative CDMA subscribers of the Group at the end of the month prior to the occurrence of the costs divided by 90%, as a percentage of the total capacity available on the CDMA network.
- (xviii) Unicom Group is the registered proprietor of the Unicom trademark in English and the trademark bearing the Unicom logo, which are registered at the PRC State Trademark Bureau. Pursuant to an exclusive PRC trademark licence agreement between Unicom Group and the Group, the Group has been granted the right to use these trademarks on a royalty free and periodic renewal basis.



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**39. RELATED PARTY TRANSACTIONS (Continued)**

39.1 Transactions with Unicom Group, Netcom Group and their subsidiaries (Continued)

(b) Other significant transaction

In January 2009, CUCL completed the acquisitions of the Target Business and the Target Assets from Unicom Group and Netcom Group while in 2008, the Company completed the merger with China Netcom by way of a scheme of arrangement. For details, please refer to Note 1.

(c) Amounts due from and to related parties/Unicom Group, Netcom Group and their subsidiaries

Amounts due to related parties as of December 31, 2009 included an unsecured short-term loan from Netcom BVI of approximately RMB2,104 million obtained for the purpose of payment of the 2008 final dividend of the Company. The loan carries an interest rate of six-month HIBOR plus 0.8% per annum and is repayable on June 16, 2010.

Long-term loans due to ultimate holding company primarily represented the long-term intercompany loans for the financing of the construction of the Telecommunications Networks in Southern China, amounting to approximately RMB27,213 million and RMB35,652 million as of January 1, 2008 and December 31, 2008, respectively. The loans are unsecured, interest bearing, and repayable on demand after the period of twelve months from the balance sheet date as of December 31, 2008. The interest expenses in relation to the long-term loans due to ultimate holding company were calculated based on the interest rate of 4.90% and 5.40% per annum for the years ended December 31, 2007 and 2008, respectively. Upon the completion of the 2009 Business Combination effective from January 2009, the long-term loans have been treated as a distribution from reserves by the Group to ultimate holding company. For details, please refer to note 4.2(b).

Apart from the short-term loan from Netcom BVI and long-term loans due to ultimate holding company as aforementioned, amounts due from and to related parties, Unicom Group, Netcom Group and their subsidiaries are unsecured, interest-free, repayable on demand/on contract terms and arise in the ordinary course of business in respect of transactions with related parties/Unicom Group, Netcom Group or their subsidiaries as described in (a) and (b) above.

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**Table of Contents****39. RELATED PARTY TRANSACTIONS (Continued)**

## 39.2 Domestic carriers

## (a) Significant recurring transactions with domestic carriers

The following is a summary of significant transactions with domestic carriers in the ordinary course of business for the continuing operations:

|  |             | <b>2007</b>      | <b>The Group</b> |             |
|--|-------------|------------------|------------------|-------------|
|  |             | <b>(As</b>       | <b>2008</b>      |             |
|  | <b>Note</b> | <b>restated)</b> | <b>(As</b>       | <b>2009</b> |
|  |             |                  | <b>restated)</b> |             |
| Interconnection revenue                          | (i)         | 10,165           | 11,135           | 12,083      |
| Interconnection charges                          | (i)         | 9,939            | 10,901           | 11,740      |
| Leased line revenue                              | (ii)        | 549              | 608              | 433         |
| Leased line charges                              | (ii)        | 334              | 252              | 102         |
| Engineering design and technical service revenue | (iii)       | 231              | 197              | 287         |

- (i) The interconnection revenue and charges mainly represent the amounts due from or to domestic carriers for telephone calls made between the Group's networks and the networks of domestic carriers. The interconnection settlements are calculated in accordance with interconnection agreements reached between the branches of the Group and domestic carriers on a provincial basis. The terms of these agreements are set in accordance with the standard settlement arrangement stipulated by the MIIT.
- (ii) Leased line charges are paid or payable to domestic carriers by the Group for the provision of transmission lines. At the same time, the Group leases transmission lines to domestic carriers in return for leased line rental income. The charges are calculated at a fixed charge per line, depending on the number of lines being used by the Group and domestic carriers.
- (iii) Engineering design and technical service revenue mainly represents the amounts due from domestic carriers for the provision of engineering design and technical services based on their demands and requirements. The prices are determined based on standards promulgated by the relevant government authorities.

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**Table of Contents****39. RELATED PARTY TRANSACTIONS (Continued)**

## 39.2 Domestic carriers

## (b) Amounts due from and to domestic carriers

|   | <b>2008</b><br>(As<br>restated) | <b>2009</b> |
|---|---------------------------------|-------------|
| Amounts due from domestic carriers  |                                 |             |
| - Receivables for interconnection revenue, leased line revenue and engineering design and technical service revenue | 1,033                           | 1,205       |
| - Less: Provision for doubtful debts  | (59)                            | (71)        |
|   | 974                             | 1,134       |
| Amounts due to domestic carriers  |                                 |             |
| - Payables for interconnection charges and leased lines charges   | 956                             | 1,136       |

All amounts due from and to domestic carriers are unsecured, interest-free and repayable within one year.

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**Table of Contents****39. RELATED PARTY TRANSACTIONS (Continued)**

## 39.2 Domestic carriers (Continued)

## (c) Disposal of the Group's CDMA business to China Telecom

In 2008, the Company completed disposal of the CDMA business to China Telecom. For details, please refer to Note 1 and Note 35.

Pursuant to the Disposal Agreement, the Group is committed to providing certain supporting services to China Telecom at no consideration during the transitional period. Such services include providing the use of certain telecommunications equipment, properties and information technology services in certain regions. The value of such services are estimated by the Group based on the costs of the underlying equipment or properties plus a margin. A portion of the consideration for disposal of the CDMA business equal to the estimated value of such services has been deferred and will be recognized over the expected service period.

In addition, pursuant to the Disposal Agreement, upon the completion of the CDMA business disposal, CUCL and China Telecom entered into agreements with respect to the swapping and operation of certain jointly used network assets in accordance with the terms set out in the Disposal Agreement. Based on the agreements, the Group concluded that the swapping and operation of these jointly used network assets would not have a significant impact on the consolidated financial statements.

As of December 31, 2008 and 2009, the balances due from/to China Telecom in relation to disposal of the CDMA business are as follows:

|  | <b>2008</b> | <b>2009</b> |
|--|-------------|-------------|
| Payables   |             |             |
| - Advances from customers received on behalf of China Telecom  | (768)       | (7)         |
| - Cash to be transferred upon the final agreement of the values of assets and liabilities transferred to China Telecom in accordance with the Disposal Agreement | (3,464)     |             |
|  | (4,232)     | (7)         |
| Proceeds receivable  | 13,140      | 5,121       |

All the proceeds receivable was subsequently settled in cash in January 2010.

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**Table of Contents****40. CONTINGENCIES AND COMMITMENTS**

## 40.1 Capital commitments

As of December 31, 2008 and 2009, the Group had capital commitments, mainly in relation to the construction of telecommunications networks, as follows:

|                                   | <b>2008</b><br>(As<br>restated) |                                   | <b>2009</b>      |               |
|-----------------------------------|---------------------------------|-----------------------------------|------------------|---------------|
|                                   | <b>Total</b>                    | <b>Land<br/>and<br/>buildings</b> | <b>Equipment</b> | <b>Total</b>  |
| Authorized and contracted for     | 6,599                           | 403                               | 8,407            | 8,810         |
| Authorized but not contracted for | 6,938                           | 198                               | 3,832            | 4,030         |
| <b>Total</b>                      | <b>13,537</b>                   | <b>601</b>                        | <b>12,239</b>    | <b>12,840</b> |

As of December 31, 2009, no capital commitment was denominated in US dollars (2008: approximately USD23 million).

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**Table of Contents****40. CONTINGENCIES AND COMMITMENTS (Continued)**

## 40.2 Operating lease commitments

As of December 31, 2008 and 2009, the Group had total future aggregate minimum lease payments under non-cancellable operating leases as follows:

|  | 2008<br>(As<br>restated) |                          |           | 2009   |       |
|--|--------------------------|--------------------------|-----------|--|-------|
|  | Total                    | Land<br>and<br>buildings | Equipment | Tele-<br>communications<br>networks in<br>Southern<br>China<br>(a) | Total |
| Leases expiring:                                       |                          |                          |           |  |       |
| - not later than one year                              | 1,851                    | 1,324                    | 585       | 2,200  | 4,109 |
| - later than one year and not later<br>than five years | 4,657                    | 3,100                    | 515       |  | 3,615 |
| - later than five years                                | 1,957                    | 1,095                    | 84        |  | 1,179 |
| Total  | 8,465                    | 5,519                    | 1,184     | 2,200  | 8,903 |

- (a) The lease commitment in relation to telecommunications networks related to the lease arrangement of the Telecommunications Networks in Southern China between CUCL and Unicom New Horizon and was estimated based on the annual leasing fees pursuant to the Network Lease Agreement. Please refer to Note 1 (b) for details.

## 40.3 Contingent liabilities

As aforementioned in Note 27, the tariffs for the services provided by the Group are subject to regulations by various government authorities. In 2008, the NDRC investigated the compliance with tariffs regulations of several branches of CUCL and CNC China. Based on management's assessment and preliminary discussions with MIIT and NDRC, management considered that the Group complied with the regulations issued by the relevant government authorities, and the likelihood of material future cash outflow as a result of the investigation is remote. Accordingly, no provisions were recorded as of December 31, 2008 and 2009.

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**41. EVENTS AFTER BALANCE SHEET DATE**

**(a) Proposed dividend**

After the balance sheet date, the Board of Directors proposed a final dividend for 2009. For details, please refer to Note 36.

**(b) Issue of commercial paper and promissory note**

On April 1, 2010, CUCL completed the issue of the first tranche of commercial paper for the year 2010 in an amount of RMB15 billion, with a maturity period of 365 days and at an interest rate of 2.64% per annum.

On April 2, 2010, CUCL completed the issue of the first tranche of promissory note for the year 2010 in an amount of RMB3 billion, with a maturity period of 3 years and at an interest rate of 3.73% per annum.

On September 20, 2010, CUCL completed the issue of the second tranche of commercial paper for the year 2010 in an amount of RMB8 billion, with a maturity period of 365 days and at an interest rate of 2.81% per annum.

In addition, on September 20, 2010, CUCL completed the issue of the second tranche of promissory note for the year 2010 in an amount of RMB12 billion, with a maturity period of 3 years and at an interest rate of 3.31% per annum.

**(c) Issue of USD1,838,800,000 0.75% guaranteed convertible bonds due 2015**

On September 28, 2010, the Company (as guarantor) entered into a subscription agreement (the Subscription Agreement), pursuant to which 0.75 per cent guaranteed convertible bonds due 2015 (the Convertible Bonds) would be issued by Billion Express Investments Limited, a wholly-owned subsidiary of the Company exchangeable into ordinary shares of the Company for an aggregate principal amount of USD1,838.8 million. Upon fulfillment of all conditions precedent under the Subscription Agreement, the issue of the Convertible Bonds was completed on October 18, 2010.

**(d) Agreement to enhance the strategic alliance (the Strategic Agreement) between the Company and Telefónica, S.A. (Telefónica)**

On January 23, 2011, the Company entered into the Strategic Agreement with Telefónica that: (a) Telefónica shall purchase such number of ordinary shares of HK\$0.10 each in the capital of the Company for the aggregate consideration of US\$500 million through acquisition from third parties, as Telefónica may determine within a nine-month period after the date of the signing of the Agreement; and (b) the Company shall acquire and Telefónica shall sell to the Company 21,827,499 ordinary shares of EUR1.00 each in the capital of Telefónica and listed on the Spanish Stock Exchange repurchased by and held in treasury by Telefónica itself (Telefónica Treasury Shares) in one transaction for an aggregate purchase price for all Telefónica Treasury Shares of EUR374,559,882.84. On January 25, 2011, the Company completed the purchase of Telefónica Treasury Shares in accordance with the Strategic Agreement.

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**42. COMPARATIVE FIGURES**

As stated in Note 2.2(a), the 2007 and 2008 comparative figures have been restated to reflect the effects of the 2009 Business Combination between entities and businesses under common control, which is accounted for using merger accounting/predecessor values method. In addition, upon the adoption of IFRS/HKFRS 8 Operating Segment in 2009, the 2007 and 2008 comparative financial information of segment information has been restated to conform to the current year's presentation. For details, please refer to Note 5.

In addition, as stated in Note 2.2(b), the 2007 and 2008 comparative figures have been restated to include Excluded Assets and Liabilities and related charge relating to the 2009 Business Combination.

**43. APPROVAL OF FINANCIAL STATEMENTS**

The financial statements were approved by the Board of Directors on February 18, 2011.

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