IMPORTANT

The Board of Directors, Supervisory Committee and the Directors, Supervisors and senior management of the Company confirm that this annual report does not contain any false information, misleading statements or material omissions, and collectively and individually accept responsibility for the truthfulness, accuracy and completeness of the contents of this annual report.

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

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

The respective financial statements of the Group for the year ended 31 December 2006 were prepared in accordance with generally accepted accounting principles in the PRC (''PRC GAAP'') and with Hong Kong Financial Reporting Standards (''HKFRSs'') respectively, and had been audited by Ernst & Young Hua Ming and Ernst & Young, and an unqualified auditors' report has been issued by each of them.

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

CONTENTS

DEFINITIONS

In this annual report, unless the context otherwise requires, the following terms shall have the meanings set out below. Certain other terms are explained in the section headed "Glossary".

"Articles of Association"	The Articles of Association of ZTE Corporation.
"Board of Directors"	The board of directors of the Company.
"CASC"	China Aerospace Science and Technology Corporation and its subsidiaries.
"CASIC"	CASIC (Group) Company, Limited and its subsidiaries.
"China"	People's Republic of China.
"China Mobile"	China Mobile Communications Corporation and its subsidiaries.
"China Netcom"	China Network Communications Group Corporation and its subsidiaries.
"China Telecom"	China Telecommunications Corporation and its subsidiaries.
"China Unicom"	China United Telecommunications Corporation and its subsidiaries.
"Company" or "ZTE"	ZTE Corporation, a joint stock limited company incorporated in China on 11 November 1997 under the Company Law of the People's Republic of China, the A shares and H shares of which are listed on the Shenzhen Stock Exchange and the Hong Kong Stock Exchange respectively.
"Group"	One or more of ZTE and its subsidiaries.
"HKFRSs"	Hong Kong Financial Reporting Standards ("HKFRS"), Hong Kong Accounting Standards ("HKAS") and Interpretations.
"Hong Kong Stock Exchange"	The Stock Exchange of Hong Kong Limited.
"Hong Kong Stock Exchange Listing Rules"	Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited (as amended from time to time).
"ITU"	International Telecommunications Union, a specialised agency for telecommunications within the United Nations, the primary aim of which is to coordinate the operation of telecommunications network and services and advance the development of communications technology.
"Lead"	Shenzhen Lead Communications Company, Limited.
"PRC GAAP"	Generally accepted accounting principles in China.
"Ruide"	Shenzhen Ruide Electronic Industrial Company, Limited.
"Shenzhen Stock Exchange"	The Shenzhen Stock Exchange of China.
"Supervisors"	The members of the supervisory committee of the Company.

DEFINITIONS

"Xi'an Microelectronics"	Xi'an Microelectronics Technology Research Institute.
"Zhongxing WXT"	Shenzhen Zhongxing WXT Equipment Company, Ltd.
"Zhongxing Xindi"	Shenzhen Zhongxing Xindi Telecommunications Equipment Company, Limited.
"Zhongxing Xinyu"	Shenzhen Zhongxing Xinyu FPC Company, Limited.
"Zhongxingxin"	Shenzhen Zhongxingxin Telecommunications Equipment Company, Limited.
"ZTE Kangxun"	ZTE Kangxun Telecom Company Limited.
"ZTE Software"	Shenzhen ZTE Software Company, Limited.

GLOSSARY

This glossary contains certain definitions of technical terms used in this annual report as they relate to the Group. Some of these definitions may not correspond to standard industry definitions or usage.

"3G"	The third generation of wireless networks. These networks should be able to support peak data rates of 144 Kbps at mobile user speeds, 384 Kbps at pedestrian user speeds and 2 Mbps in fixed locations (peak speeds), although some initial deployments were configured to support just 64 Kbps. ITU coordinates 3G standards through its IMT-2000 project and incorporates the key standards bodies, 3GPP and 3GPP2.
"ADSL"	Asymmetrical digital subscriber lines, a method of transmitting data over traditional copper telephone lines. Data can be downloaded at speeds of up to 1.547 Mbps and uploaded at speeds of 128 Kbps.
"ASON"	Automatic switching optical network, the functions of the control interface of which allow it to develop an optical communication channel customised to users' needs according to their requests on an unmanned basis and support multi-channel development, capacity expansion, configurability and network intelligence development.
"CDMA"	Code division multiple access, one of the standards for 2G mobile communications. It is a spread spectrum technology standard that assigns a pseudo-noise (PN) code to all speech and data bits, sends a scrambled transmission of the encoded speech over the air and reassembles the speech in its original format. By assigning a unique correlating code to each transmitter, several simultaneous conversations can share the same frequency allocations.
"CDMA2000"	A technical specification for the provision of enhanced capacity for voice under the CDMAOne standard with a maximum data rate of 2Mbps, comprising particular specifications such as 1xRTT (radio transmission technology), 1xEVDO (data only version) and 1xEVDV (voice and data version).
"DSL"	Digital subscriber lines, the collective name given to a number of techniques used for transmitting digital data over the local loop or subscriber line. These are also known as xDSL. Examples are ADSL, HDSL, VDSL, MDSL and RDSL.
"GSM"	A global system for mobile communications, a digital cellular phone system standard that originated in Europe. It is deployed in more than 170 countries and uses a TDMA radio propagation scheme.
"IP"	Internet protocol, as more specifically defined in RFC 791, the primary purpose of which is to define packet architecture and address format.
"IPTV"	The managed multimedia operation that provides QoS/QoE, security, interoperability and reliability in the transmission of tv, video, textual, graphical and other data on IP networks.
"NGN"	Next generation network, a data packet-based network capable of providing a variety of services by using multiple broadband transmission technology to support unlimited access to different service providers and of supporting ordinary mobile communication to provide uninterrupted services to users.
"PHS"	Personal handyphone system, a digital mobile telephone system using technology developed according to Japanese standards and operating on the 1900Mhz frequency.
"softswitch"	Abbreviation for software switch, softswitch is an application protocol interface used to link a traditional PSTN to IP networks and manage traffic containing a mixture of voice, fax, data and video.
"TD-SCDMA"	Time division synchronous code division multiple access, a 3G technology developed in China to support voice and data transmission.
"WCDMA"	Wideband CDMA, a UMTS standard for 3G digital mobile networks adopting CDMA technologies to provide enhanced capacity for voice with a theoretical maximum data rate of 3Mbps.

COMPANY PROFILE

The Company is listed on the Shenzhen Stock Exchange and the Main Board of the Hong Kong Stock Exchange. The Group is one of the leading providers of high technology telecommunciations equipment in China.

In November 1997, the Company conducted an initial public offering of A shares, which were listed on the Shenzhen Stock Exchange. The Company is currently the largest telecommunications equipment manufacturer in China's A share market in terms of market capitalization, revenue from the principal operations and net profits. In December 2004 the Company conducted an initial public offering of H shares and listed the H shares on the Main Board of the Hong Kong Stock Exchange, making the Company the first A-share company to be listed in Hong Kong.

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

The Group is one of the major telecommunications equipment suppliers in China's telecommunications market and has also succeeded in gaining access to the global telecommunications market with respect to each of its major product segments. The Group has achieved a leading market position for its telecommunications products in China with longstanding cooperative relationships with China's leading telecommunications service providers, including China Telecom, China Netcom, China Mobile and China Unicom. With respect to the global telecommunications market, the Group has sold its products to over 500 customers in more than 100 countries and regions around the world, including telecommunications service providers in the United Kingdom, India, Indonesia, Pakistan, Thailand, Russia, Nigeria, Egypt and Hong Kong. The Group continues to penetrate the markets of the developed countries and has established strategic cooperation relationships with certain global telecommunications service providers including Portugal Telecom and France Telecom.

CORPORATE INFORMATION

1.	Legal name (in Chinese)	中興通訊股份有限公司
	Chinese abbreviation	中興通訊
	Legal name (in English)	ZTE Corporation
	English abbreviation	ZTE
2.	Legal representative	Hou Weigui
3.	Secretary to the Board of Directors	Feng Jianxiong
	Joint company secretaries	Feng Jianxiong Suen Pui Yee, Samantha
	Securities affairs representative	Li Liuhong
	Registered and office address	ZTE Plaza Keji Road South Hi-Tech Industrial Park Nanshan District Shenzhen, People's Republic of China
	Postal code	518057
	Telephone	+ 86 755 26770282
	Facsimile	+ 86 755 26770286
	E-mail	fengjianxiong@zte.com.cn
	Website	http://www.zte.com.cn
	Place of business in Hong Kong	8/F Gloucester Tower The Landmark 15 Queen's Road Central Central, Hong Kong
4.	Authorised representatives	Yin Yimin Block 710 Liantang Pengji Industrial Zone Luohu District Shenzhen, Guangdong Province People's Republic of China Feng Jianxiong c/o ZTE Corporation ZTE Plaza Keji Road South Hi-Tech Industrial Park Nanshan District Shenzhen, Guangdong Province People's Republic of China
5.	Listing information	A shares Shenzhen Stock Exchange Stock code: 000063 Stock name: Zhong Xing Tong Xun H shares Hong Kong Stock Exchange Stock code: 763 Stock name: ZTE
6.	Newspapers designated for information disclosure by the Company	
	Domestic	China Securities Journal Securities Times Shanghai Securities News

CORPORATE INFORMATION

	Hong Kong	The Standard (English) Hong Kong Economic Times (Chinese)
7.	Authorised websites on which this annual report is made available	http://www.cninfo.com.cn http://www.hkex.com.hk
	Place where this annual report is available for inspection	ZTE Plaza Keji Road South Hi-Tech Industrial Park Nanshan District Shenzhen, Guangdong Province People's Republic of China
8.	Hong Kong share registrar and transfer office	Computershare Hong Kong Investor Services Limited Room 1712–16 17th Floor, Hopewell Centre 183 Queen's Road East, Wan Chai, Hong Kong
9.	Legal advisers	
	As to Chinese law	Jun He Law Offices 20th Floor, China Resources Building Beijing, People's Republic of China
	As to Hong Kong and US law	Morrison & Foerster Edinburgh Tower, 41/F, The Landmark 15 Queen's Road Central Central, Hong Kong
10.	Auditors	
	PRC	Ernst & Young Hua Ming 21/F, China Resources Building 5001 Shennan Dong Road Shenzhen, Guangdong Province People's Republic of China
	Hong Kong	Ernst & Young 18/F, Two International Finance Centre 8 Finance Street Central, Hong Kong
11.	Other related information	
	Initial registration date	11 November 1997
	Initial registered address	6th Floor, No. 710 Building Liantang Pengji Industrial Zone, Luohu District Shenzhen, Guangdong Province People's Republic of China
	Date of change of registration	29 September 2000
	Current registered address	ZTE Plaza Keji Road South Hi-Tech Industrial Park, Nanshan District Shenzhen, Guangdong Province People's Republic of China
	Licence registration no.	4403011015176
	Taxation registration certificate number	44030127939873X

CHAIRMAN'S STATEMENT

Dear Shareholders:

I am pleased to present the annual report of the Group for the financial year ended 31 December 2006. On behalf of the Board of Directors, I would like to express my sincere gratitude for your concern and support for ZTE.

REVIEW OF THE PERFORMANCE OF THE GROUP FOR 2006

The Group was confronted with increasing competition in 2006. Nevertheless the management succeeded in driving the overall development of the Group's business under the leadership of the Board of Directors by capitalising on opportunities presented by emerging markets and other regions to expand our international business, overcoming temporary difficulties experienced earlier in the year. The Group's efforts have been well rewarded with a growing share of the domestic telecommunications market and stronger competitiveness for our handset products. Such achievements have provided strong support for the longer-term development of the Group.

The adverse impact of the continuous decline in CDMA and PHS investments in China was effectively curbed as the Group increased the market shares of its GSM, network intelligence and integrated access products. We obtained satisfactory results in TD-SCDMA network trials through close collaboration with carriers, while major breakthroughs in the China Telecom DC1 project and other endeavours positioned the Group favourably for future development in China, its fundamental market.

On the international front, breakthroughs were also achieved to explore the multinational carriers' market in greater depth as the Group continued to implementing the strategy of focusing on mainstream carriers and multinational carriers. The revenue from international business grew to account for 44.4% of the total revenue of the Group, compared to 35.7% in the previous year, underpinning further the importance of internationalisation to business growth of the Group.

Following efforts in the previous year to optimise the global marketing platform, the Group conducted a major organisational reshuffling towards the domestic marketing regime during the interim period to improve its operational efficiency and provide better support to the expansion of the international business. The management standard of the international marketing platform was further improved during the year, as the Company achieved progress in business development through improvement in management measures such as the conducting of performance appraisals and the implementation of the cost leadership strategy.

CHAIRMAN'S STATEMENT

BUSINESS OUTLOOK

In the year ahead, steady growth of the global communications industry combined with the unveiling of the 3G sector in China is set to create a favourable environment for the Group's development. We plan to make further inroads in our strategies of differentiation, human resource deployment and cost leadership and pursue growth through international market expansion, product quality improvement, brand name enhancement, improvements in logistical efficiency and protection of intellectual property rights. Our focus for 2007 is as follows:

For the new year, the Group will focus on making breakthroughs in soliciting mainstream multinational carriers undergoing rapid expansion in emerging markets and realise sales in a more significant scale, while our marketing initiatives in respect of multinational carriers in developed countries will be underpinned by the customisation of new products. All in all, we will pursue a balanced international business portfolio and potential for long-term development.

The PRC market is set to present the Group with new development opportunities in 2007. We will capitalise fully on the strategic occasion of the launching of 3G and endeavour to increase our shares of various domestic carrier markets. Meanwhile, the Group will continue to provide differentiated services and point-to-point integrated solutions that will help our customers develop new businesses and therefore sources for revenue. We will also seek pro-active engagement in strategic cooperation with customers as a driver for organic growth.

After years of dedicated efforts, the Group has now established itself as a world-leading supplier of CDMA system equipment. On this basis, we will continue to originate top-rated, world-class products by enhancing the innovative element of our research and development activities, always effectively market-driven and with the benefit of proven technologies and seasoned talents.

The organisational structure of a company should provide effective backup for its development strategies and, accordingly, the Group conducted an organisational restructuring exercise in early 2007 in tandem with the above-stated strategies and objectives. We believe the adjustment will contribute to enhanced competitive edge and more efficient and satisfactory customer services by consolidating our market planning functions and integrating our commercial and technical capabilities.

The Company and the Board will strive to improve its corporate governance regime and operational transparency in the new year. We are committed to delivering sound results to the shareholders and the society by capitalising on opportunities presented by the domestic 3G sector, the international business and handset products.

Hou Weigui
Chairman

Shenzhen, China
19 April 2007

MAJOR EVENTS

MARCH 2006

ZTE was named again among "The Most Esteemed Enterprise in China 2005" in a poll conducted jointly by the Management Cases Research Centre of Peking University and *the Economic Observer* (《經濟觀察報》).

APRIL 2006

ZTE ranked first in the "Corporate Governance Assessment Report on the Top 100 PRC Listed Companies 2006" announced jointly by the Corporate Governance Centre of China Academy of Social Science and Puhan Company (甫瀚公司).

JUNE 2006

ZTE was honoured with the "Best Share Reform Award" and the "Best Large-scale Company Award" in the "Second Annual Conference for Investors' Relations in China and Investors' Relations Awards for PRC A Share Companies 2005" organised by *Securities Market Weekly* (《證券市場周刊》) and others.

JUNE 2006

ZTE entered into a strategic cooperation agreement with Tata-Indicom, subsidiary of TATA Group, a famous Indian conglomerate. As the sole supplier for the nationwide rural network of Tata-Indicom, ZTE would supply All-IP communications solutions based on CDMA2000 1X to Tata-Indicom in the coming three years and help Tata-Indicom to roll out a rural telecommunications network throughout all India.

AUGUST 2006

ZTE signed a master supply contract for 3G terminal equipment with TELUS, the second largest telecommunications carrier in Canada, signifying another major breakthrough in the high-end markets of Europe and America, the most advanced 3G markets in the world, following partnerships with heavyweights in Europe such as France Telecom and Hutchison 3G.

AUGUST 2006

ZTE ranked 13th with a brand value of US$250 million among "China's Top 20 Brands 2006" named in a poll jointly published by *Business Weekly* and Interbrand, a global brand research institution, being the only telecommunications equipment manufacturer in the list.

SEPTEMBER 2006

ZTE achieved another milestone in its CDMA business as the total capacity of ZTE's global CDMA users exceeded 50 million lines.

DECEMBER 2006

ZTE received the "China Red Star Award for Innovative Products" from China Industrial Design Association for five of its products, namely the "China Window Series Cabinet" (中國窗系列機櫃), "T500 Video Conference Terminal" (T500 視頻會議終端), "H100 Family Gateway" (H100 家庭網關), "120X Series Family Gateway" (I20X 系列家庭網關) and "V200 Video Phone" (V200 可視電話).

MAJOR EVENTS

DECEMBER 2006

On 4 December, ZTE officially announced during the ''ITU World Telecom 2006'' held in the Asia World-Expo of Hong Kong that its WCDMA 3G commercial network users in Libya had exceeded 0.3 million, signifying the inclusion of PRC communication companies among mainstream suppliers of WCDMA 3G commercial networks.

DECEMBER 2006

ZTE's ''Fixed Line 3G Solution'' was named a ''Significant Technology Invention of the IT Sector'', making ZTE the only company to have received the honour for two years in a row since 2001.

FINANCIAL HIGHLIGHTS

(1) MAJOR FINANCIAL DATA OF THE GROUP FOR 2006 PREPARED IN ACCORDANCE WITH PRC GAAP

Unit: RMB in millions

Item	Amount
Total profit	1,069.6
Net profit	807.4
Net profit after extraordinary gains or losses	753.9
Profit from principal operations	7,748.5
Profit from other operations	69.2
Operating profit	427.7
Investment income	31.8
Subsidy income	612.2
Net non-operating expenses	-2.1
Net cash outflow arising from operating activities	-1,555.0
Net decrease in cash	-1,262.1

The extraordinary gain or loss items and amounts are listed below:

Unit: RMB in millions

Item	Amount
Subsidy income	65.1
Non-operating income	24.0
Less: non-operating expenses	26.2
Less: effect of income tax	9.4
Total	53.5

FINANCIAL HIGHLIGHTS

(2) MAJOR FINANCIAL DATA AND INDICATORS OF THE GROUP FOR THE PAST THREE YEARS PREPARED IN ACCORDANCE WITH PRC GAAP

Item	2006	2005	2004
Revenue from principal operations (RMB million)	**23,031.7**	21,575.9	22,698.2
Net profit (RMB million)	**807.4**	1,194.3	1,008.9
Total assets (RMB million)	**25,916.9**	21,779.1	20,830.0
Shareholder's equity (RMB million) (excluding minority interests)	**10,678.9**	10,125.1	9,174.4
Earnings per share (RMB) *	**0.84**	1.24	1.05
Net assets per share (RMB)	**11.13**	10.55	9.56
Return on net assets (%)	**7.56**	11.80	11.00
Adjusted net assets per share (RMB)	**11.12**	10.55	9.53
Net cashflow per share arising from operating activities (RMB)	**-1.62**	0.18	1.71

* During the period from 1 January to the date of this report, there has been no change in the total share capital of the Company, which is 959,521,650 shares.

(3) RETURN ON NET ASSETS AND EARNINGS PER SHARE OF THE GROUP CALCULATED IN ACCORDANCE WITH PRC GAAP

	Return on net assets*		Earnings per share (RMB)*	
Profit for the reporting period	Fully diluted	Weighted average	Fully diluted	Weighted average
Profit from principal operations	72.56%	74.44%	8.08	8.08
Operating profit	4.01%	4.11%	0.45	0.45
Net profit	7.56%	7.76%	0.84	0.84
Net profit after extraordinary gains or losses	7.06%	7.24%	0.79	0.79

* Calculated and completed in accordance with the requirements of Rule No. 9 of the Rules for Information Disclosure and Report Compilation by Companies with Public Listed Securities of the China Securities Regulatory Commission.

FINANCIAL HIGHLIGHTS

(4) CHANGES IN SHAREHOLDERS' EQUITY OF THE GROUP PREPARED IN ACCORDANCE WITH PRC GAAP

Unit: RMB in millions

Items of shareholders' equity	At the beginning of the period	Increase for the period	Decrease for the period	At the end of the period
Share capital	959.5	0	0	959.5
Capital reserve	5,506.4	3.3	0	5,509.7
Surplus reserve	1,264.1	67.0	0	1,331.1
Retained profit	2,171.2	807.4	211.0	2,767.6
Difference in foreign currency translation	-16.0	0	16.9	-32.9
Proposed final dividend	239.9	143.9	239.9	143.9
Total shareholders' equity	10,125.1	1,021.6	467.8	10,678.9

Reasons for the changes:

1. For details of changes in share capital, capital reserve and surplus reserve during 2006, please refer to items 28, 29 and 30 of Note V to the financial statements prepared in accordance with PRC GAAP.

2. The change in retained profit is due to the net profit in 2006.

3. The change in conversion difference in foreign currency statement is due to the significant change in foreign currency exchange rate.

4. The decrease in proposed final dividend is due to the implementation of the profit distribution plan for 2005 in the proportion of RMB2.50 (tax inclusive) for every 10 shares.

FINANCIAL HIGHLIGHTS

(5) MAJOR FINANCIAL DATA OF THE GROUP PREPARED IN ACCORDANCE WITH HKFRSs

Unit: RMB in millions

	For the year ended 31 December				
	2006	2005	2004	2003	2002
Results					
Turnover	**23,031.7**	21,575.9	21,220.1	17,036.1	10,795.9
Cost of sales	**(15,250.5)**	(14,101.7)	(13,813.5)	(11,226.1)	(6,924.2)
Gross profit	**7,781.2**	7,474.2	7,406.6	5,810.0	3,871.7
Other revenue and gains	**792.1**	681.6	534.1	252.0	312.1
Research and development costs	**(2,832.7)**	(1,959.5)	(2,265.2)	(1,535.7)	(1,127.9)
Selling and distribution expenses	**(3,274.6)**	(3,186.4)	(2,799.6)	(1,981.5)	(1,277.0)
Administrative expenses	**(1,097.6)**	(1,095.4)	(981.4)	(869.0)	(542.4)
Other operating expenses	**(191.5)**	(128.6)	(162.4)	(213.9)	(212.6)
Profit from operating activities	**1,176.9**	1,785.9	1,732.1	1,461.9	1,023.9
Finance costs	**(153.7)**	(175.9)	(140.4)	(171.2)	(122.3)
Share of profits and losses of jointly-controlled entities and associates	**7.5**	(4.2)	3.1	(3.6)	4.2
Profit before tax	**1,030.7**	1,605.8	1,594.8	1,287.1	905.8
Tax	**(127.1)**	(179.8)	(115.0)	(198.5)	(159.7)
Profit before minority interests	**903.6**	1,426.0	1,479.8	1,088.6	746.1
Minority interests	**(136.6)**	(138.3)	(207.3)	(60.3)	(42.5)
Net profit from ordinary activities attributable to shareholders	**767.0**	1,287.7	1,272.5	1,028.3	703.6

Unit: RMB in millions

	As at 31 December				
	2006	2005	2004	2003	2002
Assets and liabilities					
Total assets	**26,787.2**	22,464.0	21,007.8	16,476.4	12,022.8
Total liabilities	**15,461.4**	11,742.8	11,312.2	11,649.9	8,124.8
Minority interests	**561.9**	470.7	478.4	226.6	215.4
Shareholders' equity (excluding minority interests)	**10,763.9**	10,250.5	9,217.2	4,599.9	3,682.6

FINANCIAL HIGHLIGHTS

(6) MAJOR FINANCIAL INDICATORS OF THE GROUP PREPARED IN ACCORDANCE WITH HKFRSs

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

Note: The above figures are calculated in accordance with HKFRSs.

(7) RECONCILIATION OF DIFFERENCES OF NET PROFIT 2006 AND SHAREHOLDERS' EQUITY OF THE GROUP AS AT DECEMBER 2006 PREPARED IN ACCORDANCE WITH PRC GAAP AND HKFRSs

Unit: RMB in millions

	PRC GAAP	HKFRSs
Net profit for 2006	807.4	767.0
Shareholders' equity for 2006	10,678.9	10,763.9
Explanation of differences	For details please refer to Note 46 to financial statements prepared under HKFRSs	

CHANGES IN SHARE CAPITAL AND INFORMATION OF SHAREHOLDERS

(1) CHANGES IN SHARE CAPITAL AS AT 31 DECEMBER 2006

Unit: shares

	Opening balance		Change during the year (+/-)					Closing balance	
	Number of shares	Percentage (%)	Issue of new shares	Unlocking of shares subject to lock-up[1]	Transfer from capital reserves	Bonus issue	Sub-total	Number of shares	Percentage (%)
I. Shares subject to lock-up	**423,084,674**	**44.09**		**-110,819,869**			**-110,819,869**	**312,264,805**	**32.54**
1. State-owned shares	0	0		0			0	0	0
2. State-owned legal person shares	392,079,904	40.86		-81,097,163			-81,097,163	310,982,741	32.41
3. Others domestic shares comprising:	12,713,874	1.32		-11,431,810			-11,431,810	1,282,064	0.13
Domestic legal person shares	11,431,810	1.19		-11,431,810			-11,431,810	0	0
Domestic natural person shares (including shares held by senior management of the Company)	1,282,064	0.13		0			0	1,282,064	0.13
4. Foreign shares comprising:	18,290,896	1.91		-18,290,896			-18,290,896	0	0
Foreign legal person shares	18,290,896	1.91		-18,290,896			-18,290,896	0	0
Foreign natural person shares	0	0		0			0	0	0
II. Shares not subject to lock-up	**536,436,976**	**55.91**		**+110,819,869**			**+110,819,869**	**647,256,845**	**67.46**
1. RMB ordinary shares	376,285,936	39.22		+110,819,869			+110,819,869	487,105,805	50.77
2. Domestic-listed foreign shares	0	0		0			0	0	0
3. Overseas-listed foreign shares (H shares)	160,151,040	16.69		0			0	160,151,040	16.69
4. Others	0	0		0			0	0	0
III. Total number of shares	**959,521,650**	**100**		**0**			**0**	**959,521,650**	**100**

Note 1: On 29 December 2006, 110,819,869 A shares held by holders of non-circulating shares of the Company were granted trading status and made available for listing and circulation. Please refer to the Indicative Announcement on the Unlocking of Shares of ZTE Corporation published by the Company on the designated website for information disclosure on 25 December 2006 for details.

Note 2: As at the end of reporting period, the Company did not have any employee shares.

(2) ISSUE OF NEW SHARES BY THE COMPANY FOR THE PAST THREE YEARS ENDED 31 DECEMBER 2006

Year of issue	Class of shares	Date of issue	Issue price	Quantity (no. of shares)	Date of listing	No. of shares approved for listing	Date on which trading ceased
2004	H Share	29/11/2004	HKD22	160,151,040	9/12/2004	160,151,040	—

CHANGES IN SHARE CAPITAL AND INFORMATION OF SHAREHOLDERS

(3) SHAREHOLDERS AS AT 31 DECEMBER 2006

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

The Company had 37,729 shareholders in total (of which 37,324 were holders of A shares and 405 were holders of H shares).

Top ten shareholders Name of shareholders		Nature of shareholders	Percentage shareholding (%)	Total no. of shares held (shares)	Number of shares held that are subject to lock-up (shares)	Number of shares pledged or locked up
1.	Zhongxingxin	State-owned shareholders	37.41	358,958,824	310,982,741	None
2.	HKSCC Nominees Limited	Foreign shareholders	16.64	159,643,439	0	Unknown
3.	JADE DRAGON (MAURITIUS) LIMITED	Foreign shareholders	1.91	18,290,896	0	Unknown
4.	ICBC Credit Suisse Stable Growth Stock Securities Investment Fund	Others	1.45	13,875,942	0	Unknown
5.	DEUTSCHE BANK AKTIENGESELLSCHAFT	Foreign shareholders	1.32	12,699,431	0	Unknown
6.	ICBC Credit Suisse Selected and Balanced Hybrid Fund	Others	1.26	12,096,825	0	Unknown
7.	Hunan Nantian (Group) Co., Ltd	Others	1.19	11,431,810	0	Unknown
8.	E Fund Selective Value	Others	0.92	8,860,354	0	Unknown
9.	China Life Insurance Company Limited — Dividends — Individual Dividends — 005L-FH002 Shen	Others	0.86	8,208,418	0	Unknown
10.	ICBC Credit Suisse Core Value Stock Securities Investment Fund	Others	0.73	7,009,592	0	Unknown

CHANGES IN SHARE CAPITAL AND INFORMATION OF SHAREHOLDERS

Top ten holders of shares not subject to lock-up

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

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

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

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

CHANGES IN SHARE CAPITAL AND INFORMATION OF SHAREHOLDERS

2. Controlling shareholder of the Company

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

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

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

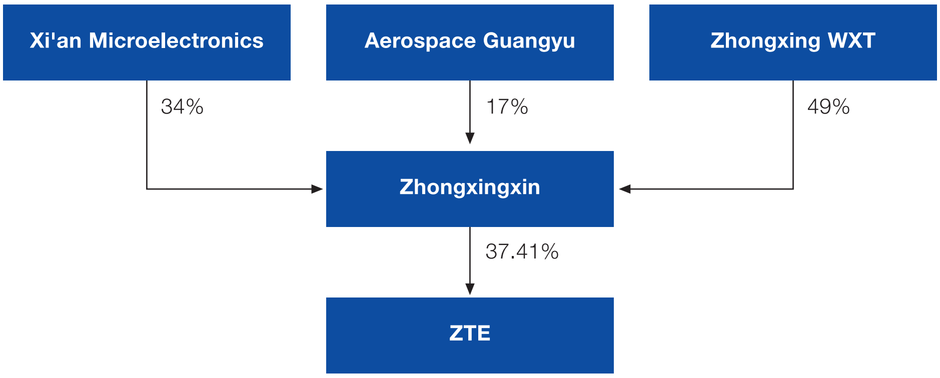
- Xi'an Microelectronics, a subsidiary of China Aerospace Times Electronics Corporation, is a large state-owned research institute, which was established in 1965 with an initial capital amounting to RMB198,530,000 upon its establishment. The legal representative of the institute is Mr. Zhang Junchao. It is the only specialized research institute in China which integrates and complements the research, development and production of semiconductor integrated circuits, mixed integrated circuits and computers.

- Aerospace Guangyu, a subsidiary of CASIC, is a wholly state-owned enterprise established on 20 March 1984. The legal representative is Mr. Xie Weiliang and the registered capital amounts to RMB17,950,000. The scope of business includes aerospace technology products, mechanical products, electrical appliance products, apparatuses and instruments; electronic products, plastic products, chemical products, hoisting and transportation products, hardware and furniture, construction materials, magnetic materials, powder metallurgy, Chinese-manufactured automobiles (except sedans), warehousing and import and export operations.

- Zhongxing WXT is a private high-technology enterprise incorporated on 23 October 1992. Its legal representative is Mr. Hou Weigui and its registered capital amounts to RMB10,000,000. The scope of business includes the development and production of telecommunications and transmission equipment, associated equipment, computer and peripheral equipment.

CHANGES IN SHARE CAPITAL AND INFORMATION OF SHAREHOLDERS

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



4. Number of shares held by shareholders subject to lock-up and terms of lock-up

(1) *Time for listing and trading of shares subject to lock-up*

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

CHANGES IN SHARE CAPITAL AND INFORMATION OF SHAREHOLDERS

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

No	Name of shareholders subject to lock-up	Shares held subject to lock-up	Time for listing and trading	Number of additional shares to be listed and traded (shares)	Lock-up terms
1	Zhongxingxin	358,958,824	29 December 2006	47,976,083	Notes 1, 2
			29 December 2007	47,976,083	and 3
			29 December 2008	263,006,658	
2	Jade Dragon (Mauritius) Limited	18,290,896	29 December 2006	18,290,896	Notes 2 & 3
3	Hunan Nantian (Group) Co., Ltd	11,431,810	29 December 2006	11,431,810	Notes 2 & 3
4	Lishan Microelectronics Corporation	5,520,180	29 December 2006	5,520,180	Notes 2 & 3
5	CASIC Shenzhen (Group) Company, Limited	5,520,180	29 December 2006	5,520,180	Notes 2 & 3
6	Shaanxi Telecommunications Industrial Company	5,520,180	29 December 2006	5,520,180	Notes 2 & 3
7	China Mobile Telecommunications No. 7 Research Institute	5,520,180	29 December 2006	5,520,180	Notes 2 & 3
8	Jilin Posts and Telecommunications Equipment Company	5,520,180	29 December 2006	5,520,180	Notes 2 & 3
9	Hebei Telecommunications Equipment Company, Limited	5,520,180	29 December 2006	5,520,180	Notes 2 & 3

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

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

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

The price of "RMB30.76" specified in the special undertaking by Zhongxingxin set out above has been adjusted to "RMB30.51" following the implementation of the 2005 profit distribution plan of the Company on 14 July 2006.

Note 2: The listed shares converted from the previously Non-circulating shares of the Company held by such shareholder shall not be traded or transferred within 12 months following the implementation date of the Share Reform Plan.

Note 3: Please refer to the Indicative Announcement on the Unlocking of Shares of ZTE Corporation published by the Company on the designated website for information disclosure on 25 December 2006 for details.

CHANGES IN SHARE CAPITAL AND INFORMATION OF SHAREHOLDERS

5. Interests of substantial shareholders and other persons in shares or debentures

As at 31 December 2006, the following shareholders were interested in 5% or more in the issued share capital of the Company, as shown in the share register maintained by the Company in accordance with Section 336 of the Securities and Futures Ordinance:

Name	Number of shareholding	Approximate shareholding as a percentage (%) of: Total share capital	The relevant class of shares
Zhongxingxin	358,958,824 A shares (L)	37.41	44.91 (L)
Zhongxing WXT	358,958,824 A shares (L)	37.41	44.91 (L)
Xi'an Microelectronics	358,958,824 A shares (L)	37.41	44.91 (L)
China Aerospace Times Electronics Corporation	358,958,824 A shares (L)	37.41	44.91 (L)
China Aerospace Science and Technology Corporation	358,958,824 A shares (L)	37.41	44.91 (L)
Fidelity International Limited	14,299,800 H shares (L)	1.49	8.93 (L)
Goldman Sachs (Asia) L L C	11,622,000 H shares (L)	1.21	7.26 (L)
Goldman Sachs (Cayman) Holding Company	11,622,000 H shares (L)	1.21	7.26 (L)
Deutsche Bank Aktiengesellschaft	11,927,100 H shares (L)	1.24	7.45 (L)
	7,895,400 H shares (S)	0.82	4.93 (S)
Allianz SE	11,215,700 H shares (L)	1.17	7.00 (L)
Aranda Investments (Mauritius) Pte Ltd	11,141,800 H shares (L)	1.16	6.96 (L)
T. Rowe Price Associates, Inc. and its affiliates	9,077,500 H shares (L)	0.95	5.67 (L)
Massachusetts Financial Services Company (''MFS'')	8,428,100 H shares (L)	0.88	5.26 (L)
Sun Life Financial, Inc.	8,428,100 H shares (L)	0.88	5.26 (L)
The Capital Group Companies, Inc.	8,207,900 H shares (L)	0.86	5.13 (L)
Halbis Capital Management (Hong Kong) Limited	8,205,800 H shares (L)	0.86	5.12 (L)

(L) long position; (S) short position; (P) lending pool

Save as disclosed above, as at 31 December 2006, so far as the Directors, Supervisors and senior management of the Company are aware, no person had an interest or short position in the shares and underlying shares of the Company that was required to be recorded in the register maintained pursuant to section 336 of the Securities and Futures Ordinance.

6. Shareholding of the public shareholders

On the basis of publicly available information known to the Board of Directors, as at 17 April 2007 the Company has sufficient public shareholding, in compliance with the minimum requirement of Hong Kong Stock Exchange Listing Rules.

DIRECTORS, SUPERVISORS, SENIOR MANAGEMENT AND EMPLOYEES

(1) BIOGRAPHICAL DETAILS OF DIRECTORS, SUPERVISORS AND SENIOR MANAGEMENT

1. Biography of Directors

Mr. Hou Weigui, 65, is the Chairman of the Board of Directors and a non-executive Director of the Company. Mr. Hou is a senior engineer and one of the founders of Shenzhen Zhongxing Semiconductor Co., Ltd., and Zhongxingxin. He was the director and President of the Company responsible for its overall operational management since the Company was listed on the Shenzhen Stock Exchange in 1997 to February 2004. He has been Chairman of the Company since February 2004 and is concurrently the Vice-chairman of Zhongxingxin as well as the Chairman of Zhongxing WXT. He has extensive experience in the telecommunications business and over 37 years of management experience.

Mr. Wang Zongyin, 62, is a Vice Chairman of the Board of Directors and a non-executive Director of the Company. Mr. Wang graduated from the Faculty of Mechanical Engineering, Beijing Institute of Technology in 1968, specializing in rocket design. Mr. Wang served as the secretary to the Party Committee and deputy head of the China Academy of Launch Vehicle Technology from 2001 to February 2003, and as the general manager of China Aerospace Times Electronics Corporation, and the Chairman of the Board of Directors of the Long March Launch Vehicle Technology Co., Ltd. from February 2003 to the present. He has been Vice Chairman of the Company since February 2004. Mr. Wang is the Member of the 10th National Committee of the Chinese People's Political Consultative Conference and representative of the 12th People's Congress, Beijing Municipality. Mr. Wang has substantial experience in management and business operations.

Mr. Xie Weiliang, 51, is a Vice Chairman of the Board of Directors and a non-executive Director of the Company. Mr. Xie graduated from the Faculty of Politics, National University of Defense Technology in 1982 and holds the title of professor. He served as the head of Nanjing Aerospace Management Cadres Institute from 2001 to 2003, and as the general manager of Aerospace Technology Shenzhen (Group) Co. Ltd and Shenzhen Aerospace Guangyu Industrial (Group) Co. Ltd since 2003. He has been Vice Chairman of the Company since February 2004. Mr. Xie has substantial experience in management and business operations.

Mr. Zhang Junchao, 53, is a non-executive Director of the Company. Mr. Zhang graduated from the Faculty of Electronic and Wireless Electricity Engineering, Xi'an Jiaotong University in 1977. He served as the deputy head of the Ninth Research Institute of CASC from 2000 to March 2003, and from March 2003 as the deputy secretary to the Party Committee of China Aerospace Times Electronics Corporation, head of its Shaanxi Management Division and head of Xi'an Microelectronics. Since March 2006, he has acted as the head of the centre of design and manufacture of integrated circuits of China Aerospace Times Electronics Corporation. He has been Non-executive Director of the Company since February 2004. Mr. Zhang has substantial experience in management and business operations.

Mr. Li Juping, 51, is a non-executive Director of the Company. Mr. Li graduated from the Department of Technical Physics, Northwest Institute of Telecommunications Engineering (now known as Xidian University) in 1982, and holds the title of researcher. He served as the head of Xi'an Microelectronics and the general manager of Lishan Microelectronics Corporation from 2000 to 2003, and as the chief engineer of China Aerospace Times Electronics Corporation from 2003 to the present. He has been Non-executive Director of the Company since April 1999. Mr. Li has substantial experience in management and business operations.

Mr. Dong Lianbo, 50, is a non-executive Director of the Company. Mr. Dong graduated from Northeastern University specialising in Business Administration in 2001, and holds the title of researcher and senior engineer. He served as the director and deputy general manager of Shenyang Aerospace Xinguang Group from 2001 to 2002, and as the Deputy Team Head of the Shenzhen Business Integration Working Group of CASIC from 2002 to 2003, and as the deputy general manager of Aerospace Technology Shenzhen (Group) Co., Ltd. since 2003. He has been Non-executive Director of the Company since February 2004. Mr. Dong has substantial experience in management and business operations.

DIRECTORS, SUPERVISORS, SENIOR MANAGEMENT AND EMPLOYEES

Mr. Yin Yimin, 43, is an executive Director of the Company, Mr Yin has been the President of the Company since 2004. He is responsible for the day-to-day management and operation of the Company. Mr. Yin is a senior engineer and graduated from the Nanjing University of Posts and Telecommunications (formerly ‘‘Nanjing Institute of Posts and Telecommunications’’) in 1988 with a Master of Science degree in engineering, specialising in telecommunications and electronic systems. Mr. Yin served as a Manager of the Research and Development Department of Shenzhen Zhongxing Semiconductor Co., Ltd. from 1991, and as Deputy General Manager of Zhongxingxin between 1993 and 1997. During the periods from 1997 to 1999 and from 1999 to 2004, he served as the Company's Vice-President and Senior Vice-President respectively and was in charge of different divisions such as research and development, marketing, sales and handsets operations. He has been an executive director of the Company since November 1997 He has many years of experience in the telecommunications industry, including over 16 years in managerial positions.

Mr. Shi Lirong, 43, is an executive Director of the Company. Mr. Shi has been a Senior Vice President of the Company since 1999 and is responsible for the sales operations of the Company. He is a senior engineer graduated from Shanghai Jiao Tong University in 1989 with a Master of Science degree in engineering, specialising in telecommunications and electronic engineering. Mr. Shi served as an engineer in Shenzhen Zhongxing Semiconductor Co., Ltd. from 1989 to 1993. From 1993 to 1997, he was the Deputy General Manager of Zhongxingxin, and from 1997 to 1999, the Vice-President of the Company responsible for marketing and sales functions of the Company. Since 1999 he has been the Senior Vice President of the Company in charge of marketing and sales. He has been an executive director of the Company since February 2001. He has many years of experience in the telecommunications industry, including over 16 years in managerial positions.

Mr. He Shiyou, 40, is an executive Director of the Company. Mr. He has been a Senior Vice President of the Company since 1999 and is responsible for the handset business of the Company. Mr. He is a senior engineer graduated from Beijing University of Posts and Telecommunications in 1990 with a Master of Science degree in engineering, specialising in electromagnetic field and microwave technology. Mr. He joined Zhongxingxin in 1993 and previously was the chief engineer of the Nanjing Research Centre and deputy head of the Shanghai Research Centre. He was the Company's Vice-President from 1998 to 1999 responsible for divisions such as research and development and marketing. Since 1999 he has been the Senior Vice President of the Company in charge of the Second Sales Division and the Handset Department. He has been an executive director of the Company since February 2001. He has many years of experience in the telecommunications industry, including over 14 years in managerial positions.

Mr. Zhu Wuxiang, 41, is an Independent Non-executive Director of the Company. Mr. Zhu is currently a professor and deputy chairman of the Department of Finance of the School of Economics and Management, Tsinghua University. Mr. Zhu graduated from Tsinghua University in 2002, specialising in economics and has obtained a doctorate degree. He has been studying and working at Tsinghua University since 1982. Mr. Zhu has been Independent Non-executive Director of the Company since July 2003. Mr. Zhu also holds concurrent independent directorships with Beijing Sanyuan Food Co., Ltd (北京三元食品股份有限公司), Tengda Construction Group Co., Ltd (浙江騰達建設股份有限公司), Zhuhai Eastcom Peace Smart Card Co.,Ltd (珠海東信和平智能卡股份有限公司) and JiangXi GanNan Fruit Co., Ltd (贛南果業股份有限公司).

Mr. Chen Shaohua, 45, is an Independent Non-executive Director of the Company. Mr. Chen is currently a professor and the deputy head of the Accounting Development and Research Centre of Xiamen University. Mr. Chen graduated from Xiamen University in 1992, specialising in accounting, and has obtained a doctorate degree. Since 1983, he has been engaged in teaching and academic research at the Department of Accounting of Xiamen University. He has been Independent Non-executive Director of the Company since July 2003.

DIRECTORS, SUPERVISORS, SENIOR MANAGEMENT AND EMPLOYEES

Mr. Qiao Wenjun, 36, is an Independent Non-executive Director of the Company. Currently, he is a partner of Zhong Lun Law Firm and the head of its Shanghai office. Mr. Qiao graduated from Fudan University in 1999, specialising in company law, and has obtained a master's degree in law. He had worked at Shanghai People's Municipal Government Overseas Chinese Affairs Department, and from 1994 to 2001, he was a partner of Pu Dong Law Firm. From 2001 to present, he has been a partner of Zhong Lun Law Firm, the head of its Shanghai office and a lawyer. He has been Independent Non-executive Director of the Company since July 2003.

Mr. Mi Zhengkun, 61, is an Independent Non-executive Director of the Company. Mr. Mi is currently a professor of the Telecommunications Engineering Department of Nanjing University of Posts and Telecommunications. Mr. Mi graduated from Nanjing University of Posts and Telecommunications in 1981, specialising in telecommunications, and has obtained a master's degree. He is a member of the expert panel of ITU-T. He is involved in various scientific research and development projects at the State and provincial levels. Since 1982, Mr. Mi has been engaged in teaching and scientific research at Nanjing University of Posts and Telecommunications. He has been Independent Non-executive Director of the Company since February 2004.

Mr. Li Jin, 39, is an Independent Non-executive Director of the Company. Mr. Li is currently the vice president of Technology Exchange Ltd. Mr. Li graduated from Peking University in China in 1989, majoring in biochemistry and received his juris doctor degree from Columbia University Law School in the United States of America in 1994. From 1997 to 2002, he was a lawyer of Skadden, Arps, Slate, Meagher & Flom LLP, and from 2002 to November 2003 a partner at Linklaters, an international law firm. From November 2003 to present, he has been the vice president of Technology Exchange Ltd. He has been Independent Non-executive Director of the Company since June 2004. Mr. Li is concurrently the independent director of Dragon Pharmaceutical Inc. (a company registered in Canada and listed on NASDAQ Stock Market in U.S.A).

2. Joint Company Secretaries

Mr. Feng Jianxiong, 33, the Secretary to the Board of Directors of the Company, is responsible for the Securities and Investor Relations department of the Company. Mr. Feng graduated from Tianjin University of Finance and Economics with a bachelor degree in economics specialising in international finance. Mr. Feng joined Zhongxingxin in July 1996. He has been the Secretary to the Board of Directors, and subsequently the head of the Investment Department, the Securities and Finance Department and the Securities and Investor Relations Department of the Company since 2000. Mr Feng has many years of experience in the telecommunications industry, including over 7 years in managerial positions.

Ms. Suen Pui Yee, Samantha, 51, was appointed as the joint secretary of the Company in November 2004. Ms. Suen obtained her MBA degree from the Kellogg School of Management of Northwestern University and the School of Business and Management of Hong Kong University of Science and Technology. Ms. Suen is the managing director of KCS Limited, a company which provides independent and integrated corporate services in Asia. Ms. Suen specializes in professional corporate secretarial services with more than 20 years' experience in corporate governance, administration and management. Ms. Suen is a fellow of The Hong Kong Institute of Chartered Secretaries, The Institute of Chartered Secretaries and Administrators of the United Kingdom, The Taxation Institute of Hong Kong and The Hong Kong Institute of Directors.

3. Biography of Supervisors

Mr. Zhang Taifeng, 65, the Chairman of the Supervisory Committee of the Company. Mr. Zhang graduated from Jilin University with a bachelor's degree in semiconductor technology in 1966. He has previously held the positions of chief engineer and head of State-owned No. 691 Factory and head of X'ian Microelectronics. He joined Zhongxingxin in April 1993. He had been the Chairman of the Board of Directors from November 1997 to February 2004. Mr. Zhang has been the Chairman of the Supervisory Committee since February 2004.

DIRECTORS, SUPERVISORS, SENIOR MANAGEMENT AND EMPLOYEES

Mr. Wang Wangxi, 40, is a Supervisor of the Company, and is Assistant to Vice President and the Head of the Executive Division. He graduated from the Electronic Engineering faculty of Southeast University in 1991 with a master's degree in electro-physics and devices. From June 1991 to October 1994, Mr. Wang worked as a teacher in the Electronic Engineering faculty of Southeastern University. Mr. Wang joined Zhongxingxin in October 1994. He was the chief executive officer of Zhongxing Telecom Pakistan (Pvt) Ltd. and deputy general manager of the Company's First Sales Division.

Ms. He Xuemei, 36, is a Supervisor of the Company and is in charge of the labor union of the Company. Ms. He graduated from Chongqing University with a bachelor's degree in mechanical engineering and a second bachelor's degree in business administration respectively obtained in 1991 and 1995. Ms. He worked at the Student Affairs Department of Chongqing University, She has worked with ZTE Kangxun and the Network Operations Division of the Company after joining the Company in January 1998.

Mr. Qu Deqian, 45, is a Supervisor of the Company. Mr. Qu graduated from the Shaanxi Economics Institute with a Undergraduate Diploma in Statistics in June 1992 and further obtained the qualification of senior accountant in the PRC in October 1994. From 1997 to 2003, Mr. Qu was the Chief of the Accounting and Auditing Centre of the Company and Deputy Chief of the Financial Centre. He has been the deputy general manager of Zhongxing WXT since 2003.

Ms. Wang Yan, 42, is a Supervisor of the Company. Ms. Wang graduated from the Department of Management and Industrial Accounting of Northeast Industrial Institute in July 1988 with a Bachelor's degree in engineering. Ms. Wang was qualified as an accountant in the PRC in December 1992 and further obtained the qualification of senior accountant in the PRC in September 1999. She joined Zhongxingxin in 1999 and had previously served as the Manager of the Financial Department. She is currently the Deputy General Manager and Chief Accountant of Zhongxingxin.

4. Biography of the Management

Mr. Yin Yimin is the President of the Company. Please refer to his biography under "Biography of Directors" in this section.

Mr. Shi Lirong is a Senior Vice President of the Company. Please refer to his biography under "Biography of Directors" in this section.

Mr. He Shiyou is a Senior Vice President of the Company. Please refer to his biography under "Biography of Directors" in this section.

Mr. Wei Zaisheng, 44, has been a Senior Vice President of the Company since 1999 and is responsible for the financial affairs of the Company. Mr. Wei graduated from the Peking University with a master's degree in business administration in 2004. He joined Shenzhen Zhongxing Semiconductor Co., Ltd. in 1988 and served as the chief financial officer and an assistant to the general manager of Zhongxingxin from 1993 to 1997. During the period from 1997 to 1999, he was the Vice President of the Company. Since 1999 he has been the Senior Vice President of the Company in charge of the financial affairs of the Company. Mr. Wei has many years of experience in the telecommunications industry, including over 18 years in managerial positions.

Mr. Xie Daxiong, 43, has been a Senior Vice President of the Company since 2004 and is responsible for the research and development of the Company. Mr. Xie is a senior engineer and holds the title of professor. He graduated from the Nanjing University of Science and Technology in 1986, specialising in applied mechanics, and has obtained a Master of Science degree in engineering. Mr. Xie joined Zhongxingxin in 1994 and had been the head of the Nanjing Research Institute of Zhongxingxin. From 1998 to 2004, Mr. Xie was the CDMA products manager, and subsequently the general manager of the Company's CDMA Division. Since 2004, he has been the Senior Vice President of the Company in charge of the Technology Centre of the Company. Mr. Xie has many years of experience in the telecommunications industry, including over 10 years in managerial positions.

DIRECTORS, SUPERVISORS, SENIOR MANAGEMENT AND EMPLOYEES

Ms. Zhou Susu, 52, has been a Senior Vice President of the Company since 1999 and is responsible for the human resources and administration of the Company. Ms. Zhou is a senior engineer graduated from the Hong Kong University of Science and Technology in 2004, specialising in business administration, and has obtained a master's degree in business administration. Ms. Zhou joined Shenzhen Zhongxing Semiconductor Co., Ltd. in 1990. From 1993 to 1997 she served as the manager of the Research and Development Division and deputy general manager of Zhongxingxin. During the period from 1997 to 1999 she was a Vice President of the Company. Since 1999 she has been the Senior Vice President of the Company in charge of the human resources centre, the President's Office and ZTE Institute of the Company. Ms. Zhou has many years of experience in the telecommunications industry, including over 16 years in managerial positions.

Mr. Tian Wenguo, 38, has been a Senior Vice President of the Company since 2005 and is responsible for the marketing operations of the Company. Mr. Tian graduated from Harbin Institute of Technology in 1991 with a bachelor of science degree in engineering, specializing in electromagnetic surveys and devices. Mr. Tian joined Zhongxingxin in 1996, and from 1997 to 2002, he was the manager of the Company's Chongqing Sales Office and the general manager of the Southwest Region, and from 2002 to 2005, he was the Vice President and general manager of Second Sales Division of the Company. Since 2005, he has been the Senior Vice President of the Company in charge of the Second Sales Division. Mr Tian has many years of experience in the telecommunications industry, including over 9 years in managerial positions.

Ms. Fang Rong, 42, has been a Vice President since 1998 and is responsible for Fourth Sales Division of the sales operations of the Company. Ms. Fang is a senior engineer, graduated from the Nanjing University of Posts and Telecommunications (formerly "Nanjing Institute of Posts and Telecommunications") in 1987 with a bachelor of science degree in engineering, specialising in telecommunications engineering. From 1987 to 1995, Ms. Fang carried out research and development work in the Wuhan Academy of Postal and Telecommunications Sciences of the Ministry of Posts and Telecommunications. From 1995 to 1997, she worked in marketing in Zhongxingxin. Since 1998 she has been the Vice President of the Company in charge of the General Product Division and the Fourth Sales Division. Ms. Fang has many years of experience in the telecommunications industry, including over 11 years in managerial positions.

Ms. Chen Jie, 48, has been a Vice President of the Company since 2002 and is responsible for commercial technology of the marketing operations. Ms. Chen graduated from the Nanjing University of Posts and Telecommunications (formerly "Nanjing Institute of Posts and Telecommunications") in 1989, specialising in telecommunications and from the New York University's Department of Computer Science in 1994 with a double master's degree. Ms. Chen holds the titles of senior researcher and senior engineer. From 1989 to 1992, Ms. Chen was a manager of the Development Division of Shenzhen Zhongxing Semiconductor Co., Ltd. From 1995 to 1998, she was the senior researcher and head of the Research Department of AT&T Bell Laboratory. From 1998 to the beginning of 2002, she served as the general manager of the Company's subsidiaries in the USA. Since 2002, she has been the Vice President of the Company in charge of the Networking Operations Division. Ms Chen has many years of experience in the telecommunications industry, including over 11 years in managerial positions.

Mr. Ding Mingfeng, 37, has been a Vice President of the Company since 1998 and is responsible for overseas telecommunications operations. Mr. Ding graduated from Harbin Institute of Technology in 1994, specializing in computer science and has obtained a master of science degree in engineering. From 1994 to 1995 Mr. Ding carried out research and development work in Zhongxingxin. From 1995 to 1997 he served as deputy head of Zhongxingxin's Nanjing Research Institute. Since 1998, he has been the Vice President of the Company in charge of the Switch Products Division, the First Sales Division, the Technology Centre and the Quality Planning Centre. He has many years of experience in the telecommunications industry, including over 10 years in managerial positions.

Mr. Zhang Chuanhai, 41, is a Vice President of the Company since 2002. Mr. Zhang graduated from the China Academy of Post & Telecommunications in 1990, specialising in telecommunications and electronic systems, and has obtained a master's degree. From 1991 to 1993, Mr. Zhang carried out research and development work in Shenzhen Zhongxing Semiconductor Co., Ltd. He joined Zhongxingxin in 1993, and from 1997 to 2002, he served as general manager of the Company's Southern China Sales Region and deputy general manager of the Second Sales Division. Mr. Zhang has many years of experience in the telecommunications industry, including over 9 years in managerial positions.

DIRECTORS, SUPERVISORS, SENIOR MANAGEMENT AND EMPLOYEES

Mr. Ye Weimin, 40, has been a Vice President of the Company since 2001 and is responsible for ZTE Kangxun of the Company's logistics operations. Mr. Ye graduated from Shanghai Jiao Tong University in 1988 with a bachelor of science degree in engineering, specialising in computer science and engineering. He joined Zhongxingxin in 1994 and was previously involved in the engineering research and development of digital programme-control switches and mobile communication systems. From 1997 to 2001, he served as the chief officer of the Company's Central Laboratory, head of the quality control department of Mobile Operations Division and the Customer Services Department and deputy general manager of the Third Sales Division. Since 2001, he has been Vice President of the Company in charge of the Mobile Operations Division and the Fifth Sales Division. Mr Ye has many years of experience in the telecommunications industry, including over 11 years in managerial positions.

Mr. Qiu Weizhao, 43, has been a Vice President of the Company since 1998, and is responsible for the logistics operations of the Company. Mr. Qiu is a senior engineer, graduated from Xi'an University of Electronic Technology in 1988, specialising in telecommunications and electronic systems, and has obtained a master of science degree in engineering. Mr. Qiu joined Changde Wired Communication (Group) Company in 1988 and served as the deputy general manager. He joined the Company in 1998 as Vice President and has been in charge of the Company's logistics and procurement operations since then. Mr Qiu has many years of experience in the telecommunications industry, including over 18 years in managerial positions.

Mr. Ni Qin, 47, has been a Vice President of the Company since 1998 and is responsible for IT functions of research and development. Mr. Ni graduated from Shanghai School of Posts and Telecommunications in 1981, specialising in telecommunications. From 1981 to 1994, Mr. Ni carried out technological research and development work in Shanghai Postal and Telecommunication Research Institute No. 1. He served as head of Shanghai Research Institute of Zhongxingxin from 1994 to 1997. Since 1998 he has been Vice President of the Company in charge of the access product Division, the Handset Division and IT construction. Mr Ni has many years of experience in the telecommunications industry, including over 12 years in managerial positions.

Mr. Zhao Xianming, 40, has been a Vice President of the Company since 2004 and is responsible for marketing. Mr. Zhao graduated from the Harbin Institute of Technology in 1997 specialising in telecommunications and electronic systems and has obtained a doctorate of science degree in engineering. From 1991 to 1998, Mr. Zhao served as a deputy manager of the Communication Engineering Teaching and Research Office of Harbin Institute of Technology. He joined the Company in 1998 and engaged in the research, development and management of the CDMA products, and had been the head of the Research & Development Group, project manager and general product manager from 1998 to 2003. Since 2004, he has been the Vice President of the Company in charge of the CDMA Division of the Company. Mr Zhao has many years of experience in the telecommunications industry, including over 15 years in managerial positions.

Mr. Xu Huijun, 33, has been a Vice President of the Company since 2004 and is responsible for the after-sales services of the sales operations of the Company. Mr. Xu graduated from Tsinghua University in 1998 with a master of science degree in engineering, specialising in electronic engineering. He joined the Company in 1998 and has served as a project manager of the General Products Division, the head of Beijing Research Centre and the general manager of the general products division from 1998 to 2003. Since 2004 he has been Vice President of the Company in charge of the general products division. Mr. Xu has many years of experience in the telecommunications industry, including over 8 years in managerial positions.

Mr. Pang Shengqing, 38, has been a Vice President of the Company since 2006 and is responsible for the Company's First Sales Divison of sales operations. Mr Pang is an engineer, graduated from Huazhong University of Science and Technology, specializing in mechanical manufacturing and obtained a doctorate of science degree in engineering in 1995. He was awarded with the Guangdong Science and Technology Award in May 2002. Mr. Pang joined Zhongxingxin in 1995. From 1997 to 2000, Mr. Pang was involved in research and development of the Company's CDMA core technology research and hardware systems. Mr. Pang was deputy general manager of the CDMA Division and general manager of the First Sales Division from 2001 to 2005. Since 2006, he has been Vice President of the Company in charge of the First Sales Division. He has many years of experience in the telecommunications industry, including over 8 years in managerial positions.

DIRECTORS, SUPERVISORS, SENIOR MANAGEMENT AND EMPLOYEES

Mr. Zhong Hong, 37, has been a Vice President of the Company since 2006 and is responsible for sales of corporate networks and network of government institutions, channels sales operations. Mr. Zhong graduated from Shanghai Jiaotong University with a master of science degree in engineering specialising in mechanical engineering in 1995. Mr. Zhong joined Zhongxingxin in 1995. From 1997 to 2005, Mr. Zhong was a director of Shanghai Research Institute and products general manager of the Network Business Division of the Company. Since 2006, he has been Vice President of the Company in charge of the Company's Data Business Division. He has many years of experience in the telecommunications industry, including over 6 years in managerial positions.

Mr. Fan Qingfeng, 38, has been a Vice President of the Company since 2006, and is responsible for the Company's Beijing branch. Mr. Fan graduated from Liaoning Engineering Technology University in 1992 with a bachelor's degree, specialising in industrial electrical automation. He graduated from Tsinghua University in 2006 with a master's degree in business administration. He joined Zhongxingxin in 1996. From 1997 to 2005, Mr. Fan acted as the project manager of the Company's Zhengzhou office, the manager of Chongqing office, regional vice president of Eastern China region and manager of Ji'nan Office, deputy general manager of the Company's Second Sales Division and head of Beijing branch. Since 2006, he has been Vice President of the Company in charge of the Beijing Branch. He has many years of experience in the telecommunications industry, including over 7 years in managerial positions.

Mr. Yu Yong, 40, has been a Vice President of the Company since 2006 and is currently in charge of financing of the financial operations of the Company. Mr. Yu graduated from Nankai University in 1995 with a master's degree in business administration. Mr. Yu joined the Company in 1997 and was director of the Financial Management Centre and the Financial Centre from 1997 to 2005. Since 2006, he has been Vice President of the Company in charge of the financing of the financial operations of the Company. Mr Yu has many years of experience in the telecommunications industry, including over 10 years in managerial positions.

Mr. Zeng Xuezhong, 33, has been a Vice President of the Company since August 2006 and is responsible for the Company's Third Sales Division of sales operations. Mr. Zeng graduated from Tsinghua University with a bachelor of science degree in engineering in modern applied science in 1996. Mr. Zeng joined Zhongxingxin in 1996. From 1997 to August 2006, Mr. Zeng was the Company's senior project manager, manager of Guiyang branch and manager of Kunming branch, deputy general manager and general manager of the Second Sales Division. Since August 2006, he has been Vice President of the Company in charge of the Third Sales Division. Mr. Zeng has many years of experience in the telecommunications industry, including over 7 years in managerial positions.

Mr. Feng Jianxiong is the secretary to the board of directors of the Company. Please refer to ''Joint Company Secretaries'' in this section.

DIRECTORS, SUPERVISORS, SENIOR MANAGEMENT AND EMPLOYEES

(2) CHANGES IN THE SHAREHOLDINGS AND REMUNERATION OF DIRECTORS, SUPERVISORS AND SENIOR MANAGEMENT OF THE COMPANY

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

Note 1: The above term represents the term of the third session of the Board of Directors and the third session of the Supervisory Committee. Details of the re-election of the members of the fourth session of the Board of Directors and the fourth session of the Supervisory Committee and the re-appointment and new appointment of senior management members by the Board of Directors are set out in the section headed "(V) CHANGES IN DIRECTORS, SUPERVISORS AND SENIOR MANAGEMENT" hereunder.

DIRECTORS, SUPERVISORS, SENIOR MANAGEMENT AND EMPLOYEES

(3) INFORMATION CONCERNING DIRECTORS, SUPERVISORS AND SENIOR MANAGEMENT HOLDING POSITIONS IN SHAREHOLDERS OF THE COMPANY

Name	Name of shareholder	Position in the shareholder	Term of office
Hou Weigui	Zhongxingxin	Vice Chairman	4/2004–4/2007
Xie Weiliang	Zhongxingxin	Vice Chairman	4/2004–4/2007
	CASIC Shenzhen (Group) Company Limited	Director and General Manager	Since 2003
Zhang Junchao	Lishan Microelectronics Corporation	General Manager	Since 10/2003
Dong Lianbo	Zhongxingxin	Director	4/2004–4/2007
	CASIC Shenzhen (Group) Company Limited	Director and Deputy General Manager	Since 2003
Yin Yimin	Zhongxingxin	Director	4/2004–4/2007
Shi Lirong	Zhongxingxin	Director	4/2004–4/2007
Zhang Taifeng	Zhongxingxin	Chairman	4/2004–4/2007
Qu Deqian	Zhongxingxin	Supervisor	4/2004–4/2007
Wang Yan	Zhongxingxin	Deputy General Manager	4/2004–4/2007

(4) INFORMATION CONCERNING DIRECTORS, SUPERVISORS AND SENIOR MANAGEMENT HOLDING POSITIONS IN ENTITIES OTHER THAN SHAREHOLDERS OF THE COMPANY

Name	Name of entity in which position is held	Position
Hou Weigui	Holds positions in 8 subsidiaries including ZTE Software	Chairman
	Zhongxing WXT	Chairman
Wang Zongyin	China Aerospace Times Electronics Corporation	General Manager
	Long March Launch Vehicle Technology, Co., Ltd	Chairman
Xie Weiliang	Shenzhen Aerospace Guangyu Industrial (Group) Company	General Manager
Zhang Junchao	Xi'an Microelectronics	Legal representative
Li Juping	China Aerospace Times Electronics Corporation	Chief engineer
Dong Lianbo	Shenzhen Aerospace Guangyu Industrial (Group) Company	Deputy General Manager
Zhu Wuxiang	Tsinghua University	Professor
	Beijing Sanyuan Food Co., Ltd	Independent Director
	Tengda Construction Group Co., Ltd	Independent Director
	Zhuhai Eastcom Peace Smart Card Co.,Ltd	Independent Director
	JiangXi GanNan Fruit Co., Ltd	Independent Director
Chen Shaohua	Xiamen University	Professor
Qiao Wenjun	Zhong Lun Law Firm	Partner/the head of Shanghai office
Mi Zhengkun	Nanjing University of Posts and Telecommunications	Professor
Li Jin	Technology Exchange Ltd	Vice President
	Dragon Pharmaceutical Inc.	Independent Director
Zhang Taifeng	Holds positions in 2 subsidiaries including ZTE Kangxun	Chairman
Yin Yimin	Holds positions in 10 subsidiaries including ZTE Kangxun	Chairman/Director
	Zhongxing WXT	Vice Chairman
Shi Lirong	Holds positions in 11 subsidiaries including ZTE Kangxun	Chairman/Director
	Zhongxing WXT	Director
He Shiyou	Holds positions in 2 subsidiaries including Shenzhen Changfei Investment Company, Limited	Chairman/Director
	Zhongxing WXT	Supervisor

DIRECTORS, SUPERVISORS, SENIOR MANAGEMENT AND EMPLOYEES

Name	Name of entity in which position is held	Position
Wei Zaisheng	Holds positions in 10 subsidiaries including ZTE Kangxun	Chairman/Director
	Zhongxing WXT	Director
Xie Daxiong	Shenzhen Zhongxing Wireless Communication Equipment Company Limited (深圳市中興無綫通訊設備有限公司)	Chairman/Director
Zhou Susu	Holds positions in 8 subsidiaries including ZTE (H.K.) Limited	Chairman/Director
	Zhongxing WXT	Director
Qiu Weizhao	Holds positions in 4 subsidiaries including ZTE (H.K.) Limited	Director/General Manager
Fang Rong	Holds positions in 3 subsidiaries including ZTE (H.K.) Limited	Chairman/Director
Chen Jie	Holds positions in 8 subsidiaries including Nanjing Zhong Xing Software Development Technology Co., Ltd.	Chairman/Director
Ding Mingfeng	Holds positions in 11 subsidiaries including ZTE (H.K.) Limited	Chairman/Director
Tian Wenguo	Holds positions in 3 subsidiaries including Beijing Zhongxing Intelligent Transportation Systems Ltd.	Chairman/Director
Zhang Chuanhai	Zhongxing WXT	Supervisor
	Shenzhen Zhongxing International Investment Company Limited (深圳市中興國際投資有限公司)	General Manager
Zhao Xianming	Holds positions in 4 subsidiaries including Zimax (Cayman) Holding Co.	Director
Xu Huijun	Holds positions in 3 subsidiaries including Wuxi Zhongxing Optoelectronics Technologies Company, Limited	Chairman/Director
Yu Yong	Shenzhen Zhongxing International Investment Company Limited (深圳市中興國際投資有限公司)	Chairman
	Holds positions in 2 subsidiaries including Congo-Chine Telecom S.A.R.L.	Director
Zeng Xuezhong	Holds positions in 2 subsidiaries including Anhui Wantong Posts and Telecommunications Company, Limited	Chairman
Qu Deqian	Hold positions in 2 subsidiaries including Shenzhen Kangquan Electromechanical Company, Limited	Director/Supervisor
	Zhongxing WXT	Deputy General Manager
Wang Yan	Hold positions in 3 subsidiaries including Zhongxing Xinyu	Director/Supervisor
Feng Jianxiong	Holds positions in 2 subsidiaries including Shenzhen Zhongxing Telecom Equipment Technology & Service Company, Limited	Supervisor

(5) CHANGES IN DIRECTORS, SUPERVISORS AND SENIOR MANAGEMENT

1. Changes in Directors, Supervisors and Senior Management during the reporting period

(1) There were no changes in Directors and supervisors of the Company during the year.

(2) *Changes in senior management of the Company*

Mr Pang Shengqing, Mr Zhong Hong, Mr Fan Qingfeng and Mr Yu Yong were each appointed a vice president of the Company pursuant to the resolution on the appointment of senior management considered and approved at the sixteenth meeting of the third session of the Board of Directors of the Company convened on 6 April 2006.

Mr Zeng Xuezhong was appointed a vice president of the Company pursuant to the resolution on the appointment of senior management considered and approved at the eighteenth meeting of the third session of the Board of Directors of the Company convened on 24 August 2006.

DIRECTORS, SUPERVISORS, SENIOR MANAGEMENT AND EMPLOYEES

2. Changes in Directors, Supervisors and Senior Management after the year

At the Second Extraordinary Meeting of the Company for 2007 convened on 30 March 2007, all Directors of the third session of the Board of Directors of the Company were re-elected as Directors of the fourth session of the Board of Directors of the Company. The term of the fourth session of the Board of Directors of the Company shall be from 30 March 2007 to 29 March 2010.

At the Second Extraordinary Meeting of the Company for 2007 convened on 30 March 2007, Mr Qu Deqian and Ms Wang Yan, being Shareholders' Representative Supervisors of the third session of the Supervisory Committee of the Company, were re-elected Shareholders' Representative Supervisors of the fourth session of the Supervisory Committee of the Company. Mr Zhang Taifeng, Mr Wang Wangxi and Ms He Xuemei, being Staff Representative Supervisors of the third session of the Supervisory Committee of the Company, were re-elected Staff Representative Supervisors of the fourth session of the Supervisory Committee of the Company through democratic elections by the staff representative of the Company on 30 January 2007. The term of the fourth session of the Supervisory Committee of the Company shall be from 30 March 2007 to 29 March 2010.

At the first meeting of the fourth session of the Board of Directors of the Company, Mr Hou Weigui was elected Chairman of the fourth session of the Board of Directors and Mr Wang Zongyin and Mr Xie Weiliang were elected Vice Chairmen of the fourth session of the Board of Directors. The fourth session of the Board of Directors approved the re-appointment of Mr Yin Yimin as President of the Company, the re-appointment of Mr. Shi Lirong, Mr He Shiyou, Mr Wei Zaisheng (who was also re-appointed as Chief Financial Officer of the Company), Mr Xie Daxiong, Ms Zhou Susu and Mr Tian Wenguo each as a Senior Vice President, the new appointment of Mr Qiu Weizhao as a Senior Vice President of the Company, the re-appointment of Ms Chen Jie, Ms Fang Rong, Mr Zhao Xianming, Mr Ding Mingfeng, Mr Pang Shengqing, Mr Fan Qingfeng, Mr Zeng Xuezhong, Mr Xu Huijun, Mr Yu Yong, Mr Ye Weimin, Mr Zhong Hong, and Mr Ni Qin each as a Vice President of the Company, the new appointment of Mr Wu Zengqi as a Vice President of the Company, the re-appointment of Mr Feng Jianxiong as a Secretary to the Board of the directors of the Company.

(6) DECISION MAKING PROCESS AND CRITERIA FOR DECIDING REMUNERATION OF DIRECTORS, SUPERVISORS AND SENIOR MANAGEMENT

The Remuneration and Evaluation Committee makes recommendations on the allowances for Directors by reference to the performance of Directors as well as the levels offered by other listed companies in the industry. Such recommendations shall be confirmed upon consideration and approval both by the Board of Directors and the general meetings of shareholders.

The Supervisory Committee makes recommendations on the allowances for Supervisors by reference to the working conditions of Supervisors as well as the levels offered by other listed companies in the industry. Such recommendations shall be confirmed upon consideration and approval at the general meetings of shareholders.

The Remuneration and Evaluation Committee conducts appraisals on the performance of the senior management annually, and determines their remuneration according to the appraisal results.

DIRECTORS, SUPERVISORS, SENIOR MANAGEMENT AND EMPLOYEES

(7) THE GROUP'S EMPLOYEES AND JOB DIVISION

As at the end of the year, the Group had 39,266 employees, with an average age of 27.6. There were 21 retired employees.

Classification by specialisation as follows:

Specialisation	Number of employees	Percentage of total number of employees (%)
R&D	13,600	34.6
Marketing and Sales	4,644	11.8
Customer Service	7,266	18.5
Manufacturing	8,321	21.2
Administration	5,435	13.9
Total	39,266	100

Classification by academic qualifications:

Academic qualifications	Number of employees	Percentage of total number of employees (%)
Doctorate degree	410	1.0
Master's degree	8,932	22.8
Bachelor's degree	18,220	46.4
Others	11,704	29.8
Total	39,266	100

CORPORATE GOVERNANCE STRUCTURE

(1) CORPORATE GOVERNANCE REPORT PREPARED IN ACCORDANCE WITH CHINESE SECURITIES REGULATORY REQUIREMENTS

1. Status of corporate governance

Shareholders and general meetings: The Company has established a corporate governance structure to ensure that all shareholders can fully exercise their rights and enjoy equal status, in particular, for minority shareholders. Sufficient time should be provided at general meetings of shareholders, which are to be convened legally and validly, for the discussion of each proposal, to provide a good opportunity for communications between the Board and the shareholders. In addition, shareholders may contact the Company through its shareholder hotline during normal working hours or through its designated e-mail address for any enquiries.

Controlling shareholder and the listed company: the Company's controlling shareholder is Zhongxingxin. The controlling shareholder exercises its rights as an investor in strict compliance with the law, without adversely affecting the lawful rights and interests of the Company and other shareholders. Candidates for election as Directors and Supervisors are nominated in strict compliance with laws and regulations and the terms and procedures as set out in the Articles of Association. The staffing, assets, financial affairs, organisation and business of the controlling shareholder are independent to those of the listed company, with the controlling shareholder and listed company each carrying out independent auditing and assuming its own responsibilities and risks. The controlling shareholder has not directly or indirectly interfered with the decision-making and business activities of the Company beyond the general meeting.

Directors and Board of Directors: the Company appoints directors in strict compliance with the procedures set out its Articles of Association, ensuring that the directors are appointed in an open, fair, just and independent manner. In order to fully reflect the opinions of minority shareholders, a cumulative voting scheme is adopted for the appointment of directors. The Board of Directors has a reasonable professional structure, acting in the best interests of the Company and in good faith. The Company has formulated a set of rules of procedure for Board of Directors meetings, and board meetings are convened and held in strict compliance with the Articles of Association and Rules of Procedure of the Board of Directors Meetings. To optimise the corporate governance structure, three specialist committees - the Nomination Committee, Audit Committee and Remuneration and Evaluation Committee - have been established by the Board of Directors in accordance with the Governance Standards for Listed Companies. The majority of members and the convenors in each of these committees are Independent Directors, providing scientific and professional opinions and reference for the decision-making by the Board of Directors.

Supervisors and Supervisory Committee: The Supervisors possess professional knowledge and work experience in legal, accounting and other areas and are elected by way of cumulative voting. They monitor the financial affairs and supervise the lawful and regulatory performance of duties by the Company's Directors, the President and other members of the senior management, and safeguard the legal rights and interests of the Company and shareholders. The Company has formulated a set of rules of procedure for the Supervisory Committee meetings. Meetings of the Supervisory Committee are convened and held in strict compliance with the Articles of Association and the Rules of Procedure for Supervisory Committee Meetings.

Results appraisal and incentive binding mechanism: during the reporting period, the Remuneration and Evaluation Committee of the Board of Directors has linked the salaries of the senior management with the results of the Company and personal performance of the individual, in accordance with the Proposal on the Management of Remuneration and Performance of the Senior Management. Senior management personnel are recruited and appointed in strict compliance with relevant rules, regulations and the Articles of Association. In order to establish a long-term incentive mechanism closely linked with the Company's business performance and long-term strategy, so as to help optimise the overall remuneration structure and create a competitive advantage in human resources that will contribute to the long-term, sustainable growth of the Company's operation, the Remuneration and Evaluation Committee of the Board of Directors of the Company has formulated Phase I of the Share Incentive Scheme of the Company, which has been approved by the general meeting of the Company and has started to take effect.

CORPORATE GOVERNANCE STRUCTURE

Stakeholders: the Company respects the legal rights and interests of banks and other stakeholders such as creditors, employees, consumers, suppliers, and the community, and works actively together with these stakeholders to promote the sustainable and healthy development of the Company.

Information disclosure and transparency: the secretary to the Board of Directors and relevant professional officers are responsible for the Company's information disclosure obligations and reception of visits by shareholders and handling of shareholder enquiries. The Company discloses relevant information in strict compliance with Fair Information Disclosure by Companies Listed on the Shenzhen Stock Exchange and the Articles of Association in a true, accurate, complete and timely manner, and ensures that all shareholders have an equal opportunity to obtain access to information.

2. Performance of duties by Independent Non-executive Directors

During the reporting period, the Independent Directors' function in perfecting the corporate governance structure of the Company and protecting the interests of minority shareholders was particularly evident. During the reporting period, the Independent Directors of the Company raised no objections on the resolutions passed by the Board of Directors meetings and other matters of the Company. In relation to important matters for which they were required to give independent opinions (including connected transactions, third-party guarantees,the appointment of Directors and senior management and the Share Incentive Scheme), the Independent Directors have seriously considered the matters and have issued written independent opinions. The Independent Directors provided valuable and professional recommendations on major decisions by the Company, improving the rationality and objectiveness of the Company's decisions. Attendance of Independent Directors of the Company at Board of Directors meetings during 2006 was as follows:

Name of Independent Director	Number of Board Meetings requiring attendance	Attendance in person	Attendance by proxy	Absent
Zhu Wuxiang	5	3	2	0
Chen Shaohua	5	5	0	0
Qiao Wenjun	5	3	2	0
Mi Zhengkun	5	4	1	0
Li Jin	5	5	0	0

3. "Five Separations"

The Company is independent of its controlling shareholder Zhongxingxin in respect of the staff, assets, finance, organisation and business. Each of the Company and Zhongxingxin is audited independently and assumes its own responsibilities and risks.

With respect to staffing, the Company is fully independent in matters including the management of labour, human resources and salaries. Members of the senior management receive their remuneration from the Company and do not receive any remuneration from the controlling shareholder or take up other major positions other than as directors.

With respect to assets, the Company's assets are fully independent and the Company has clear ownership of its assets. The Company has an independent production system, a supplementary production system and associated facilities. Intangible assets such as industrial property rights, trademarks, and other non-patentable technologies are owned by the Company. The Company's procurement and sales systems are independently owned by the Company.

With respect to finance, the Company has an independent financial department. It has established an independent accounting and auditing system and a financial management system, and maintains an independent bank account.

CORPORATE GOVERNANCE STRUCTURE

With respect to business, the Company's business is fully independent from the controlling shareholder. Neither the controlling shareholder nor its subsidiaries are engaged in any business identical or similar to that of the Company.

With respect to organisation, the Board of Directors, the Supervisory Committee and other internal organisations of the Company operate in complete independence from the controlling shareholder. There are no subordinate relationships between the controlling shareholder (and its functional departments) and the Company (and its functional departments).

4. Establishment and Implementation of the Appraisal and Incentive Mechanism for Senior Management of the Company

The Company has established a performance appraisal system for senior management and an incentive mechanism linking remuneration to the Company's results and the individual staff member's performance. The Remuneration and Evaluation Committee is mainly responsible for formulating and examining proposals for the management of remuneration and performance of the Directors and senior management of the Company, conducting annual performance appraisals for the senior management of the Company and determining the remuneration of the senior management based on the results of the appraisal.

(2) CORPORATE GOVERNANCE REPORT PREPARED IN ACCORDANCE WITH THE REQUIREMENTS OF THE LISTING RULES OF THE STOCK EXCHANGE OF HONG KONG

The Group is dedicated to raising the corporate governance standards and improving the accountability and transparency of the Group by adopting stringent corporate governance practices, with a view to maximising value for its shareholders in the long term.

The Group had fully complied with all the principles and code provisions of the Code on Corporate Governance Practices set out as Appendix 14 to the Rules Governing the Listing of Securities on the Stock Exchange of Hong Kong Limited (the ''Listing Rules'') in 2006.

I. Shareholders

The Board of Directors and the senior management understand that it is their responsibility to act in the interest of the shareholders as a whole and to use their best effort to enhance value for shareholders. To comply with the new Company Law of the People's Republic of China (''Company Law'') enacted on 1 January 2006, the Company had made comprehensive revisions to the Articles of Association and the revision was reviewed and passed by the shareholders by way of special resolution at the annual general meeting of the Company held on 14 June 2006.

The Company Law and the Articles of Association provide that shareholders holding more than 10% of the shares of the Company alone or in aggregate shall have the right to request the Board of Directors to convene an extraordinary general meeting; shareholders holding more than 3% of the shares of the Company alone or in aggregate shall have the right to propose ex tempore motions and submit the same in writing to the convenor 10 days prior to the convening of the general meeting.

The Company has always maintained sound communications with its shareholders by reporting the Group's results and operations to Shareholders through numerous official channels, such as disclosures in annual reports, interim reports and quarterly reports. Shareholders may also express their views or exercise their rights through communication channels set up by the Group, such as the investors' hotline and e-mail contacts. In particular, the Company regards the convening of its annual general meeting as one of the most important events for the Company. All Directors and members of the senior management will attend the meeting on a best effort basis and engaged in direct dialogue with the shareholders who will be given time to raise questions.

Please refer to the Articles of Association posted on the website designated for information disclosure (http://www.cninfo.com.cn) on 7 April 2006 for information relating to the procedures of general meetings, voting by shareholders and the appointment of proxies.

CORPORATE GOVERNANCE STRUCTURE

Details of the shareholding structure of the Company are set out in the section headed ''Changes in Share Capital and information of Shareholders'' of this Annual Report.

II. Board of Directors

Members of the Board of Directors seek to act in the best interests of the Company, providing leadership and supervision over the Group and assuming joint and individual responsibility to all shareholders of the Company in respect of the management, control and operations of the Company.

(I) *Functions of the Board*

The Board of Directors is responsible for convening general meetings, reporting its work to the general meeting, implementing resolutions of the general meeting in a timely manner, monitoring the development of the overall operational strategy of the Company, deciding on the operational direction and investment plans of the Company, as well as supervising and guiding the management of the Company. The Board of Directors should also monitor the business and financial performance and formulate the annual financial budgets and final accounts of the Company.

The Directors confirm that it is their responsibility to prepare financial statements in respect of each financial year to give a true and fair report on the Group's conditions, as well as the results and cash flow accounts for the relevant periods. The Directors have consistently applied appropriate accounting policies and complied with all applicable accounting standards in preparing the financial statements for the year ended 31 December 2006. After due enquiries, the Directors are of the opinion that the Group has sufficient resources to carry on operations in the foreseeable future, and as a result it is appropriate for the Group to prepare its financial statements on an ongoing concern basis.

(II) *Composition of the Board*

The Board of the Company comprises fourteen Directors, including a Chairman and two Vice Chairmen. All Directors (save for the Chief Executive Officer and two Executive Directors) are Non-executive Directors independent of the management, including five Independent Non-executive Directors who have substantial experience and possess academic and professional qualifications in the telecommunications, financial, legal and banking sectors and who are able to exercise influence in a pro-active manner, and six Non-executive Directors who have extensive business and management experience. Their presence enables stringent review and control of the management procedures and ensures that the interests of shareholders as a whole, including minority shareholders, are safeguarded. The profile and terms of office of the Directors are set out under the section headed ''Directors, Supervisors, Senior Management and Staff'' of this annual report.

The Company confirms that it has received written confirmations of independence from all the Independent Directors regarding their independence in accordance with Rule 3.13 of the Listing Rules. The Company is of the opinion that all such Directors are independent persons.

(III) *Appointment and Removal of Directors*

The term of office of each Director is 3 years for each session, which may be extended upon expiry, and the term of office of each Independent Non-executive Director must not be longer than 6 years. Each of the Directors has entered into a Director's Service Contract with the Company for a term of three years (the term of office of a Director appointed during a session would be less than 3 years). The appointment and removal of Directors is subject to the approval of the general meeting of the Company. Details of the Directors of the Fourth Session of the Board of Directors of the Company to be re-elected are set out under the section headed ''Changes in the Directors, Supervisors and Senior Management'' of this annual report.

CORPORATE GOVERNANCE STRUCTURE

(IV) *Board Meetings*

1. The Articles of Association requires that the Board of Directors should convene at least four meetings a year. In 2006, the Board of Directors of the Company convened five working meetings in 2006, the details of which are set out under the section headed "Daily Work of the Board of Directors" of this Annual Report. Attendance of Directors at the on-site meetings of the Board of Directors in 2006 was as follows:

Members of the Board of Directors	Attendance in person	Attendance by proxy
Hou Weigui	5/5	—
Wang Zongyin	3/5	2/5
Xie Weiliang	3/5	2/5
Zhang Junchao	3/5	2/5
Li Juping	4/5	1/5
Dong Lianbo	5/5	—
Yin Yimin	5/5	—
Shi Lirong	3/5	2/5
He Shiyou	2/5	3/5
Zhu Wuxiang	3/5	2/5
Chen Shaohua	5/5	—
Qiao Wenjun	3/5	2/5
Mi Zhengkun	4/5	1/5
Li Jin	5/5	—

2. As required by the Articles of Association, all Directors should be given 14 days' notice prior to the commencement of a regular Board of Directors meeting and 3 days' notice prior to the commencement of an interim Board of Directors meeting. The secretary to the Board of Directors should provide details of a regular Board of Directors meeting (including information in relation to each of the specialist Board committees) not later than 3 days prior to the commencement of the meeting to ensure all Directors are briefed on matters to be considered in the meeting in advance.

   As for interim Board of Directors meetings which are convened by means of telephone or video conference as requested by the Company's management, information about the meeting would be provided simultaneously to all Directors via e-mail and facsimile and sufficient time would be given to the Directors to consider the matters. The secretary to the Board of Directors would respond to any questions raised by the Directors and take appropriate action in a timely manner to assist Directors to ensure that the procedures of the Board of Directors is in compliance with the applicable regulations, such as Company Law of the People's Republic of China, the Articles of Association and the Hong Kong Stock Exchange Listing Rules.

3. Minutes of each Board of Directors meeting should be signed by the attending Directors and person taking the minutes, and be kept for a term of 10 years, during which the minutes are available for Directors' inspection from time to time upon their request.

4. When the Board of Directors considers any matters, including connected transactions, that are considered by the Board of Directors as a material conflict of interest, any Directors who are by any means connected would abstain from voting.

CORPORATE GOVERNANCE STRUCTURE

(V) *Measures Taken to Ensure the Performance of Duties by Directors*

1. The Company would supply the Director with all the relevant and necessary information when the Director takes office. The Company subsequently provide the Directors with all the newly promulgated laws and regulations as well as information and development concerning the Company, such as its internal publications, and arrange for the Directors to attend relevant continuing professional training courses, in order to assist them in understanding their duties as a director under the requirements of relevant laws and regulations, such as the Listing Rules, as well as gaining comprehensive insight in the Company's operation in a timely manner.

2. Whenever the Directors of the Company are required to provide an opinion in relation to matters including provision of external guarantees, appropriation of funds and connected transactions, the Company would engage relevant independent professional bodies, such as auditors, independent financial advisors and lawyers, to provide independent and professional advice so as to assist the Directors in performing their duties.

3. The Company has purchased liability insurance for Directors, Supervisors and senior management from AIU Insurance Company Shenzhen Branch in respect of potential legal actions arising from the performance of duties by the Directors and the policy was considered and approved at the nineteenth meeting of the third session of the Board of Directors held on 25 October 2006 with the mandate of the general meeting.

(VI) *Board Committees*

There are three specialist committees under the Board of Directors, namely the Remuneration and Evaluation Committee, the Nomination Committee and the Audit Committee. The terms of reference defining the responsibilities and authority for each of the specialist committees have been formulated. The order of meeting for the specialist committees is implemented by reference to the statutory procedures for meetings of the Board of Directors.

1. *The Remuneration and Evaluation Committee*

(1) The role and functions of the Remuneration and Evaluation Committee

The Remuneration and Evaluation Committee is responsible for determining and reviewing specific remuneration packages and performances of the Directors and senior management based on the management policies and structures for the remuneration and performance of Directors and senior management laid down by the Board of Directors.

(2) Members and Meetings of the Remuneration and Evaluation Committee

The Remuneration and Evaluation Committee comprises seven members, including four Independent Directors, two Non-executive Directors and one Executive Director. The convenor of the Remuneration and Evaluation Committee is Independent Director Mr. Zhu Wuxiang. Members of the committee include Mr. Hou Weigui, Mr. Wang Zongyin, Mr. Yin Yimin, Mr. Chen Shaohua, Mr. Mi Zhengkun and Mr. Li Jin.

At the twentieth meeting of the third session of the Board of Directors of the Company convened on 15 December 2006, the Board of Directors considered and approved the resolution regarding the resignation of Mr Yin Yimin (Executive Directors and President of the Company) as a member of the Remuneration and Evaluation Committee of the third session of the Board of Directors of the Company (mainly owing to the relevant regulations of competent State authorities that remuneration and evaluation committees of listed companies planning to implement share incentive schemes should be formed by external directors). It also approved the amendment of the provision regarding the number of committee numbers in the Working Rules of the Remuneration and Evaluation Committee of the Board of Directors of the Company (namely from seven members to six members).

CORPORATE GOVERNANCE STRUCTURE

In 2006, the Remuneration and Evaluation Committee convened four meetings. Attendance at the meetings was as follows:

Members of the Remuneration and Evaluation Committee	Attendance in person	Attendance by proxy
Zhu Wuxiang	3/4	1/4
Hou Weigui	3/4	1/4
Wang Zongyin	3/4	1/4
Yin Yimin	2/4	2/4
Chen Shaohua	4/4	—
Mi Zhengkun	3/4	1/4
Li Jin	4/4	—

(3) The decision-making process and criteria for determining remuneration for Directors and senior management

The Remuneration and Evaluation Committee makes recommendations to the Board of Directors on the allowances for Directors by reference to the work performance of the Directors of the Company as well as the levels offered by other listed companies in the industry. Such recommendations shall be confirmed upon consideration and approval both by the Board of Directors and the general meeting.

The Remuneration and Evaluation Committee reviews remuneration appraisals on an annual basis to determine the annual remuneration budget. It also conducts annual performance appraisals in respect of each senior management personnel of the Company and determines the remuneration of such senior management personnel based on the results of such appraisals.

(4) Work of the Remuneration and Evaluation Committee during the year

The Remuneration and Evaluation Committee held four meetings in 2006 to review the remuneration packages for 2005 and the remuneration budget of the Company for 2006. It also reviewed the Performance of the President and other senior management of the Company for 2005 and determined their remuneration for 2005.

As a specialist committee under the Board of Director, the Remuneration and Evaluation Committee formulated Phase I of the Share Incentive Scheme of the Company and The Performance Appraisal System for Phase I of the Share Incentive Scheme, to establish a long-term incentive mechanism closely linked with the Company's business performance and long-term strategy, so as to help optimise the overall remuneration structure and create a competitive advantage in human resources that will contribute to the long-term, sustainable growth of the Company. The scheme has started implementation upon approval by the general meeting of the Company. The Remuneration and Evaluation Committee will deal with matters pertaining to the Share Incentive Scheme within its scope of authority mandated by the general meeting.

2. *The Nomination Committee*

(1) The role and functions of the Nomination Committee

The Nomination Committee is primarily responsible for considering standards and procedures for the selection of Directors and senior management of the Company. The committee considers the criteria, procedures and duration of appointment for Directors and senior management of the Company in accordance with relevant laws and regulations and the Articles of Association and taking into account the actual conditions of the Company. The Nomination Committee then submits a proposal to the Board of Directors for its approval, and implements the decisions made by the Board of Directors.

CORPORATE GOVERNANCE STRUCTURE

(2) Members and Meetings of the Nomination Committee

The Nomination Committee comprises seven members, including four Independent Non-executive Directors and three Non-executive Directors. The convenor of the Nomination Committee is Independent Director Mr. Mi Zhengkun. Members of the committee included Mr. Hou Weigui, Mr. Xie Weiliang, Mr. Li Juping, Mr. Zhu Wuxiang, Mr. Qiao Wenjun and Mr. Li Jin.

In 2006, the Nomination Committee convened two meetings. Attendance of the meetings was as follows:

Members of the Nomination Committee	Attendance in person	Attendance by proxy
Mi Zhengkun	1/2	1/2
Hou Weigui	1/2	1/2
Xie Weiliang	1/2	1/2
Li Juping	2/2	—
Zhu Wuxiang	2/2	—
Qiao Wenjun	1/2	1/2
Li Jin	2/2	—

(3) Procedures for the election and appointment of Directors and the senior management

The Nomination Committee conducts extensive searches for candidates of Directors and senior management both internally in the Company, its subsidiaries or associate companies and externally in the open market after considering the Company's requirements for new Directors and senior management. With the consent of the potential candidates, a meeting of the Nomination Committee will be convened to examine the qualifications of the initial nominees based on the conditions for appointment of Directors and senior management. One month prior to the election of new Directors, the Nomination Committee will propose candidates for directorship to the Board of Directors and furnish the Board with relevant information. Prior to the appointment of any new senior management staff, the Nomination Committee will also propose to the Board of Directors candidates to be appointed as senior management staff and furnish the Board with relevant information.

(4) Work of the Nomination Committee during the year

In 2006, the Nomination Committee held two meetings to approve resolutions on the appointments of Mr Pang Shengqing, Mr Zhong Hong, Mr Fan Qingfeng, Mr Yu Yong and Mr Zeng Xuezhong as Vice Presidents of the Company and submit the same to the Board of Directors for review and approval.

3. *The Audit Committee*

(1) The role and functions of the Audit Committee

The Audit Committee is primarily responsible for making recommendations to the Board of Directors on the appointment and dismissal, remuneration and terms of engagement of external auditors, supervising the implementation of the Company's internal audit system, reviewing the financial information of the Company and its disclosure (including the inspection of the Company's financial statements and annual reports and accounts, interim reports and quarterly reports as to whether they are complete, as well as the review of significant opinions on financial reporting contained in the statements and reports), assessing the financial controls, internal controls and risk management system of the Company, and reviewing material connected transactions.

CORPORATE GOVERNANCE STRUCTURE

(2) Members and Meetings of the Audit Committee

The Audit Committee comprises seven members, including four Independent non-executive Directors and three Non-executive Directors. The convenor of the Audit Committee is Independent Director Mr. Chen Shaohua. Members of the committee included Mr. Hou Weigui, Mr. Zhang Junchao, Mr. Dong Lianbo, Mr. Zhu Wuxiang, Mr. Qiao Wenjun and Mr. Mi Zhengkun. The Audit Committee was in compliance with Rule 3.21 of the Hong Kong Stock Exchange Listing Rules.

In 2006, the Audit Committee convened two meetings. Attendance of the meetings was as follows:

Members of the Audit Committee	Attendance in person	Attendance by proxy
Chen Shaohua	2/2	0
Hou Weigui	1/2	1/2
Zhang Junchao	1/2	1/2
Dong Lianbo	2/2	0
Zhu Wuxiang	2/2	0
Qiao Wenjun	1/2	1/2
Mi Zhengkun	1/2	1/2

(3) Work of the Audit Committee during the year

The Audit Committee convened two meetings in 2006 to:

(a) Review the financial report of the Company for the year ended 31 December 2005, which was then submitted to the Board of Directors for its consideration and approval;

(b) Review the internal audit and internal control reports of the Company for the year ended 31 December 2005;

(c) Review the interim financial report of the Company for the six months ended 30 June 2006, which was then submitted to the Board of Directors for its consideration and approval;

(d) Review whether actions taken by the management in litigations in which the Company or any members of the Group is a defendant are appropriate;

(e) Review the audit fees payable to the PRC and international auditors for the year ended 31 December 2005 and submit the same to the Board of Directors for review and approval;

(f) Review resolutions of the Company on the appointment of PRC and international auditors for 2006 and submit the same to the Board of Directors and general meeting for review and approval.

The Audit Committee reviewed the accounting principles and standards adopted by the Group in close collaboration with the management, investigated, audited and improved the internal control systems of the Company, the effectiveness testing for operations and financial reporting, including the audited financial report for the year ended 31 December 2006.

CORPORATE GOVERNANCE STRUCTURE

(VII) ***The Division of Responsibilities between the Board of Directors and Management***

The responsibilities and duties of the Board of Directors and the management have been clearly defined. Duties of the Board of Directors are set forth in Article 160 of the Articles of Association, while the management should be accountable to the Board of Directors by furnishing adequate information to the Board of Directors and the specialist committees to enable them to make informed decisions. Each Director is entitled to obtain further information from the management of the Group.

(VIII) ***Chairman and the Chief Executive Officer***

The Chairman of the Company is Mr. Hou Weigui and the President of the Company is Mr. Yin Yimin. The role of the Chairman is separated from that of the President of the Company and this is clearly defined in the Articles of Association. Duties of the Chairman and the President of the Company are set forth in Articles 164 and 180 of the Articles of Association, respectively.

The Chairman is responsible for the operation of the Board of Directors and advising the Board of Directors and the Group on the overall strategy and policies of the Company so as to ensure that all Directors act in the best interest of the shareholders.

The President of the Company is responsible for leading the management team of the Group to take charge of the day-to-day management and operation of the Company according to the objectives and directions set up by the Board of Directors and the internal control policy and procedure of the Company.

The President of the Company should maintain on-going communications with the Chairman and all Directors and report his work to the Board of Directors regularly to ensure that all Directors are well informed of all material business development of the Group.

III. The Supervisory Committee

(I) ***Members and Meetings of the Supervisory Committee***

The Supervisory Committee of the Company comprises Mr. Zhang Taifeng (Chairman), Mr. Wang Wangxi, Ms. He Xuemei, Mr. Qu Deqian and Ms. Wang Yan. For details of re-election of the fourth session of supervisory committee please refer to the section headed "Changes in the Directors, Supervisors and Senior Management" of the Annual Report.

Attendance of meetings of the Supervisory Committee in 2006 is set out as follows:

Name of Supervisor	Attendance in person	Attendance by proxy
Zhang Taifeng	4/4	—
Wang Wangxi	2/4	2/4
He Xuemei	3/4	1/4
Qu Deqian	4/4	—
Wang Yan	3/4	1/4

(II) Details of the Supervisory Committee meetings convened during the year and the work of the Supervisory Committee in 2006 are set out in the section headed "Report of the Supervisory Committee" of this Annual Report.

CORPORATE GOVERNANCE STRUCTURE

IV. Remuneration and Interests of Directors, Supervisors and the President

(I) *Remuneration*

Please refer to the section headed "Changes in Shareholdings and Remunerations of Directors, Supervisors and Senior Management for the year" of this Annual Report for details of the annual remuneration of the Directors, Supervisors and senior management of the Company.

Further details of the remuneration of Directors and Supervisors for the year are set out in note 8 to the financial statements prepared in accordance with HKFRSs.

(II) Interests

(1) Service contracts and contractual interests of the Directors and Supervisors

None of the Directors and Supervisors of the Company has entered into any service contract with the Group which is not determinable by the Group within one year without payment of compensation (other than statutory compensation).

(2) Interests of Directors and Supervisors in contracts

None of the Directors and Supervisors of the Company was materially interested, either directly or indirectly, in any contracts of significance to which the Group is a party subsisting during or at the end of 2006.

(3) Interests of Directors, Supervisors and Presidents in shares or debentures

The interests in shares of the Company held by Directors, Supervisors and the President of the Company as at 31 December 2006 are set out in the section headed "Changes in the Shareholdings and Remuneration of the Company's Directors, Supervisors and Senior Management" of this Annual Report.

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

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

(4) Securities transactions by Directors

The Company has adopted code provisions relating to the dealing in the Company's shares by Directors contained in the Model Code. After making specific enquiry with all Directors, the Company confirms that all Directors of the Company were in full compliance with the Model Code throughout 2006.

V. Remuneration Package and Retirement Benefits for Employees

The remuneration package for the Group's employees includes salary, bonuses and allowances. Our employees also receive welfare benefits including medical care, housing subsidies, retirement and other miscellaneous benefits. In accordance with applicable PRC regulations, the Group participated in social insurance contribution plans organised by the relevant government authorities, under which we paid monthly contributions towards each employee's social insurance in an amount equivalent to a specified percentage of his/her monthly salaries. Further details of the remuneration of top 5 employees of the company for the year are set out in note 9 to the financial statements prepared in accordance with HKFRSs.

Details of staff retirement benefits provided by the Group are set out in note 33 to the financial statements prepared in accordance with HKFRSs.

CORPORATE GOVERNANCE STRUCTURE

VI. Auditors' Remuneration

Ernst & Young Hua Ming and Ernst & Young acted as the Group's domestic auditors and Hong Kong's auditors, respectively.

Shenzhen Dahua Tiancheng Certified Public Accountants acted as the Company's domestic auditors for the year 2004. Ernst & Young Hua Ming has been appointed auditors of the Company's domestic auditors for two consecutive years (2005 and 2006). Ernst & Young has been appointed auditors of the Company's Hong Kong's auditor for three consecutive years since 2004.

The external auditors of the Group did not provide any non-audit services.

	Amount	Auditors
Audit fees 2006	RMB0.8 million	Ernst & Young Hua Ming
Audit fees 2006	HKD4.8 million	Ernst & Young

VII. Internal Control

The Board of Directors of the Company is responsible for reviewing the Company's internal control systems to ensure its effective implementation. The Board of Directors has delegated to the Audit Committee the responsibility for reviewing the effectiveness of the internal control systems of the Company and its subsidiaries.

With a view to enhancing and improving the internal control system of the Company, an internal control task force was formed in 2006 to streamline and improve the Company's internal control system and institutions in five areas, namely environmental controls, risk assessment, business controls, information and communications and supervision, aiming to further enhance corporate governance and the organisational structure and to ensure the effective implementation of the internal control system.

The Audit Committee under the Board of Directors convened two regular meetings each year to review the effectiveness of and identify rooms for further improvements in financial, operational and supervisory controls and the risk management procedures. Reports were submitted to the Board of Directors of the Company on the implementation of internal control measures.

The internal control system of the Company was designed to provide reasonable (but not absolute) assurance against material misstatements or losses, to manage (but not eliminate) risks arising from the malfunctioning of operating systems or failures to attain the Company's objectives. The Board of Directors is of the view that the internal control system was in normal operation as at 31 December 2006.

VIII. Investors' Relationship

In 2006, the Company continued to dedicate its efforts to promoting investors' relationship and maintain sound communications with its shareholders. Positive interaction with investors was maintained through the investors' hotline and e-mail communications.

The Company holds results presentation meetings each year after the announcement of its annual, interim and quarterly results. In 2006, the Company held two results presentation meetings and four telephone results presentation conferences.

The Group's website is updated regularly to provide investors and the public with timely information of the Group's latest developments.

GENERAL MEETINGS OF SHAREHOLDERS

The 2005 annual general meeting was held on site on 14 June 2006. The announcement of resolutions passed at the meeting was published in China Securities Journal, Securities Times and Shanghai Securities News, The Standard and Hong Kong Economic Times on 15 June 2006.

REPORT OF THE BOARD OF DIRECTORS

The Board of Directors is pleased to present its report together with the audited financial statements of the Company and the Group for the year ended 31 December 2006.

BUSINESS OF THE GROUP

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

FINANCIAL RESULTS

Please refer to p. 100 and p. 174 this annual report for the results of the Group for the year ended 31 December 2006 prepared in accordance with PRC GAAP and HKFRSs.

FINANCIAL SUMMARY

Set out on page 17 of this annual report are the results and financial position summary of the Group for the three financial years ended 31 December 2006 prepared in accordance with the PRC GAAP.

Set out on page 19 to page 20 of this annual report are the results and financial position summary of the Group for the five financial years ended 31 December 2006 prepared in accordance with HKFRSs, which have been extracted from the accountants' report of the Group for the three fiscal years ended 31 December 2003 contained in the prospectus dated 29 November 2004 issued by the Company in connection with its initial public offering of H shares and financial statements of the Group for the years ended 31 December 2004, 2005 and 2006 prepared in accordance with HKFRSs.

BUSINESS REVIEW

(I) Business review for 2006

Overview of the PRC telecommunications industry in 2006

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

Overview of the global telecommunications industry in 2006

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

REPORT OF THE BOARD OF DIRECTORS

Operating results of the Group for 2006

Revenue from the Group's principal operations based on the financial statements prepared in accordance with PRC GAAP amounted to RMB23.032 billion, representing a year-on-year growth of 6.7%. Net profit amounted to RMB807 million, representing a year-on-year decrease of 32.4%.

Revenue from the Group's principal operations based on the financial statements prepared in accordance with Hong Kong Financial Reporting Standards amounted to RMB23.032 billion, representing a year-on-year growth of 6.7%. Net profit amounted to RMB767 million, representing a year-on-year decrease of 40.4%.

By markets:

The domestic market

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

The international market

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

By products:

Wireless communications products

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

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

REPORT OF THE BOARD OF DIRECTORS

Switch and access products

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

Data and optical communications and products

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

Handsets

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

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

Miscellaneous

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

(II) Discussion and analysis prepared under PRC GAAP

The financial data below are extracted from the Group's audited financial statements for the year ended 31 December 2006 prepared in accordance with PRC GAAP. The following discussion and analysis should be read in conjunction with the Group's financial statements audited by Ernst & Young Hua Ming Certified Public Accountants and the accompanying notes thereto.

REPORT OF THE BOARD OF DIRECTORS

1 ***Certain indicators by industry, product and geographic segments for the reporting period as compared to the previous year***

	Breakdown of income	Revenue from principal operations (RMB in millions)	Cost of principal operations (RMB in millions)	Profit margin of principal operations (%)	Year-on-year increase/ decrease in revenue from principal operations	Year-on-year increase/ decrease in cost of principal operations	Year-on-year increase/ decrease in profit margin (basis point)
I.	**By industry**						
	Manufacturing of communications systems	23,031.7	15,171.8	33.6%	6.7%	8.8%	–1.3
	Total	23,031.7	15,171.8	33.6%	6.7%	8.8%	–1.3
II.	**By product**						
	Wireless communications systems	9,186.9	5,225.0	42.6%	2.9%	6.0%	–1.7
	Wireline switch and access systems	2,279.4	1,356.2	40.0%	–17.2%	9.3%	–14.5
	Optical and data communications systems	3,874.7	2,944.6	23.5%	15.6%	10.5%	3.5
	Handset	4,519.5	3,375.2	24.8%	4.3%	–5.6%	7.8
	Telecommunication software systems, services and other products	3,171.2	2,270.8	27.9%	43.7%	48.0%	–2.1
	Total	23,031.7	15,171.8	33.6%	6.7%	8.8%	–1.3
	Including: connected transactions	69.5	46.4	33.0%	4.7%	8.4%	–2.5
	Explanatory statement on the pricing principles, necessity and continuity of connection transactions.	Prices at which the Company conducted connected transactions with the connected parties were consistent with market prices. Sales to the connected parties by the Company represented mainly marketing of the Company's products by the connected parties as agents. Such transactions were of an ongoing nature.					
III.	**By region**						
	The PRC	12,801.8	8,553.9	32.7%	–7.7%	–8.7%	0.7
	Asia (excluding the PRC)	5,753.7	3,918.2	31.4%	25.9%	45.5%	–9.2
	Africa	2,563.2	1,501.3	40.9%	–9.6%	–8.8%	–0.6
	Other regions	1,913.0	1,198.4	36.9%	543.0%	393.8%	19.0
	Total	23,031.7	15,171.8	33.6%	6.7%	8.8%	–1.3

2 ***Certain indicators for major products accounting for 10% of revenue from principal operations or profit from principal operations***

Product segment	Revenue from principal operations (RMB in millions)	Cost of principal operations (RMB in millions)	Profit margin of principal operations (%)
Wireless communications	9,186.9	5,225.0	42.6%
Wireline switch and access	2,279.4	1,356.2	40.0%
Optical and data communications	3,874.7	2,944.6	23.5%
Handset	4,519.5	3,375.2	24.8%
Telecommunication software systems, services and other products	3,171.2	2,270.8	27.9%

REPORT OF THE BOARD OF DIRECTORS

3 *Breakdown of the Company's assets*

Unit: RMB in millions

	2006		2005		
Item	Amount	As a percentage of total assets	Amount	As a percentage of total assets	Increase/ decrease (%)
Total assets	**25,916.9**	**100.0%**	21,779.1	100.0%	19.0%
Amounts receivable	**7,360.7**	**28.4%**	4,994.4	22.9%	47.4%[1]
Total fixed assets	**3,061.5**	**11.8%**	2,506.9	11.5%	22.1%
Long-term equity investments	**100.7**	**0.4%**	85.5	0.4%	17.8%
Construction in progress	**469.6**	**1.8%**	126.7	0.6%	270.6%[2]
Short-term borrowings	**945.7**	**3.6%**	136.1	0.6%	594.9%[3]
Inventories	**2,761.0**	**10.7%**	2,519.5	11.6%	9.6%
Long-term borrowing	**1,679.2**	**6.5%**	767.8	3.5%	118.7%[4]

Note 1: The balance of amounts receivable (comprising bills receivable, amounts receivable and long-term amounts receivable) increased by 47.4%, year-on-year, as a result of deferred contract payments as part of the favourable credit terms granted by the Group to its customers.

Note 2: The balance of construction in progress increased by 270.6%, year-on-year, reflecting the Group's acquisition and construction of ZTE Industrial Park in Xili and R&D centres in Nanjing and Shanghai during the year.

Note 3: The balance of short-term borrowings increased by 594.9%, year-on-year, as a result of the increase in the Group USD Loans to meet working capital requirements.

Note 4: The balance of long-term borrowings increased by 118.7%, year-on-year, as the Group utilised long-term bank loans as additional working capital and project construction funds during the year.

4 *Breakdown of profit, expenses and income tax of the Company for the period*

	As a percentage of total profit		
Item	2006	2005	Increase/ decrease (%)
Profit margin from principal operations	**724.4%**	501.1%	223.31[1]
Profit margin from other operations	**6.5%**	1.1%	5.4
Expenses for the period	**690.9%**	429.4%	261.52[2]
Investment gains	**3.0%**	–4.0%	7.0
Subsidy income	**57.2%**	30.5%	26.7
Non-operating income and expenses, net	**–0.2%**	0.7%	–0.9

Note 1: Profit from principal operations as a percentage of total profit increased by 223.3 percentage points mainly as a result of increased expenses and reduced total profit for the period.

Note 2: Expenses as a percentage of total profit for the period increased by 261.5 percentage points mainly as a result of increased R&D investment in customised products for overseas strategic markets and advanced technologies such as 3G, WIMAX and IMS.

REPORT OF THE BOARD OF DIRECTORS

Unit: RMB in millions

Item	2006	2005	Increase/ decrease (%)
Selling and distribution expenses	**3,140.1**	3,023.1	3.9%
General and administrative expenses	**4,010.2**	3,137.1	27.8%
Finance expenses	**239.6**	288.8	–17.0%
Income tax	**125.6**	158.5	–20.8%

5 *Breakdown of cash flow*

Unit: RMB in millions

Item	2006	2005	Increase/ decrease (%)
Net cash flow from operating activities	**–1,555.0**	177.3	–977.0%[1]
Net cash flow from investing activities	**–1,163.6**	–984.3	–18.2%
Net cash flow from financing activities	**1,465.8**	–1,195.5	222.6%[2]

Note 1: Net cash flow from operating activities decreased by 977.0%, year-on-year, mainly as a result of increased operating receivables for the Group during the year. Amounts receivable increased as contract payments were deferred as part of the favourable business terms offered by the Group to its customers. Meanwhile, cash-settled expenses increased following expanded operations, resulting in a wider margin between operating cash flow and net profit.

Note 2: Net cash flow from financing activities increased by 222.6%, year-on-year, mainly as a result of new loans drawn by the Group during the year for use as additional working capital and project construction funds.

6 *Business operations and results of principal subsidiaries*

Business operations of the Company's principal subsidiaries:

Name of company	Registered capital (RMB in millions)	Percentage of equity interest (%)	Scope of business	Total assets (in millions)	Net profit (in millions)	Revenue from principal operations (in millions)	Profit from principal operations (in millions)
ZTE Kangxun	50 million	90	Production of electronic products and related parts (excluding restricted items)	5,783.6	168.9	11,414.0	495.4
ZTE Software	50 million	98	Development, production and sale of telecommunications system drivers, software for service-based businesses and provision of related technical consultancy services	1,813.4	1,975.4	4,074.0	4,060.0

The Company does not hold any interest in any company in which the Company's share of its income accounted for more than 10% of the net profit of the Company.

For details of other subsidiaries and principal associates, please refer to Note IV to the financial statements prepared in accordance with PRC GAAP.

REPORT OF THE BOARD OF DIRECTORS

7 *Major suppliers and customers*

Purchases by the Group from its largest supplier amounted to RMB980 million in 2006, accounting for 7.1% of the total purchases of the Group for the year, while the purchases made from its five largest suppliers amounted to RMB2,762 million, accounting for 19.5% of the total purchases of the Group for the year. None of the Directors or Supervisors or their associates or any of the shareholders of the Company (other than Zhongxingxin) had any interest in any of the five largest suppliers of the Group (the above figures for the Group prepared in accordance with PRC GAAP were consistent with corresponding figures prepared in accordance with HKFRSs).

Sales by the Group in 2006 to its largest customer amounted to RMB4,708.6 million, accounting for 20.4% of the total sales of the Group for the year, while sales to its five largest customers amounted to RMB9,171.4 million, accounting for 39.8% of the total sales of the Group for the year. None of the Directors or Supervisors or their associates or any of the shareholders of the Company had any interest in any of the five largest customers of the Group (the above figures of the Group are consistent under PRC GAAP and HKFRSs).

8 *Investments*

(1) *Use of proceeds from the global issue of H shares*

In December 2004, the Company completed a global offering of 160,151,040 H shares (including H shares issued pursuant to the exercise of the over-allotment option) at an issue price of HKD22.00 per share, raising total proceeds of HKD3,523,322,880.00, equivalent to RMB3,734,722,252.80. After deduction of the underwriting fees and expenses relating to the global offering and reduction in shareholding of state-owned shares, the net proceeds of RMB3,542,177,725.94 were credited into the designated account of the Company on 9 December 2004 and 16 December 2004 respectively. Shenzhen Dahua Tiancheng Certified Public Accountants had examined and verified the net proceeds and issued a capital verification report (Shenhua (2005) Yanzi No.(003)).

The Group intended to use the above net proceeds for the following purposes:

- the Group intended to use approximately RMB2,125,306,635.56 from the above net proceeds for the expansion of the Group's overseas operations; and

- the Group intended to use approximately RMB1,416,871,090.38 from the above net proceeds for the research and development on new products and technologies of strategic importance.

REPORT OF THE BOARD OF DIRECTORS

As at the end of the reporting period, the net proceeds from the H share global offering of the Company was applied as follows:

For the year 2004, 2005 and 2006, application of proceeds amounted to RMB1,160,319,000, RMB2,137,048,000 and RMB244,811,000 respectively.

Unit: in RMB10,000

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

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

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

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

IP switching platforms for mobile communications

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

Integrated mobile broadband service system

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

High-speed packet mobile communications base station systems

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

REPORT OF THE BOARD OF DIRECTORS

Intelligent wireless integrated access systems

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

Core routers

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

NGN systems

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

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

Automated optical switching network systems

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

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

(2) *Major investments using funds other than the share issue proceeds*

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

REPORT OF THE BOARD OF DIRECTORS

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

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

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

9 ***There were no changes in the accounting estimates and tracking of accounting errors of the Group.***

10 ***For the Special Notice on the Use of Funds of Listed Companies by the Controlling Shareholder and other Connected Parties issued by Ernst & Young Hua Ming, please refer to the announcement published by the Company on the website designated for information disclosure, on 19 April 2007.***

11 ***The independent opinion of the Independent Directors on the use of funds by Connected Parties and the Company's accumulated and current guarantees for 2006 was as follows:***

(1) The transfer of funds between the Company and the controlling shareholder and other connected parties represent sales and purchases of goods in the ordinary course of business. Such transactions have been conducted based on fair market prices and were not adverse to the Company's interests. Neither the controlling shareholder of the Company nor its subsidiaries nor other connected parties have appropriated the Company's funds.

(2) In order to standardised the management of third-party guarantees, the Company has formulated the Administrative Measures on Third-party Guarantees, and set out provisions in the Articles of Association the examination and approval procedures in relation to third-party guarantees. Details of guarantees disclosed in the 2006 annual report are true and the Company has not committed any unlawful acts of guarantees or connected guarantees.

(3) As required by China Securities Regulatory Commission, the Independent Directors of the Company have reviewed the Company's transactions against the Notice Regulating Third-party Guarantees made by Listed Companies (Zheng Jian Fa[2005] No. 120) the Notice Regulating Several Issues of Fund Uses with Connected Persons and Third-party Guarantees for Listed Companies (Zheng Jian Fa[2003] No. 56) and are of the view that the Company has been in strict compliance with the relevant provisions under the Notice and have not found any matter which is in breach of the Notice.

REPORT OF THE BOARD OF DIRECTORS

12 *Day-to-day operation of the Board of Directors*

(1) *During 2006, the Board of Directors of the Company convened five meetings, the details of which are as follows:*

Session of the Board of Directors	Date of meeting	Mode of meeting	Date of announcing resolutions of meetings	Newspapers for publication of announcements
16th meeting of the third session	6 April 2006	On-site meeting	7 April 2006	China Securities Journal, Securities Times, Shanghai Securities News, The Standard and Hong Kong Economic Times
17th meeting of the third session	25 April 2006	Video conference	26 April 2006	
18th meeting of the third session	24 August 2006	On-site meeting	25 August 2006	
19th meeting of the third session	25 October 2006	On-site meeting	26 October 2006	
20th meeting of the third session	15 December 2006	Video conference	18 December 2006	

(2) *Board implementation of resolutions of the general meeting*

Pursuant to the relevant resolution passed at the 2005 annual general meeting, the Board of Directors of the Company implemented the 2005 profit distribution plan, according to which RMB2.5 for every 10 shares (including tax) or a total of RMB239,880,000 was paid in cash on the basis of the Company's total share capital of 959,521,650 shares as at 31 December 2005. Record date for dividend payment for A shares: 13 July 2006. Ex-dividend date: 14 July 2006. Record date for dividend payment for H shares: 12 May 2006. Dividend payment date: 14 July 2006.

13 *The 2006 profit distribution proposal*

The audited net profit of the Company for the year 2006 calculated in accordance with PRC GAAP amounted to RMB650,356,000. Profit available for distribution amounted to RMB3,766,426,000 after adding the undistributed profit of RMB3,116,070,000 carried forward at the beginning of the year.

The audited net profit of the Company for the year 2006 calculated in accordance with HKFRSs amounted to RMB831,130,000. Profit available for distribution amounted to RMB1,786,512,000 after adding the undistributed profit of RMB955,382,000 carried forward at the beginning of the year.

In accordance with the requirements of the Ministry of Finance of the People's Republic of China and the Articles of Association, profit available for distribution shall be the lower of profit available for distribution as calculated in accordance with PRC GAAP and that calculated in accordance with HKFRSs. Therefore the amount of profit available for distribution is RMB1,786,512,000. The 2006 profit distribution proposal recommended by the Board of Directors of the Company is as follows: RMB1.50 (including tax) for every 10 shares or a total of RMB143,928,000 in cash on the basis of the Company's total share capital of 959,521,650 shares as at 31 December 2006.

REPORT OF THE BOARD OF DIRECTORS

14 *Designated newspapers for information disclosure*

China Securities Journal, Securities Times and Shanghai Securities News have been designated as newspapers for information disclosure by the Company in China. The Standard (English) and Hong Kong Economic Times (Chinese) have been designated as newspapers for information disclosure by the Company in Hong Kong.

(III) Business Outlook and Risk Exposure in 2007

1. *Business outlook for 2007*

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

(1) to cope with market conditions and customer requirements by conducting market-driven research and development, realigning our organizational structure, enhancing overall capabilities of solutions and building customer-oriented capabilities and organization underpinned by integrated marketing and integrated commercial technologies;

(2) To adopt further customer differentiation, optimise the allocation of resources, improve the functional positioning of the overseas regional platforms and representative offices at various levels and to enhance global execution capabilities for leading strategies;

(3) To enhance training of critical staff;

(4) To resolve issues arising from customer dissatisfaction with deliveries and compartmentalized logistics management by developing logistics capabilities and organization oriented towards customers and driven by uniform sources of information;

(5) To better define the nature of engineering and after-sales services by developing a customer-oriented engineering and after-sales service team capable of uniform dispatching and speedy response to ensure that engineering and after-sales services will grow into a core business and a profit centre.

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

2. *Risk exposure*

(1) *Policy risks*

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

REPORT OF THE BOARD OF DIRECTORS

(2) *International market risks*

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

(3) *Foreign exchange risks*

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

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

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

In accordance with "Enterprise Accounting Standard No. 38 — Initial Implementation of the Enterprise Accounting Standards," the Company shall classify, recognise and measure all new assets, liabilities and shareholders' equity in accordance with the provisions of the Enterprise Accounting Standards on the date of initial implementation. The effect of the adjustment on the date of initial implementation on the shareholders' equity at the beginning of 2007 was a decrease of RMB21,955,000 in shareholders' equity. Please refer to Appendix II of the Notes to the Financial Statements prepared under PRC GAAP, *Statement of reconciliation of differences between shareholders' equity prepared in accordance with the current and the new PRC accounting standards and the notes thereto.*

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

1. Research and development expenses incurred by the Company during the development stage may, subject to certain conditions, be recognised as intangible assets and amortised over the benefit period;

2. For sales contracts that effectively have a financing nature with deferred receipt of sales amounts, operating income shall be recognised at the fair value of the goods sold and finance gains arising from the contracts shall be recognised on a deferred basis;

3. Staff welfare expenses shall be recognised as remuneration payable to staff (staff welfare) based on the actual staff welfare expenses and the welfare schemes;

4. Share-based payments settled in equity (such as the Phase 1 Share Incentive Scheme of the Company) shall be recognised as current expenses at the fair value of the equity tools based of the number of options exercised;

5. Government subsidies shall be recognised when the conditions of grant are being fulfilled and such subsidies become receivable, rather than upon actual receipt. Expenses or asset depreciation related to government subsidies shall be directly charged to the current profit and loss when incurred; government subsidies used as compensation shall be concurrently recognised as non-operating income;

REPORT OF THE BOARD OF DIRECTORS

6. Changes in the fair value of financial assets or liabilities that are measured at fair value and whose changes are dealt with in profit and loss shall be directly taken into account in the current income statement and the balance sheet;

7. Derivative financial tools, hedging tools and their profit or loss shall be separately recognised in the financial report;

8. Real estate properties held for investment purposes shall be separately recognised in the financial report using cost model measurement, if such costs can be reliably measured;

9. Investments in subsidiaries shall be accounted for using the cost method and dividends payable by the subsidiaries to the parent shall not be recognised as investment gains until being declared, with no impact on the consolidated statement.

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

(IV) Other Matters in the Report of the Directors

1. *Property, plant and equipment*

Details of changes in the property, plant and equipment of the Company and the Group for the year are set out in note 15 and note 16 to the financial statements prepared in accordance with HKFRSs.

2. *Bank loans and other borrowings*

Details of bank loans and other borrowings of the Company and the Group as at 31 December 2006 are set out in note 32 to the financial statements prepared in accordance with HKFRSs.

3. *Reserves*

Details of the reserves and changes in the reserves of the Company and the Group for the year are set out in note 40 to the financial statements prepared in accordance with HKFRSs.

4. *Pre-emptive rights*

There is no provision under the Company Law of the People's Republic of China or the Articles of Association regarding pre-emptive rights that requires the Company to offer new shares to its existing shareholders on a prorate basis.

5. *Purchase, sale or redemption of shares*

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

6. *Share capital*

Details of the share capital of the Company during the year, together with the changes in the share capital and the reasons therefor, are set out in note 37 to the financial statements prepared in accordance with HKFRSs and on page 21 in this annual report.

MANAGEMENT DISCUSSION AND ANALYSIS

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

FINANCIAL DATA

Unit: RMB in millions

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

MANAGEMENT DISCUSSION AND ANALYSIS

REVENUE ANALYSED BY PRODUCT AND GEOGRAPHIC REGION

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

Unit: RMB in millions

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

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

Unit: RMB in millions

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

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

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

MANAGEMENT DISCUSSION AND ANALYSIS

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

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

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

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

COST OF SALES AND GROSS PROFIT ANALYSED BY PRODUCT

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

Unit: RMB in millions

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

MANAGEMENT DISCUSSION AND ANALYSIS

Unit: RMB in millions

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

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

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

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

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

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

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

Other Revenue and Gains

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

MANAGEMENT DISCUSSION AND ANALYSIS

Research and Development Costs

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

Selling and Distribution Costs

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

Administrative Expenses

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

Other Expenses

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

Profit from Operating Activities

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

Finance Costs

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

Tax

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

Minority Interests

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

MANAGEMENT DISCUSSION AND ANALYSIS

Gearing Ratio and the Basis of Calculation

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

Liquidity and Capital Resources

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

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

CASH FLOW DATA

Unit: RMB in millions

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

Operating Activities

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

Investing Activities

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

MANAGEMENT DISCUSSION AND ANALYSIS

Financing Activities

Net cash inflow from the Group's financing activities in 2006 amounted to RMB1,975.6 million, as compared to net cash outflow of RMB735.0 million in 2005, representing mainly new loans amounting to RMB1,945.3 million.

Capital Expenditure

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

Unit: RMB in millions

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

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

INDEBTEDNESS

Unit: RMB in millions

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

Unit: RMB in millions

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

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

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

MANAGEMENT DISCUSSION AND ANALYSIS

CONTRACTUAL OBLIGATIONS

Unit: RMB in millions

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

CONTINGENT LIABILITIES

Unit: RMB in millions

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

CAPITAL COMMITMENTS

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

Unit: RMB in millions

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

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

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

Prospects for New Business

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

MANAGEMENT DISCUSSION AND ANALYSIS

Employees

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

Charges on Assets

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

Plans for Significant Investments or Acquisition of Capital Assets

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

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

Market Risks

Interest rate risks:

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

Foreign exchange risks:

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

REPORT OF THE SUPERVISORY COMMITTEE

(I) SUPERVISORY COMMITTEE MEETINGS

The Supervisory Committee held four meetings in 2006, details of which are as follows:

1. The eighth meeting of the third session of the Supervisory Committee of the Company was held on 6 April 2006. The Supervisory Committee considered and approved the full text of the 2005 annual report, annual report summary and results announcement of the Company, the 2006 final financial accounts, the 2005 profit distribution plan of the Company, the resolution regarding revising the estimation methodology for bad debt provision in respect of accounts receivable, the resolutions appointing the PRC and Hong Kong auditors of the Company for 2006, the resolution determining the PRC auditors and Hong Kong auditors' 2005 audit fees, the proposed 2006 connected transactions framework agreements, the resolution regarding the proposed application for composite credit facilities for the six months ended 30 June 2006, the 2005 report of the Supervisory Committee and the resolution regarding comprehensive amendments to the Rules of Procedure for Supervisory Committee Meetings.

   The announcement of the resolutions of the Supervisory Committee was published in China Securities Journal, Securities Times, and Shanghai Securities News, The Standard and Hong Kong Economic Times on 7 April 2006.

2. The ninth meeting of the third session of the Supervisory Committee of the Company was held on 24 August 2006. The Supervisory Committee considered and approved the full text and the summary and results announcement of the 2006 interim report of the Company, the financial analysis report of the Company for the six months ended 30 June 2006, the resolution regarding the proposed application for composite banking credit facilities for the six months ended 31 December 2006, the resolution regarding the approval process and authority regulating the write-off of long-term assets of the Company and the resolution regarding the approval process and authority regulating the write-off of bad debts and discounted settlement of payments of the Company.

   The announcement of the resolutions of the Supervisory Committee was published in China Securities Journal, Securities Times, and Shanghai Securities News, The Standard and Hong Kong Economic Times on 25 August 2006.

3. The tenth meeting of the third session of the Supervisory Committee of the Company was held on 25 October 2006. The Supervisory Committee considered and approved the 2006 third quarterly report of the Company, the resolutions of the Company on the proposed connected transactions framework agreements for 2007, the resolutions of the Company on the Renewal of Continuous Connected Transactions for 2007 to 2009, the Share Incentive Scheme (Phase I) (Draft) of the Company, and the resolution regarding the verification of the name list of the scheme participants of the Share Incentive Scheme (Phase I) of the Company.

   The announcement of the resolutions of the Supervisory Committee was published in China Securities Journal, Securities Times, and Shanghai Securities News, The Standard and Hong Kong Economic Times on 26 October 2006.

4. The eleventh meeting of the third session of the Supervisory Committee of the Company was held on 15 December 2006. The Supervisory Committee considered and approved the resolution on the revision of the Share Incentive Scheme (Phase I) (Draft) of the Company and the revised Share Incentive Scheme (Phase I) (Revised) of the Company.

   The announcement of the resolutions of the Supervisory Committee was published in China Securities Journal, Securities Times, and Shanghai Securities News, The Standard and Hong Kong Economic Times on 18 December 2006.

REPORT OF THE SUPERVISORY COMMITTEE

(II) OPINIONS REGARDING THE COMPANY'S CONDITION FOR THE YEAR 2006 HAS BEEN FURNISHED BY THE SUPERVISORY COMMITTEE, AS FOLLOWS:

1. The Company has established a proper internal control system with proper documentation such as the Articles of Association, the Rules of Procedure for Shareholders' General Meetings, the Rules of Procedure for Board of Directors' Meetings and the Rules of Procedure for Supervisory Committee Meetings, the Company's management systems are in good order. The decision-making process of the Company is in compliance with the relevant requirements of the Company Law of the People's Republic of China and the Articles of Association of the Company. The procedures, proposed resolutions and implementation of resolutions of the general meetings and meetings of the Board of Directors were also in compliance with relevant provisions of the laws, regulations and the Articles of Association. Obligations of information disclosure have been duly performed.

2. The Directors and the management diligently performed their duties, abided by the laws and carefully executed all the resolutions of the shareholders' general meetings and meetings of the Board of Directors. They did not violate any laws, regulations and the Articles of Association in exercising their duties, nor did they act against the Company and its shareholders' interests.

3. The preparation and review processes for the full text and summary of the 2006 annual report of the Company were in compliance with provisions of the laws and regulations and the Articles of Association. The contents and format of the full text and summary of the 2006 annual report of the Company were in compliance with various requirements of regulatory authorities including the China Securities Regulatory Commission, Shenzhen Stock Exchange and the Stock Exchange of Hong Kong Limited. The 2006 financial report of the Company gives a true and accurate view of the financial position, and operating results of the Company for the year 2006.

4. All connected party transactions entered into by the Company and its related parties had conducted at arm's length basis, and were not against the interests of the Company and its shareholders.

5. The proceeds from the issue of overseas-listed foreign shares by the Company in 2004 had been fully utilized as at 31 December 2006. After due examination by the Supervisory Committee, the use of proceeds was found to be consistent with the plan as stated in the prospectus.

MATERIAL MATTERS

(I) MATERIAL LITIGATION OR ARBITRATION

During the year, the Group had no material litigation or arbitration. Progress during the year of litigation and arbitration proceedings occurring prior to the reporting period and other litigation and arbitration during the year were as follows:

1. In November 2005, Beijing Success Communications and Electronic Engineering Co., Ltd. instituted litigation against the Company's subsidiary Yangzhou Zhongxing Mobile Telecom Equipment Co., Ltd. (''Yangzhou Zhongxing''), and the Company to demand an indemnity of RMB71 million, comprising the refund of an advanced payment of RMB35 million and compensation for interests and other losses amounting to RMB36 million.

   The court in charge of the first trial filed a written request for instructions to the Supreme People's Court after its trial committed failed to reach a unanimous opinion following two sessions of court hearing for the first trial. The case is now pending the instructions of the Supreme People's Court. As the case is currently under trial, it is difficult at this stage to ascertain with any certainty the final outcome of the litigation. Based on the legal opinion furnished by the Company's lawyers, the Directors are of the opinion that the above litigation will not have any material adverse impact on the Group's current financial position.

2. Shenzhen Intermediate People's Court handed its judgement for the first trial of the litigation instituted by the Company against Fairchild Semiconductor Corporation in November 2006, ordering Fairchild Semiconductor Corporation to pay an indemnity of RMB65,733,478 to ZTE. Fairchild Semiconductor Corporation has filed an appeal to the Guangdong Provincial People's High Court against the first trial judgement.

3. On December 2005, a supplier of the Company alleged that the Company had breached the supply contract and infringed its intellectual property and claimed indemnity for a total amount of US$36.45 million (approximately RMB294.2 million) by instituting overseas arbitration.

   As at the date of publication of this report, the arbitration tribunal had been formed and the Company had filed its defences and paid the arbitration fees. As the arbitration authority had yet to issue an award, it is difficult at this stage to ascertain with any certainty the final outcome of the arbitration. Based on the legal opinion furnished by the Company's lawyers, the Directors are of the opinion that the above case will not have any material adverse impact on the Group's current financial position.

4. In August 2005, an Indian consultant firm issued an arbitration notice to the Company to claim indemnity for a total amount of approximately US$1,714,000 (approximately RMB13,384,000) in respect of advisory fees, agency fees and related damages. The consultant firm subsequently raised its total claim amount to approximately US$2,143,000 (approximately RMB16,734,000).

   As at the date of this annual report, the Terms of Reference submitted by the two parties to the case had not been approved by the Commission on Arbitration of the International Chamber of Commerce. As the case is currently under trial, it is difficult at this stage to ascertain with any certainty the final outcome of the arbitration. Based on the legal opinion furnished by the Company's lawyers, the Directors are of the opinion that the above case will not have any material adverse impact on the Group's current financial position.

5. An administrative penalty notice had been served upon Zhongxing Telecom Pakistan (Pvt) Ltd, a subsidiary of the Company (the ''Pakistanis Subsidiary''), by the Rawalpindi Collectorate of Customs in respect of a claim of additional custom duties of approximately 177 million Pakistan Rupee (approximately RMB23.9 million) for the misdeclaration of the imported goods by the Pakistanis Subsidiary. Subsequently, Rawalpindi Collectorate of Customs raised the claim of additional custom duties to approximately 240 million Pakistan Rupee (approximately RMB31.2 million) and a fine of approximately 2.4 billion Pakistan Rupee (approximately RMB324 million). In September 2005, the Committee for Alternate Dispute Resolution Islamabad (ADRC) appointed by the Central Board of Revenue (CBR) of Pakistan to resolve

MATERIAL MATTERS

the dispute furnished a Report of Committee to CBR. As at the date of this annual report, the Group was awaiting the final decision of the CBR and no administrative penalties had yet been paid. Based on the legal opinion on the dispute furnished by the lawyers engaged by the Company and the ADRC report, the Directors are of the opinion that the Company has sufficient and valid reasons to believe that the CBR will give a just ruling based on the ADRC report and this matter would not have any material adverse impact on the Group's current financial position.

6. In August 2006, a certain customer instituted arbitration against the Company and demanded indemnity in the amount of 762,982,000 Pakistan Rupee (approximately RMB97,890,000). As at the date of this annual report, the arbitration authorities had not granted any ruling to establish whether there had been a breach of contract and to determine the amount of loss. Meanwhile, the Company had put forth counter-claims of breach of contract against the customer and demanded it to pay indemnity in respect of the Company's losses arising from its breach of contract. As the arbitration authorities has yet to grant any ruling, it is difficult at this stage to ascertain with any certainty the final outcome of the arbitration. Based on the legal opinion furnished by the Company's lawyers, the Directors are of the opinion that the above case will not have any material adverse impact on the Group's current financial position.

   The Company will make timely announcement in the event of any substantial progress of the above arbitration and litigation proceedings.

(II) ACQUISITIONS, DISPOSALS OF ASSETS, MERGERS AND TAKEOVERS

The Group had no acquisition and disposal of assets, merger or takeover during the year.

(III) SIGNIFICANT CONNECTED TRANSACTIONS OF THE GROUP

1. Significant connected transactions of the Group during the year:

(1) *Significant connected transactions under applicable laws and regulations of the PRC:*

During the year, the Company has not made purchases from any one of its connected persons that exceeded 5% of the audited net assets of the Company. Ongoing connected transactions during the reporting period are set out as follows:

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

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

MATERIAL MATTERS

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

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

The Company has entered into the 2007 connected transactions framework agreements with the connected persons, which has been approved at the nineteenth meeting of the third session of the Board of Directors on 25 October 2006 and at the First Extraordinary General Meeting for 2007 on 13 March 2007. For details please refer to the announcement on ongoing connected transactions published by the Company in China Securities Journal, Securities Times and Shanghai Securities news on 26 October 2006, the announcement on the resolutions of the First Extraordinary General Meeting for 2007 published by the Company in China Securities Journal, Securities Times and Shanghai Securities News on 14 March 2007.

MATERIAL MATTERS

(2) *Continuing connected transactions under the Hong Kong Stock Exchange Listing Rules:*

Following the listing of the Company's H shares on the Hong Kong Stock Exchange, the Group will continue certain transactions that constitute continuing connected transactions within the meaning of the Hong Kong Stock Exchange Listing Rules as stated below. With respect to the continuing connected transactions, the Hong Kong Stock Exchange has granted to the Group certain waivers from announcement and/or independent shareholders' approval requirements under the Hong Kong Stock Exchange Listing Rules. Details of such waiver have been disclosed in the prospectus of the Company dated 29 November 2004. Details of the continuing connected transactions are as follows:

a) *Purchases of handset batteries by ZTE Kangxun from Ruide*

- Description of the connected relationship between the parties to the transaction:

The Company holds 90% stake in ZTE Kangxun:

The Company holds 57.5% stake in Ruide through its subsidiaries, Shenzhen Changfei Investment Company, Limited. The other substantial shareholder of Ruide is Zhongxing Xindi with approximately 23.0% stake. The remaining stake of approximately 19.5% in Ruide is held by an individual shareholder who is a director of Ruide and a connected person of the Group (while not at the level of the Company). Zhongxing Xindi is a non-wholly owned subsidiary of Zhongxingxin and is therefore an associate of Zhongxingxin as defined under the provisions of the Hong Kong Stock Exchange Listing Rules. Zhongxingxin holds 60% stake in Zhongxing Xindi. Given that Zhongxingxin is a controlling shareholder of the Company (and also a promoter of the Company), Zhongxing Xindi, being an associate of Zhongxingxin, constitutes a connected person of the Company at the level of the Company (and not at the level of the Company's subsidiaries). In addition, given that Zhongxing Xindi is a substantial shareholder of Ruide, Ruide itself constitutes a connected person of the Group under the Hong Kong Stock Exchange Listing Rules.

- Total transaction amount for 2006:

Approximately RMB176,961,000

- Pricing and other terms:

ZTE Kangxun has entered into a framework purchase agreement dated 19 November 2004 with Ruide expiring on 31 December 2006. Ruide will still be required to undergo the Group's qualification and bidding procedures for the selection of suppliers. If Ruide succeeds in its bid to supply to ZTE Kangxun, ZTE Kangxun will issue purchase orders from time to time to Ruide pursuant to the framework agreement entered into with it. Purchase orders will specify product types, agreed quantities and prices, quality specifications, delivery times, places and modes, as well as contact details. Prices will be arrived at after arm's length negotiations, with reference to the prices quoted by Ruide for sales of similar quantities of the same or similar products to independent third parties at the relevant time.

MATERIAL MATTERS

- Reasons for such transactions

The Group's handset products have become one of the major sources of revenue for the Company. The Directors of the Company consider it an important strategy to have a co-operative and reliable supplier for handset batteries. The Group's investment in Ruide was made with this purpose in mind. Through the Group's qualification and bidding procedures, Ruide was selected as one of our suppliers.

b) *Sales of liquid crystal displays (LCD) and electronic components by ZTE Kangxun to Lead*

- Description of the connected relationship between the parties to the transaction:

The Company is a major shareholder of Lead with a 62.5% stake. Zhongxingxin is a substantial shareholder of Lead with a 22.5% stake while an individual holds the remaining 15% stake. Given that Zhongxingxin is a connected person of the Group at the level of the Company (and not at the level of the Company's subsidiaries) and is a substantial shareholder of Lead, Lead itself constitutes a connected person of the Group under the Hong Kong Stock Exchange Listing Rules.

- Total transaction amount for 2006:

Approximately RMB6,213,000

- Pricing and other terms:

ZTE Kangxun has entered into a framework agreement dated 19 November 2004 with Lead expiring on 31 December 2006. Pursuant to the framework agreement, lead is to issue purchase orders to ZTE Kangxun from time to time, specifying product types, agreed quantities and prices, quality specifications, delivery times, places and modes, as well as contact details. Prices will be arrived at after arm's length negotiations, with reference to the prices quoted by the Group for sales of similar quantities of the same or similar products to independent third parties at the relevant time.

- Reasons for such transactions

The Group's handset products have become one of the major sources of revenue for the Company. Liquid crystal modules are required for the production of handsets and the Group does not produce such components. The production of liquid crystal modules involves the assembly of liquid crystal displays with various electronic components. As this involves merely low cost assembly work, the Directors of the Company consider it suitable for outsourcing the production of liquid crystal modules to Lead and other independent third parties. Lead was selected as our supplier through the Group's qualification and bidding procedures. As Lead does not produce the said components required for the production of liquid crystal modules, ZTE Kangxun (as the Group's principal platform for procurement) purchases liquid crystal displays and various electronic components from independent third party suppliers for onward supply to Lead. The Directors of the Company consider it to be convenient and cost effective to include Lead's requirements in ZTE Kangxun's procurements for such parts.

c) *Purchases of raw materials and components comprising primarily telecommunications cabinets, cases and racks, and distribution frames by ZTE Kangxun from Zhongxingxin, Zhongxing Xindi and Zhongxing Xinyu*

- Description of the connected relationship between the parties to the transaction:

Zhongxingxin is the largest shareholder of the Company.

MATERIAL MATTERS

Given that Zhongxing Xindi is a non-wholly owned subsidiary of Zhongxingxin, Zhongxing Xindi is an associate of Zhongxingxin as defined under the provisions of the Hong Kong Stock Exchange Listing Rules. Zhongxingxin holds a 70% stake in Zhongxing Xindi. Given that Zhongxingxin is a controlling shareholder of the Company (and also one of the promoters of the Company), Zhongxing Xindi, as an associate of Zhongxingxin, constitutes a connected person of the Group.

Given that Zhongxing Xinyu is a non-wholly owned subsidiary of Zhongxingxin, Zhongxing Xinyu is an associate of Zhongxingxin as defined under the provisions of the Hong Kong Stock Exchange Listing Rules. Zhongxingxin holds a 55% stake in Zhongxing Xinyu. Given that Zhongxingxin is a controlling shareholder of the Company (and also one of the promoters of the Company), Zhongxing Xinyu, as an associate of Zhongxingxin, constitutes a connected person of the Group.

- Total transaction amount for 2006:

Approximately RMB450,809,000

- Pricing and other terms:

ZTE Kangxun has entered into framework purchase agreements dated 19 November 2004 with Zhongxingxin, Zhongxing Xindi and Zhongxing Xinyu, respectively. The framework agreements expired on 31 December 2006. Zhongxingxin and its relevant subsidiaries will each still be required to undergo the Group's qualification and bidding procedures for the selection of suppliers. If any one of them succeeds in its bid to supply to ZTE Kangxun, ZTE Kangxun will issue purchase orders from time to time to the successful bidder pursuant to the relevant framework agreement entered into with that bidder. Purchase orders will specify product types, agreed quantities and prices, quality specifications, delivery times, places and modes, as well as contact details. Prices will be arrived at after arm's length negotiations and on normal commercial terms.

- Reasons for such transactions

Zhongxingxin, Zhongxing Xindi and Zhongxing Xinyu were selected through the Group's qualification and bidding procedures, and the Group believes that they have consistently been able to meet the Group's stringent demands for fast product turnaround time, high product quality and timely delivery. By virtue of the foregoing, Zhongxingxin and Zhongxing Xindi were selected as the suppliers of distribution frames and packaging materials and Zhongxing Xinyu was selected as the supplier of flexible printed circuit boards. As the Group considers that having reliable and cooperative suppliers is important and beneficial to us, purchasing from Zhongxingxin, Zhongxing Xindi and Zhongxing Xinyu allows us to secure essential control over most of the components of our production by being able to ensure timely delivery of such components while maintaining product quality.

d) *Purchases of liquid crystal modules (LCM) by ZTE Kangxun from Lead*

- Description of the connected relationship between the parties to the transaction:

Lead is a connected person of the Group as its substantial shareholder, Zhongxingxin, is a connected person at the level of the Company (and not at the level of the subsidiaries of the Company). Please refer to the above for further details of Lead.

- Total transaction amount for 2006:

Approximately RMB196,576,000

- Pricing and other terms:

ZTE Kangxun has entered into a framework purchase agreement dated 19 November 2004 with Lead expiring on 31 December 2006. Lead will still be required to undergo the Group's qualification and bidding procedures for the selection of suppliers. If Lead succeeds in its bid to supply to ZTE Kangxun, ZTE Kangxun will issue purchase orders from time to time to Lead pursuant

MATERIAL MATTERS

to the framework agreement entered into with it. Purchase orders will specify product types, agreed quantities and prices, quality specifications, delivery times, places and modes, as well as contact details. Prices will be arrived at after arm's length negotiations, with reference to the prices quoted by Lead for sales of similar quantities of the same or similar products to independent third parties at the relevant time.

- Reasons for such transactions

The Group's handset products have become one of the major sources of revenue for the Company. The Group requires steady, reliable and quality supplies of liquid crystal modules for the Group's handset products. As the production of these liquid crystal modules involves merely low value-added assembly work, there are few suppliers of raw materials and components that are able to undertake such large-scale production as required by the Group for the prices we offer. Lead was established to handle large-scale production at low unit cost and to specialise in the supply of liquid crystal modules. The Group believes that it has also been able to provide us a fast production turnaround time, consistent product quality and timely delivery. The Group has now taken a majority stake in Lead as the Directors of the Company consider that having Lead as our subsidiary allows us to secure steady supplies of quality liquid crystal modules in large volumes from a co-operative, reliable and specialised supplier that would not otherwise be easily available from other suppliers for comparable prices.

The Group has entered into connected transactions framework agreements with the above connected parties for the three years from 2007 to 2009, and has fulfilled the statutory procedure of reporting, announcement and seeking approval at the general meeting in accordance with Chapter 14A of the Hong Kong Stock Exchange Listing Rules in respect of the estimated annual caps for the connected transactions for the years 2007 to 2009. For details please refer to the announcements on ongoing connected transactions and the resolutions of the First Extraordinary General Meeting for 2007 published by the Company in The Standard and Hong Kong Economic Times on 2 November 2006 and 14 March 2007, respectively.

2. The Independent Non-executive Directors of the Company have reviewed the connected transactions of the Group and confirmed that:

- the transactions were conducted in the ordinary and usual course of business of the Company;
- the transactions were entered into on normal commercial terms; and
- the transactions were conducted in accordance with the terms of the agreements governing them and the terms of the transactions are fair and reasonable and in the interests of the shareholders of the Company as a whole.

3. The auditors of the Company have reviewed the connected transactions and confirmed to the Board of Directors of the Company that the transactions:

- were approved by the Board of Directors of the Company;
- were conducted in accordance with the pricing policies of the Company;
- were conducted in accordance with the terms of the agreements governing them; and
- within the relevant annual caps as agreed by the Hong Kong Stock Exchange.

(4) DEBTORS AND CREDITORS BETWEEN THE GROUP AND ITS CONNECTED PARTIES

Debtors and creditors between the Company and its connected parties during the year were incurred during the ordinary course of business and did not have any material impact on the Company. There were no guarantees for connected parties between the Company and its connected parties.

MATERIAL MATTERS

(5) MATERIAL CONTRACTS OF THE GROUP

1. During the year, the Group did not put on trust, sub-contract, or lease any assets of other companies nor did other companies put on trust, sub-contract or lease any of the Company's assets of a material nature.

2. External guarantee by the Company

(1) External guarantees of the Group during the reporting period are set out as follows:

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

Guaranteed party	Date of incurrence (date of execution of relevant agreements)	Amounts guaranteed	Type of guarantee	Term	Whether fully performed	Whether provided in favour of connected parties (Yes/No)
Djibouti Telecom S.A	8 September 2006	RMB50 million	Joint liability	12 years	No	No

Total amount guaranteed during the reporting period	RMB50 million
Total balance of amount guaranteed at the end of the reporting period (A)	RMB50 million
Guarantees provided in favour of subsidiaries	
Total amount guaranteed in favour of subsidiaries during the reporting period (Note 1)	US$3 million
Total amount guaranteed among subsidiaries during the reporting period	RMB47,015,000 US$117,600
Total balance of amount guaranteed in favour of subsidiaries at the end of the reporting period (B)	RMB47,015,000 US$3,117,600
Total amount guaranteed by the Company (including guarantees in favour of subsidiaries)	
Total guaranteed amount (A+B) (Note 2)	RMB121,359,400
Total guaranteed amount as a percentage of net assets of the Company at the end of the reporting period	1.14%
of which:	
Amounts of guarantees provided in favour of shareholders, de facto controllers and their connected parties (C)	0
Amount of debt guarantee provided directly or indirectly in favour of parties with a gearing ratio exceeding 70% (D)	0
Amount of total guarantee exceeding 50% of net assets (E)	0
Aggregated amount of the three guarantee amounts stated above (C+D+E)	0

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

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

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

MATERIAL MATTERS

(2) Progress of previously granted guarantees during the reporting period

In January 2005, the Company performed its guarantee to make a repayment of RMB3.50 million on behalf of Chengdu Information Port Company Limited. As at the end of the reporting period, Juyou Industrial Group Limited, as counter-guarantor, had made a repayment of RMB1.55 million to the Company, and an amount of RMB1.95 million remained outstanding. The Group will continue to actively procure the settlement of the outstanding amount. (Please refer to the 2005 annual report of the Group for details of the guarantee).

3. During the year, the Group did not have any entrusted investments.

(VI) UNDERTAKINGS

1. Undertaking in respect of Share Reform

The statutory and special undertakings given by the nine holders of shares of the Company that are subject to lock-up in connection with the Share Reform are set out in the section headed "Number of shares held by shareholders subject to lock-up and terms of lock-up" in this report.

2. The above undertakings had been properly fulfilled and there had been no circumstances of violations of such undertakings.

Change in the number of circulating shares not subject to lock-up held by the original holder of non-circulating shares (Zhongxingxin) holding over 5% of the Company's shares at the end of the reporting period is set out as follows:

Name of shareholder	Circulating shares not subject to lock-up held on the date of listing of shares subject to lock-up (shares)	Increase/ decrease during the year (shares)	Reasons for change	Circulating shares not subject to lock-up held at the end of the year (shares)
Zhongxingxin	47,976,083	0	—	47,976,083

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

3. There were no other undertakings by the Company or shareholders interested in 5% or more of the shares in the Company.

MATERIAL MATTERS

(7) INFORMATION ON THE PHASE I SHARE INCENTIVE SCHEME OF THE COMPANY

I. Principal terms of the Phase I Share Incentive Scheme of the Company are set out as follows:

ZTE shall implement the Share Incentive Scheme by way of the grant of new shares. Specifically, ZTE shall grant to Scheme Participants a quota of 47,980,000 Subject Shares, representing approximately 5% of the Total Share Capital of ZTE. Upon the fulfilment of the unlocking conditions, Scheme Participants may apply to unlock the granted Subject Shares on an annual basis pursuant to the Share Incentive Scheme. The unlocked Subject Shares shall be freely tradable in accordance with the laws. The quota of Subject Shares shall be cancelled if the unlocking conditions are not satisfied.

2. The Share Incentive Scheme shall be in force for a term of five years, comprising a Lock-up Period of two years and an Unlocking Period of three years:

(a) The Lock-up Period shall last for a period of two years commencing from the date of approval of the Share Incentive Scheme by the general meeting of ZTE, during which the Subject Shares granted to Scheme Participants under the Share Incentive Scheme shall be subject to lock-up and shall not be transferable;

(b) The Unlocking Period shall last for three years following expiry of the Lock-up Period, during which Scheme Participants may, subject to unlocking conditions stipulated by the Share Incentive Scheme being satisfied, apply for unlocking in 3 tranches: the first unlocking period shall be the first year following the expiry of the Lock-up Period and the number of shares to be unlocked shall not exceed 20% of the aggregate number of the Subject Shares granted; the second unlocking period shall be the second year following the expiry of the Lock-up Period and the number of shares to be unlocked shall not exceed 35% of the aggregate number of the Subject Shares granted; the third unlocking period shall be the third year following the expiry of the Lock-up Period and the number of shares to be unlocked shall represent all outstanding Subject Shares. If the unlocking conditions are not satisfied in any one year during the Unlocking Period, no application made by the Scheme Participants during such year, nor in subsequent years for the unlocking of such Subject Shares will be accepted. ZTE shall return the Scheme Participants the Subscription Cost for the Subject Shares still subject to the lock-up purchased by the Scheme Participants at their own cost. The quota for such Subject Shares shall be cancelled if the unlocking conditions are not satisfied.

3. The Scheme Participants of the Share Incentive Scheme shall be the Directors and Senior Management of ZTE and Key Personnel of ZTE and its controlled subsidiaries. Scheme Participants who have participated in the Share Incentive Scheme shall not participate in ZTE's distribution of Deferred Bonus in 2006. Employees not participating in the Share Incentive Scheme will not be entitled to receive the portion of the 2006 Deferred Bonus which will be converted for Scheme Shares and which would otherwise be distributed to the Scheme Participants if they did not participate in the Share Incentive Scheme.

4. Out of the total number of Subject Shares under Share Incentive Scheme, 10% or 4,798,000 shares will be set aside for employees who make significant contributions to the Company and important personnel required by the Company who are identified after the Share Incentive Scheme has been reviewed and passed at the general meeting. The Supervisory Committee will verify the qualifications of the aforesaid employees. The admission of Directors, Supervisors and Senior Management as Scheme Participants shall be submitted to the general meeting for its approval.

5. The weighted average rates of return on net assets of ZTE for the years 2007, 2008 and 2009 shall be adopted as the results appraisal conditions to Scheme Participants' application for unlocking the Subject Shares in the first, second and third tranche, respectively. Such rates of return on net assets shall not be less than 10% (before or after extraordinary income/loss items, whichever is lower).

MATERIAL MATTERS

6. After the Share Incentive Scheme has been approved by the general meeting and the grant conditions have been fulfilled, the Scheme Participants shall pay the subscription amounts for the Subject Shares to get the quota for the Subject Shares.

7. The price per share at which ZTE shall grant to the Scheme Participants the Subject Shares shall be the Grant Price, which, unless otherwise stipulated in the Share Incentive Scheme, shall represent the closing price of ZTE A Shares as quoted on the Stock Exchange on the trading day immediately preceding the date on which the Board meeting for reviewing the Share Incentive Scheme for the first time was convened. Upon the grant of shares to the Scheme Participants by the Company, Scheme Participants shall pay the subscription amounts for the Subject Shares on the basis of the purchase of 5.2 Subject Shares at the Grant Price for every 10 Subject Shares granted, out of which the subscription amounts for 3.8 shares shall be funded by Scheme Participants at their own cost and the subscription amounts for 1.4 Subject Shares shall be funded by the conversion of the Deferred Bonus that Scheme Participants would have received prior to their agreement not to participate in the distribution of 2006 Deferred Bonus, calculated as a percentage of the Grant Price.

8 ZTE shall not provide loans or other financial assistance in any form to the Scheme Participants, including guarantees for loans.

9. The Share Incentive Scheme shall be formulated by the Remuneration and Evaluation Committee of the Board of Directors of ZTE and reviewed by the Board. It shall be implemented upon approval by the general meeting of the Company after due examination and approval by the CSRC and consent of the holders of the state-owned shares with the approval of the State-owned assets management authorities.

II. Progress of the Phase I Share Incentive Scheme

The Phase I Share Incentive Scheme of the Company was formulated by the Remuneration and Evaluation Committee of the Board of Directors of the Company to establish a long-term incentive mechanism closely linked with the Company's business performance and long-term strategy, so as to help optimise the overall remuneration structure and create a competitive advantage in human resources that will contribute to the long-term, sustainable growth of the Company's operation. Phase I of the Share Incentive Scheme (Draft) was approved at the nineteenth meeting of the third session of the Board of Directors of the Company on 25 October 2006. Thereafter the Company submitted Phase I of the Share Incentive Scheme (Draft) to the State-owned Assets Management Commission under the State Council and CSRC for approval in accordance with relevant State regulations. The Remuneration and Evaluation Committee thereafter revised the scheme according to the comments of relevant regulatory authorities, and Phase I of the Share Incentive Scheme (Revised Version) was approved at the twentieth meeting of the third session of the Board of Directors of the Company on 15 December 2006. To further improve Phase I of the Share Incentive Scheme, the Company further revised Phase I of the Share Incentive Scheme (Revised Version). A no comment letter was issued by CSRC with respect to the Phase I of the Share Incentive Scheme (Version Dated 5 February 2007), which was then approved at the First Extraordinary General Meeting of the Company for 2007 on 13 March 2007.

Relevant Scheme Participants of the Phase I Share Incentive Scheme of the Company paid subscription amounts for their Subject Shares between 14 March 2007 and 18 March 2007, which will be used as additional working capital for the Company.

III. Accounting treatment adopted for the Phase I Share Incentive Scheme

The Phase I Share Incentive Scheme shall be accounted for in accordance with PRC Enterprise Accounting Standard No. 11 — Share-based Payments and Hong Kong Accounting Standards/HKFRS 2 — Share-based Payments. For details of the accounting methods and their impact on the Company, please refer to Item 21 of Note II to the financial statements prepared in accordance with PRC GAAP and Note 38 to the financial statements prepared in accordance with HKASs.

MATERIAL MATTERS

(8) INTERNAL CONTROL OF THE COMPANY

Information on the internal control of the Company is set out in the section headed "Internal Control" in the Corporate Governance Report under "Corporate Governance Structure" of this annual report.

(9) ENGAGEMENT OF AUDITORS BY THE COMPANY

Details are set out in the section headed "Remuneration of Auditors" under "Corporate Governance Structure" of this annual report.

(10) AMENDMENTS TO THE ARTICLES OF ASSOCIATION

Resolutions approving comprehensive amendments to the Articles of Association were passed by the 2005 annual general meeting of the Company held on 14 June 2006.

(11) RECEPTION OF INVESTORS AND ANALYSTS, COMMUNICATIONS AND PRESS INTERVIEWS

Nature	Location	Time	Mode	Audience received	Contents of discussion	Materials furnished
Presentation of company	Hong Kong	April 2006	2005 results presentation	Analysts and investors	2005 Annual Report	Published regular reports
	Hong Kong	August 2006	2006 interim results presentation	Analysts and investors	2006 Interim Report	Published regular reports
	Company	April 2006	Teleconference	Analysts and investors	First quarterly report 2006	Published regular reports
	Company	October 2006	Teleconference	Analysts and investors	Third quarterly report 2006	Published regular reports
External meetings	Hong Kong	February 2006	Credit Suisse presentation	Customers of Credit Suisse	Day-to-day operations of the Company	Published regular reports
	Shenzhen	March 2006	BNP presentation	Customers of BNP	Day-to-day operations of the Company	Published regular reports
	Beijing	March 2006	Deutsche Bank presentation	Customers of Deutsche Bank	Day-to-day operations of the Company	Published regular reports
	Shanghai	May 2006	Haitong Securities presentation	Customers of Haitong Securities	Day-to-day operations of the Company	Published regular reports
	Shanghai	May 2006	CLSA presentation	Customers of CLSA	Day-to-day operations of the Company	Published regular reports
	Shanghai	May 2006	CICC presentation	Customers of CICC	Day-to-day operations of the Company	Published regular reports
	Huizhou	June 2006	China Merchant Securities presentation	Customers of China Merchant Securities	Day-to-day operations of the Company	Published regular reports
	Hong Kong	September 2006	CLSA presentation	Customers of CLSA	Day-to-day operations of the Company	Published regular reports
	Beijing	November 2006	Goldman Sachs Gao Hua Securities presentation	Customers of Goldman Sachs Gao Hua Securities	Day-to-day operations of the Company	Published regular reports
	Shenzhen	December 2006	CICC presentation	Customers of CICC	Day-to-day operations of the Company	Published regular reports

MATERIAL MATTERS

Nature	Location	Time	Mode	Audience received	Contents of discussion	Materials furnished
Company visits by analysts	Overseas investors					
	Company	During 2006	Verbal	Lehman Brothers, GENESIS Assets Management, PANTERA CAPITAL MANAGEMENT, LP Schroders London, Naito Securities, Guotai Junan (Hong Kong) Securities, JP Morgan Chase, ABN, Deutsche Bank, Ginger Capital Fund, SKANDIA, UBS, TEMPLETON, CLSA, Citibank, Willington Funds, Fidelity Funds, Value Partners, Pacific Crest Securities Inc., Capital Securities, Goldman Sachs Gao Hua, Daiwa (Hong Kong), SG Assets Management (Singapore) Limited, ROBECO of the Netherlands, Credit Suisse, Gold Financial Holdings Group Limited, Morgan Stanley, UOB Kay Hian, First Shanghai Securities, HALBIS PARTNERS, Merill Lynch Securities	Day-to-day operations of the Company	Published regular reports
	Domestic investors					
	Company	During 2006	Verbal	China Re Asset Management Company Limited, CITIC Securities, Penghua Fund, Fortune SGAM Fund Management Co., Ltd, Huaan Securities, PICC Group, China Jianshe Securities (中國建設証券), Southern Fund Management Co., Ltd, CITIC Fund, Changsheng Fund Management Co., Ltd, Everbright Securities, Guotai Junan Securities, CICC, China International Fund Management Co., Ltd. (上投摩根基金公司), Haifutong Fund (海富通基金公司), Bosera Funds, Pingan Securities, CITIC-Prudential Fund Management Co., Ltd, Sinolink Securities Co., Ltd, Jiashi Fund, ICBC-Credit Suisse Fund	Day-to-day operations of the Company	Published regular reports

(12) *INVESTIGATIONS, ADMINISTRATIVE PENALTIES, PUBLIC CENSURES AND REPRIMANDS*

During the year, the Company, the Board of Directors and the Directors have not been investigated, under administrative penalty or publicly censured by the China Securities Regulatory Commission or openly reprimanded by the Shenzhen Stock Exchange.

(13) *SIGNIFICANT EVENTS*

During the year, the Company was not involved in any significant events as specified under Rule 67 of the Securities Law of the People's Republic of China and Rule 17 of Detailed Rules Governing Public Listed Companies' Information Disclosure (Provisional) and matters which the Board of Directors considered as significant events.

(14) *OTHER MATERIAL MATTERS*

During the year, the Company and its subsidiaries were not involved in any material matters requiring disclosure that have not been disclosed.

NOTICE OF 2006 ANNUAL GENERAL MEETING

NOTICE IS HEREBY GIVEN that an Annual General Meeting (hereinafter referred to as the "AGM") of ZTE Corporation (hereinafter referred to as the "Company") for the year 2006 will be held in accordance with the resolution passed by the second meeting of the fourth session of the Board of Directors of the Company held on 18 April 2007. Details of the AGM are set out below:

1. INFORMATION REGARDING THE MEETING

(1) Time of meeting

The AGM will commence at 9:00 a.m. on 15 June 2007.

(2) Venue

The AGM will be held at the Conference Room on the 4th floor of the Company's headquarters in Shenzhen

Address: 4th Floor, Block A, ZTE Plaza, Keji Road South, Hi-Tech Industrial Park, Nanshan District, Shenzhen.

Tel: +86 755 26770282

(3) Convener

The AGM will be convened by the Board of Directors of the Company.

(4) Voting method

Voting will be carried out on-site at the AGM.

(5) Attendees

1. All ZTE (000063) shareholders registered with China Securities Depository & Clearing Corporation Limited, Shenzhen Office upon the close of trading of its A shares on the Shenzhen Stock Exchange (hereinafter referred to as "Domestic Shareholders") on Tuesday, 15 May 2007 at 3:00 p.m.;

2. All shareholders registered on the Company's H share register maintained by Computershare Hong Kong Investor Services Limited upon the close of trading of its H shares on The Stock Exchange of Hong Kong Limited on Tuesday, 15 May 2007 at 4:00 p.m. (hereinafter referred to as "H Shareholders");

3. Directors, supervisors and senior management of the Company; and

4. Representatives of intermediaries engaged by the Company and guests invited by the Board of Directors.

(6) Period of closure of H share register

The Company will close its H share register from Wednesday, 16 May 2007 to Thursday, 14 June 2007 (inclusive). Any H Shareholder who wishes to receive the final dividend for the year shall lodge an instrument of transfer, together with the corresponding share certificate(s) with Computershare Hong Kong Investor Services Limited at Room 1712-16, 17th Floor, Hopewell Centre, 183 Queen's Road East, Wanchai, Hong Kong by 15 May 2007 at 4:00 p.m. Details of the record date of dividend payment, dividend payment method and dividend payment date for Domestic Shareholders will be announced separately.

NOTICE OF 2006 ANNUAL GENERAL MEETING

2. MATTERS TO BE CONSIDERED AT THE AGM

To consider and, if thought fit, pass the following resolutions at the AGM as follows:

Ordinary Resolutions

1. to consider and approve the financial report for the year ending 31 December 2006 audited by the Company's PRC and Hong Kong auditors;

2. to consider and approve the report of the Board of Directors of the Company for the year ending 31 December 2006;

3. to consider and approve the report of the Supervisory Committee of the Company for the year ending 31 December 2006;

4. to consider and approve the report of the President of the Company for the year ending 31 December 2006;

5. to consider and approve the final financial accounts of the Company for the year ending 31 December 2006;

6. to consider and approve the profit distribution plan of the Company for the year ending 31 December 2006;

7. to consider and approve the appointment of the PRC auditors and the Hong Kong auditors of the Company for the year ending 31 December 2007:

7.1 That Ernst & Young Hua Ming be re-appointed as the PRC auditors of the Company for 2007 and a proposal be made to the shareholders' general meeting to authorise the Board of Directors to determine the audit fees of Ernst & Young Hua Ming for 2007 based on specific audit work to be conducted.

7.2 That Ernst & Young be re-appointed as the Hong Kong auditors of the Company for 2007 and a proposal be made to the shareholders' general meeting to authorise the Board of Directors to determine the audit fees of Ernst & Young for 2007 based on the specific audit work to be conducted.

In compliance with the Regulatory Opinion on General Meetings of Listed Companies, five Independent Directors of the Company shall deliver their work reports at the AGM.

Special Resolution

8. To consider and, if thought fit, pass the following resolution of the Company on the general mandate for 2007 by the Company as a special resolution:

"THAT:

1. Subject to the conditions set out below, the Board of Directors be hereby granted an unconditional and general mandate during the Relevant Period to separately or concurrently allot, issue and deal with additional domestic shares and overseas-listed foreign shares ("H Shares") of the Company and to make or grant offers, agreements or options in respect of the above:

(1) such mandate shall not extend beyond the Relevant Period, other than in the case of the making or granting of offers, agreements or options by the Directors during the Relevant Period which might require the performance or exercise of such powers after the close of the Relevant Period;

NOTICE OF 2006 ANNUAL GENERAL MEETING

(2) the aggregate nominal amount of domestic shares and H shares authorised to be allotted and issued or agreed conditionally or unconditionally to be allotted and issued (whether pursuant to an option or otherwise) by the Board of Directors, otherwise than pursuant to (i) a Rights Issue or (ii) any option scheme or similar arrangement from time to time being adopted for the grant or issue to Directors, Supervisors, senior management and/or employees of the Company and/or any of its subsidiaries of shares or rights to acquire shares of the Company, shall not exceed 20% of the aggregate nominal amount of each of the share capital of the domestic shares and H shares of the Company in issue at the date on which this Resolution is passed; and

(3) the Board of Directors will only exercise the above authority in compliance with the Company Law of the People's Republic of China (as amended from time to time) and Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited (as amended from time to time) and with the necessary approvals of the China Securities Regulatory Commission and/or other relevant PRC government authorities.

2. For the purpose of this resolution:

"Relevant Period" means the period from the passing of this Resolution until the earliest of:

(1) the conclusion of the next annual general meeting of the Company following the passing of this Resolution;

(2) the expiration of a twelve-month period following the passing of this Resolution; or

(3) the revocation or variation of the authority given to the Directors under this Resolution by the passing of a special resolution of the Company at the shareholders' general meeting.

"Rights Issue" means an offer to all shareholders of the Company (except any shareholders to which the making of such offers by the Company is not permitted under the laws of the jurisdictions where they reside) and, as appropriate, holders of other equity securities of the Company who are qualified for such offers to for the allotment and issue of shares or other securities in the Company which will or might require the allotment and issue of shares in proportion to their existing holdings of such shares or other equity securities (subject to the exclusion of fractional entitlements).

3. Where the Board of Directors resolve to issue shares pursuant to paragraph 1 of this resolution, the Board of Directors be hereby authorised to approve and execute all documents and deeds and do all things or to procure the execution of such documents and deeds and the doing of such things necessary in their opinion for the issue of the new shares (including but not limited to determining the time and place for issue, submitting all necessary applications to relevant authorities, entering into underwriting agreements (or any other agreements), determining the use of proceeds, and fulfilling filing and registration requirements of the PRC, Hong Kong and other relevant authorities, including but not limited to the registration with relevant PRC authorities of the increase in registered share capital as a result of the issue of shares pursuant to paragraph 1 of this Resolution); and

4. The Directors be hereby authorised to amend the Company's Articles of Association as they deem necessary to increase the registered share capital of the Company and to reflect the new capital structure of the Company following the allotment and issue of the Company's shares contemplated in paragraph 1 of this Resolution."

3. REGISTRATION AT THE AGM

(1) Registration of attendance

1. Any legal person shareholder (including but not limited to corporate shareholders) entitled to attend the AGM shall produce to the register with a duplicate of its corporate business licence, a duly signed power of attorney and the identity card of the attendee.

NOTICE OF 2006 ANNUAL GENERAL MEETING

2. Any individual shareholder entitled to attend the AGM shall produce for registration his own identity card, stock account card and evidence of shareholding.

3. Any shareholder intending to attend the AGM shall deliver the confirmation slip to the AGM registry by courier, registered mail or fax.

(2) Time of registration

From 21 May 2007 to 25 May 2007

(3) Address for registration

Registration for the AGM will be conducted at: 6/F, Block A, ZTE Building, Keji Road South, Hi-Tech Industrial Park, Nanshan District, Shenzhen, PRC 518057.

(4) Requirements when registering and voting by way of proxy

1. Any shareholder entitled to attend and vote at the meeting may entrust one or more person (whether or not a shareholder) as his proxy(ies) to attend and vote at the meeting on his behalf. The shareholder may attend and vote at the meeting in person notwithstanding that he has completed and submitted the proxy form; in such a case, the proxy form is deemed withdrawn. For a shareholder who entrusts two or more proxies, the voting rights to be exercised by such proxies in aggregate shall not exceed the total number of votes the shareholder is entitled to exercise at the meeting, and any one share may not be voted by different proxies.

2. A shareholder shall appoint a proxy in writing by using the proxy form, which shall be signed by the authorising shareholder or his duly authorised attorney. The proxy form shall be notarized if it is to be signed by any person other than by the authorising shareholder himself. The proxy form is valid only if it is deposited at the registered address of the Company no less than 24 hours before the AGM.

3. If a shareholder entrusts his proxy(ies) to attend and vote at the meeting on behalf of him, such proxy(ies) shall produce for registration his own identity card, the duly signed proxy form, the stock account card of shareholder and evidence of share holding.

4. MISCELLANEOUS

(1) It is expected that the AGM will take less than one day; all accommodation, travel and expenses relating to attending the meeting shall be borne by the attendees.

(2) AGM Contact: Li Liuhong

(3) Contact telephone number: + 86 755 26770285

(4) Contact fax number: + 86 755 26770286

5. REFERENCE

Resolutions of the Second Meeting of the Fourth Session of the Board of Directors of ZTE Corporation

By order of the Board
Hou Weigui
Chairman

Shenzhen, the PRC
19 April 2007

REPORT OF THE PRC AUDITORS

ERNST & YOUNG HUA MING
安永华明会计师事务所

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

To the members of ZTE Corporation:

We have audited the accompanying consolidated balance sheets and the balance sheets of ZTE Corporation (hereinafter referred to as the ''Company'') and its subsidiaries (collectively the ''Group'') as at 31 December 2006, the consolidated income statements and the statements of income distribution, income statements and the statements of income distribution of the Company for the year then ended and consolidated statements of cash flows and the statements of cash flows of the Company for the year then ended and notes to the financial statements.

MANAGEMENT'S RESPONSIBILITY FOR THE FINANCIAL STATEMENTS

The management is responsible for preparing financial statements in accordance with Accounting Standards for Business Enterprises and the Accounting System for Business Enterprises. This responsibility includes (1) designing, implementing and maintaining the internal control relevant to the preparation of the financial statements that are free from material misstatement whether due to fraud or error; (2) selecting and applying appropriate accounting policies; and (3) making accounting estimates that are reasonable in the circumstances.

AUDITOR'S RESPONSIBILITY

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with the Chinese Auditing Standards issued by the Chinese Institute of Certified Public Accountants. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain a reasonable assurance as to whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, we consider the internal control relevant to the entity's preparation of financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of the accounting policies used and the reasonableness of the accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

OPINION

In our opinion, the financial statements referred to above have been prepared in accordance with Accounting Standards for Business Enterprises and the ''Accounting System for Business Enterprises'', and presented fairly, in all material aspects, the financial position of the Company as of 31 December 2006 and the results of its operations and its cash flows for the year then ended.

Ernst & Young Hua Ming

Xie Feng
Chinese certified public Accountant

Beijing, the People's Republic of China

Li Di
Chinese Certified Public Accountant

18 April 2007

CONSOLIDATION BALANCE SHEET

(Prepared under PRC GAAP)
(All amounts in RMB'000 unless otherwise stated)
(English translation for reference only)

	Note V	31 Dec, 2006	31 Dec, 2005
Current assets			
Cash in banks and on hands	1	**4,311,060**	5,573,132
Short-term investment	2	**16,693**	—
Notes receivable	3	**1,658,406**	1,244,853
Dividend receivable		**1,136**	—
Trade receivables	4	**5,329,628**	3,441,922
Factored trade receivables	5	**152,848**	36,416
Other receivables	6	**439,904**	279,975
Accounts prepaid	7	**51,757**	151,174
Inventories	8	**2,760,995**	2,519,547
Amount due from customers for contract work	9	**5,833,480**	4,689,157
Total current assets		**20,555,907**	17,936,176
Long-term investment			
Long-term equity investments	10	**100,681**	85,459
Total long-term investments		**100,681**	85,459
Fixed assets			
Fixed assets — cost	11	**4,234,574**	3,623,940
Less: accumulated depreciation	11	**1,555,714**	1,148,789
Net fixed assets	11	**2,678,860**	2,475,151
Less: fixed assets impairment provision	11	**87,002**	94,980
Fixed assets — net book value	11	**2,591,858**	2,380,171
Construction in progress	12	**469,636**	126,741
Total fixed assets		**3,061,494**	2,506,912
Intangible and other assets			
Intangible assets	13	**152,859**	160,264
Long-term trade receivables	4	**372,703**	307,666
Factored long-term trade receivables	5	**1,399,206**	687,765
Long-term deferred assets	14	**40,416**	13,996
Total intangible and other assets		**1,965,184**	1,169,691
Deferred tax			
Deferred tax assets	15	**233,683**	80,893
TOTAL ASSETS		**25,916,949**	21,779,131

Notes on page 110 to page 164 form an integral part of these financial statements.

CONSOLIDATION BALANCE SHEET

(Prepared under PRC GAAP)
(All amounts in RMB'000 unless otherwise stated)
(English translation for reference only)

	Note V	31 Dec, 2006	31 Dec, 2005
Current liabilities			
Short-term loans	16	**945,726**	99,695
Bank advances on factored trade receivables	5	**152,848**	36,416
Notes payable	17	**2,242,566**	1,977,584
Trade payables	18	**4,749,099**	4,292,208
Amount due to customers for contract work	9	**996,275**	733,455
Advances from customers	19	**635,875**	861,024
Accrued payroll		**668,307**	622,804
Welfare payable		**298,430**	394,216
Dividend payable	20	**83,941**	163,008
Taxes payable	21	**(699,658)**	(670,282)
Other levies		**8,891**	7,134
Other payables	22	**666,430**	626,066
Accrued expenses	23	**387,619**	346,668
Provision	24	**35,680**	20,035
Long-term loans due within 1 year	25	**—**	500,000
Total current liabilities		**11,172,029**	10,010,031
Non-current liabilities			
Long-term loans	26	**1,679,242**	80,000
Bank advances on factored long-term trade receivables	5	**1,399,206**	687,765
Specific payables	27	**425,669**	405,511
Total non-current liabilities		**3,504,117**	1,173,276
Total liabilities		**14,676,146**	11,183,307
Minority interests		**561,892**	470,729
Owner's equity:			
Share capital	28	**959,522**	959,522
Capital surplus	29	**5,509,666**	5,506,424
Surplus reserves	30	**1,331,059**	1,264,060
Undistributed profits	31	**2,767,616**	2,171,190
Exchange differences		**(32,880)**	(15,981)
Proposed final dividend		**143,928**	239,880
Total owner's equity		**10,678,911**	10,125,095
TOTAL LIABILITIES AND OWNER'S EQUITY		**25,916,949**	21,779,131

Notes on page 110 to page 164 form an integral part of these financial statements.

Legal Representative:	Chief Financial Officer:	Head of Finance Division:
Hou Weigui	Wei Zaisheng	Shi Chunmao

CONSOLIDATED INCOME STATEMENTS & STATEMENTS OF INCOME DISTRIBUTION

(Prepared under PRC GAAP)
(All amounts in RMB'000 unless otherwise stated)
(English translation for reference only)

	Note V	2006	2005
Revenue from principal operations	32	**23,031,684**	21,575,920
Less: Cost of sales	32	**15,171,797**	13,944,797
Taxes and surcharges	33	**111,360**	105,660
Profit from principal operations		**7,748,527**	7,525,463
Add: Profit from other operations	34	**69,152**	15,779
Less: Operating expenses		**3,140,108**	3,023,126
General and administrative expenses		**4,010,206**	3,137,066
Finance expenses	35	**239,617**	288,751
Operating profit		**427,748**	1,092,299
Add: Investment income	36	**31,849**	(59,354)
Subsidy income	37	**612,163**	458,014
Non-operating income	38	**24,008**	27,627
Less: Non-operating expenses	39	**26,151**	16,722
Total profit		**1,069,617**	1,501,864
Less: Income tax		**125,624**	158,545
Minority interests		**136,640**	148,976
Net profit		**807,353**	1,194,343
Add: Undistributed profits at beginning of year		**2,171,190**	1,495,431
Distributable profit		**2,978,543**	2,689,774
Less: Statutory surplus reserves		**66,999**	278,704
Profit available for distribution to owners		**2,911,544**	2,411,070
Less: Proposed final dividend		**143,928**	239,880
Undistributed profits at year-end		**2,767,616**	2,171,190

Supplemental Information

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

Notes on page 110 to page 164 form an integral part of these financial statements.

Legal Representative:	Chief Financial Officer:	Head of Finance Division:
Hou Weigui	Wei Zaisheng	Shi Chunmao

CONSOLIDATED CASH FLOW STATEMENT

(Prepared under PRC GAAP)
(All amounts in RMB'000 unless otherwise stated)
(English translation for reference only)

Items		Note V	2006	2005
1.	Cash flows from operating activities			
	Cash received from sale of goods or rendering of services		**21,600,437**	21,315,221
	Cash received from taxes returned		**1,404,449**	458,014
	Cash received relating to other operating activities		**131,464**	119,215
	Sub-total of cash inflow		**23,136,350**	21,892,450
	Cash paid for goods and services		**17,685,647**	13,915,822
	Cash paid to and on behalf of employees		**3,514,280**	2,793,854
	Payments of taxes and levies		**1,265,754**	1,679,312
	Cash paid relating to other operating activities	40	**2,225,655**	3,326,157
	Sub-total of cash outflow		**24,691,336**	21,715,145
	Net cash flows from operating activities		**(1,554,986)**	177,305
2.	Cash flows from investing activities			
	Cash received from sale of investments		**22,766**	331
	Net cash received from the disposal of subsidiaries		**—**	(31,555)
	Cash received from gains of investment		**23,265**	—
	Net cash received from disposal of fixed asset, intangible assets and other long-term assets		**20,851**	41,372
	Sub-total of cash inflow		**66,882**	10,148
	Cash paid to acquire fixed asset, intangible assets and other long-term assets		**1,181,162**	921,463
	Cash paid for acquisition of equity investments		**48,889**	72,955
	Cash paid relating to other investing activities		**394**	—
	Sub-total of cash outflow		**1,230,445**	994,418
	Net cash flow from investing activities		**(1,163,563)**	(984,270)

Notes on page 110 to page 164 form an integral part of these financial statements.

CONSOLIDATED CASH FLOW STATEMENT

(Prepared under PRC GAAP)
(All amounts in RMB'000 unless otherwise stated)
(English translation for reference only)

Items		Note V	2006	2005
3.	Cash flows from financing activities			
	Cash received from investment		**30,366**	25,227
	Cash received from borrowings		**3,093,148**	108,695
	Sub-total of cash inflow		**3,123,514**	133,922
	Cash paid for debt repayments		**1,147,875**	869,867
	Cash payments for distribution of dividends and interest expenses		**509,886**	459,553
	Sub-total of cash outflow		**1,657,761**	1,329,420
	Net cash flow from financing activities		**1,465,753**	(1,195,498)
4.	Effect of foreign exchange rate changes on cash		**(9,276)**	(22,628)
5.	Net increase (decrease) in cash and cash equivalents		**(1,262,072)**	(2,025,091)

Notes on page 110 to page 164 form an integral part of these financial statements.

CONSOLIDATED CASH FLOW STATEMENT

(Prepared under PRC GAAP)
(All amounts in RMB'000 unless otherwise stated)
(English translation for reference only)

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

Notes on page 110 to page 164 form an integral part of these financial statements.

Legal Representative:	Chief Financial Officer:	Head of Finance Division:
Hou Weigui	Wei Zaisheng	Shi Chunmao

BALANCE SHEET

(Prepared under PRC GAAP)
(All amounts in RMB'000 unless otherwise stated)
(English translation for reference only)

ASSETS	Note V	**31 Dec, 2006**	31 Dec, 2005
Current assets			
Cash in banks and on hands		**2,957,920**	4,258,936
Notes receivable		**1,617,133**	1,209,151
Dividends receivable		**817,631**	16,465
Trade receivables	4	**5,753,208**	4,481,796
Factored trade receivables		**275,830**	5,007
Other receivables	6	**1,220,098**	1,230,352
Accounts prepaid		**20,619**	67,305
Inventories		**1,458,946**	1,557,312
Amount due from customers for contract work		**5,809,647**	4,440,842
Total current assets		**19,931,032**	17,267,166
Long-term investment			
Long-term equity investments	10	**2,632,569**	2,833,305
Total long-term investments		**2,632,569**	2,833,305
Fixed assets			
Fixed assets-cost		**2,510,628**	2,491,000
Less: accumulated depreciation		**811,658**	712,768
Net fixed assets		**1,698,970**	1,778,232
Less: fix assets impairment provision		**87,002**	87,002
Fixed assets-net book value		**1,611,968**	1,691,230
Construction in progress		**402,430**	77,261
Total fixed assets		**2,014,398**	1,768,491
Intangible and other assets			
Intangible assets		**78,456**	87,081
Long-term trade receivables	4	**328,166**	327,122
Factored long-term trade receivables		**1,394,970**	683,598
Total intangible and other assets		**1,801,592**	1,097,801
Deferred taxes			
Deferred taxes assets		**217,307**	76,419
TOTAL ASSETS		**26,596,898**	23,043,182

Notes on page 110 to page 164 form a part of these financial statements.

BALANCE SHEET

(Prepared under PRC GAAP)
(All amounts in RMB'000 unless otherwise stated)
(English translation for reference only)

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

Notes on page 110 to page 164 form an integral part of these financial statements.

Legal Representative:	Chief Financial Officer:	Head of Finance Division:
Hou Weigui	Wei Zaisheng	Shi Chunmao

INCOME STATEMENTS & STATEMENTS OF INCOME DISTRIBUTION

(Prepared under PRC GAAP)
(All amounts in RMB'000 unless otherwise stated)
(English translation for reference only)

	Note V	2006	2005
Revenue from principal operations	32	**21,215,583**	20,565,052
Less: Cost of sales	32	**18,846,594**	16,671,822
Taxes and surcharges		**44,080**	56,009
Profit from principal operations		**2,324,909**	3,837,221
Add: Profit from other operations		**684,036**	149,282
Less: Operating expenses		**2,291,774**	2,360,822
General and administrative expenses		**1,929,543**	1,451,749
Finance expenses		**285,112**	294,898
Operating loss		**(1,497,484)**	(120,966)
Add: Investment income	36	**2,106,953**	919,713
Subsidy income		**44,223**	8,259
Non-operating income		**10,011**	19,834
Less: Non-operating expenses		**13,095**	6,321
Total profit		**650,608**	820,519
Less: Income tax		**252**	27,953
Net profit		**650,356**	792,566
Add: Undistributed profits at beginning of year		**3,116,070**	2,682,269
Distributable profit		**3,766,426**	3,474,835
Less: Statutory surplus reserves		**—**	118,885
Profit available for distribution to owners		**3,766,426**	3,355,950
Less: Proposed final dividend		**143,928**	239,880
Undistributed profits at year-end		**3,622,498**	3,116,070

Notes on page 110 to page 164 form an integral part of these financial statements.

Legal Representative: Hou Weigui

Chief Financial Officer: Wei Zaisheng

Head of Finance Division: Shi Chunmao

CASH FLOW STATEMENT

(Prepared under PRC GAAP)
(All amounts in RMB'000 unless otherwise stated)
(English translation for reference only)

Items	2006	2005
1. Cash flows from operating activities		
Cash received from sale of goods or rendering of services	**20,378,716**	22,269,031
Cash received from taxes returned	**810,891**	8,259
Cash received relating to other operating activities	**91,495**	205,278
Sub-total of cash inflow	**21,281,102**	22,482,568
Cash paid for goods and services	**19,211,544**	18,549,739
Cash paid to and on behalf of employees	**1,503,266**	1,788,552
Payments of taxes and levies	**161,113**	724,097
Cash paid relating to other operating activities	**2,145,255**	1,756,749
Sub-total of cash outflow	**23,021,178**	22,819,137
Net cash flows from operating activities	**(1,740,076)**	(336,569)
2. Cash flows from investing activities		
Cash received from sale of investments	**9,430**	331
Cash received from gains of investment	**9,196**	2,621
Net cash received from disposal of fixed assets, intangible assets and other long-term assets	**3,942**	172,186
Sub-total of cash inflow	**22,568**	175,138
Cash paid to acquire fixed asset, intangible assets and other long-term assets	**778,177**	796,746
Cash paid for equity investment	**6,340**	43,552
Sub-total of cash outflow	**784,517**	840,298
Net cash flow from investing activities	**(761,949)**	(665,160)

Notes on page 110 to page 164 form an integral part of these financial statements.

CASH FLOW STATEMENT

(Prepared under PRC GAAP)
(All amounts in RMB'000 unless otherwise stated)
(English translation for reference only)

Items		2006	2005
3.	Cash flows from financing activities		
	Cash received from borrowings	**2,626,523**	—
	Sub-total of cash inflow	**2,626,523**	—
	Cash paid for debt repayments	**1,055,218**	790,344
	Cash payments for distribution of dividends and interest expenses	**363,718**	407,651
	Sub-total of cash outflow	**1,418,936**	1,197,995
	Net cash flow from financing activities	**1,207,587**	(1,197,995)
4.	Effect of foreign exchange rate changes on cash	**(6,578)**	(4,505)
5.	Net increase (decrease) in cash and cash equivalents	**(1,301,016)**	(2,204,229)

Notes on page 110 to page 164 form an integral part of these financial statements.

CASH FLOW STATEMENT

(Prepared under PRC GAAP)
(All amounts in RMB'000 unless otherwise stated)
(English translation for reference only)

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

Notes on page 110 to page 164 form an integral part of these financial statements.

Legal Representative: Hou Weigui

Chief Financial Officer: Wei Zaisheng

Head of Finance Division: Shi Chunmao

NOTES TO FINANCIAL STATEMENTS

(Prepared under PRC GAAP)
(All amounts in RMB'000 unless otherwise stated)
(English translation for reference only)

I. COMPANY BACKGROUND

ZTE Corporation (''The Company'') was a joint-stock limited company jointly founded by Shenzhen Zhongxingxin Telecommunications Equipment Company, Limited, China Precision Machinery Import & Export Shenzhen Company, Lishan Microelectronics Corporation, Shenzhen Zhaoke Investment Development Co., Limited, Hunan Nantian (Group) Company, Limited, Jilin Posts and Telecommunications Equipment Company and Hebei Telecommunications Equipment Company, Limited and incorporated in People's Republic of China through a public offering of shares to the general public. As approved under Document Zheng Jian Fa Zi (1997) No. 452 and Document Zheng Jian Fa Zi No. 453 issued by China Securities Regulatory Commission, on 6 October 1997, the Company issued ordinary shares to the general public within the network through the Shenzhen Stock Exchange and the shares were listed and traded on the Shenzhen Stock Exchange on 18 November 1997.

In 2003, Shenzhen Zhaoke Investment Development Co., Limited transferred its entire shareholdings in the company to Shenzhen Gaotejia Venture Investment Co., Limited. The time of the share transfer was already more than three years from the date of establishment of the company and was therefore in compliance with the applicable provision under the Company Law. In December 2003, Shenzhen Gaotejia Venture Investment Co., Limited transferred its entire shareholdings in the Company to Fortune Trust & Investment Co., Ltd. Fortune Trust & Investment Co., Ltd. transferred its entire shareholdings in the Company to Jade Dragon (Mauritius) Company Limited in November 2005.

On 11 November 1997, the Company was registered and established upon approval by Guangdong Shenzhen Industrial and Commercial Administrative Bureau with registration no. of 4403011015176 (revised), and was issued a Corporate Business License (license no.: Shen Si Zi N35868). The Company and its subsidiaries mainly engaged in the production of remote control switch systems, multi-media communications systems and communications transmission systems; provision of technical design, development, consultation and related services for the research and manufacture and production of mobile communications systems equipment, satellite communications, microwave communications equipment, beepers, computer hardware and software, closed-circuit TVs, microwave communications, automated signal control, computer information processing, process monitoring systems, fire alarm systems; provision of technical design, development, consultation and related services for wireline and wireless communications projects of railways, mass transit railways, urban rail transit, highways, plants and mines, ports and terminals and airports (excluding restricted projects); purchase and sale of electronic devices, micro-electronic components (excluding franchised, state-controlled and monopolized merchandises); sub-contracting of communications and related projects outside the PRC and global tendering projects within the PRC, as well as import and export of the equipment and materials required by the aforesaid projects outside the PRC and sending labours and workers for carrying out the aforesaid projects outside the PRC; technical development and sale of electronics systems equipment (excluding restricted items and franchised, state controlled and monopolized merchandises); operations of import and export businesses (implemented in accordance with the provision under the certificate of qualifications approved and issued by Shenzhen Bureau of Trade and Development); specialized sub-contracting of telecommunications projects.

On 9 December 2004, pursuant to a resolution adopted at the Company's second temporary shareholders' general meeting and the provision under the revised Articles of Association, and upon approval under Document Guo Zi Gai Ge [2004] No. 865 issued by State-owned Assets Supervision and Administration Commission of the State council and verification and approval under Document Zheng Jian Guo He Zi [2004] No. 38 issued by China Securities Regulatory Commission, the Company made an overseas public offering of 160,151,040 overseas listed foreign invested shares (H Shares), of which 158,766,450 new shares were issued by the Company and 1,384,590 shares were sold by the Company's state-owned corporate shareholders.

On 28 December 2005, the share reform plan of the Company was formally implemented and completed. On the first trading day subsequent to the implementation of the share reform plan, all original non-tradable shares held by non-tradable shareholders of the Company obtained the right of listing and circulation. As at 31 December 2006, the total accumulated share capital in issue of the Company was 959,522,000 shares. Please see Notes V.28 for details.

NOTES TO FINANCIAL STATEMENTS

(Prepared under PRC GAAP)
(All amounts in RMB'000 unless otherwise stated)
(English translation for reference only)

II. PRINCIPAL ACCOUNTING POLICIES, ACCOUNTING ESTIMATES AND CONSOLIDATION OF FINANCIAL STATEMENTS

The financial information set out in the financial statements was prepared in accordance with the following principal accounting policies and accounting estimates which were proposed in accordance with Accounting Standards for Business Enterprises and ''Accounting System for Business Enterprises'' and other related supplementary regulations as issued by China.

1. Accounting system

The Group has implemented Accounting Standards for Business Enterprises and ''Accounting System for Business Enterprises''.

2. Financial year

The financial year of the Group is from 1 January to 31 December of each calendar year.

3. Reporting currency

Reporting currency and the currency used in preparing the financial statements were Renminbi. The amounts in the financial statements were denominated in Renminbi, unless otherwise stated.

4. Recording basis and accounting

The Company adopted the accrual basis as the basis of accounting. All items were recorded at historical cost.

5. Foreign currency transaction

Foreign currency transactions are translated into the reporting currency at the exchange rates quoted by the People's Bank of China (or SAFE) prevailing at the beginning of the month.

At the end of the year, balance of foreign currency accounts is adjusted at the mid-point exchange rates quoted at the end of the year. Exchange differences arising from these translations are recorded in the current income statement as profit or loss from exchange differences. Foreign exchange gain or loss arising from special borrowings in foreign currency to finance the acquisition or construction of fixed assets are dealt with according to the principle of the capitalization of borrowing costs.

6. Foreign currency translation

All assets and liabilities were translated to Renminbi at the exchange rates prevailing at the balance sheet date; shareholders' equity, with the exception of ''undistributed profit'', was translated at the exchanged rates prevailing at the transaction date; ''undistributed profit'' was recorded based on the amount stated on the statement of income and profit appropriation after translation adjustments; differences arising from the difference between total translated assets and the sum of total translated liabilities and translated shareholders' equity were dealt with in the exchange fluctuation reserve as a separate allocation of 'exchange differences'. All statement of income and profit appropriation items were translated at the average exchange rates during the year. All cash flow statement items were translated at exchange rates prevailing at the balance sheet date. All opening balances and last year actual amounts were stated at last year's translated amounts.

NOTES TO FINANCIAL STATEMENTS

(Prepared under PRC GAAP)
(All amounts in RMB'000 unless otherwise stated)
(English translation for reference only)

II. PRINCIPAL ACCOUNTING POLICIES, ACCOUNTING ESTIMATES AND CONSOLIDATION OF FINANCIAL STATEMENTS (continued)

7. Cash equivalents

Cash equivalents represent short-term highly liquid investments that are readily convertible into known amounts of cash, subject to an insignificant risk of changes in value.

8. Short-term investments

Short-term investments refer to those investments that can be realized at any time and that are intended to be held for less than one year. They included stocks, bonds and investment funds. Short-term investments were initially accounted for at cost. Declared but unpaid cash dividends and interest on bonds, which had been accrued at the time of acquisition, are separately accounted for as receivables and are not included in the cost of short-term investments.

Cash dividends and interest on short-term investments earned during the holding period are netted off against the book value of the investment (as a return of the investment cost) when received, except for those recorded as receivables upon acquisition of the investments.

Upon disposal, the difference between the book value and the proceeds on disposal is recorded as a gain or loss for the current period. The cost of the investments disposed of is determined on an individual item basis.

Short-term investments are carried at the lower of cost and market value. Provisions for impairment in value of short-term investments are determined on an individual item basis, and the resulting gain or loss is recognised in the current period.

9. Bad debts provision

(1) Recognition criteria for bad debts:

— the irrecoverable amount of a bankrupt or deceased debtor who had insufficient assets or estate to repay the debt;

— the irrecoverable receivables, supported by evident characteristics, of a debtor who was unable to comply with the repayment obligation after the debt fell due.

(2) The Group has adopted the provision method to account for bad debt losses, whereby specific and general provisions are made to account for possible bad debt losses expected to be incurred. A specific provision refers to a bad debt provision based on management's assessment of the recoverability of individual receivables. A general provision refers to a bad debt provision made by the management, other than the specific provision, on the year-end balances of other receivables and accounts prepaid based on the ageing analysis.

NOTES TO FINANCIAL STATEMENTS

(Prepared under PRC GAAP)
(All amounts in RMB'000 unless otherwise stated)
(English translation for reference only)

II. PRINCIPAL ACCOUNTING POLICIES, ACCOUNTING ESTIMATES AND CONSOLIDATION OF FINANCIAL STATEMENTS (continued)

9. Bad debts provision (continued)

(3) Provision for expenses on other receivables is made as follows:

Ageing	Percentage of provision for bad debts (%)	Remark
1–2 months	—	Applicable to other receivables arising from domestic operations
Over 2 months	100%	Applicable to other receivables arising from domestic operations
1–3 months	—%	Applicable to other receivables arising from overseas operations
3–4 months	58%	Applicable to other receivables arising from overseas operations
4–5 months	75%	Applicable to other receivables arising from overseas operations
5–6 months	92%	Applicable to other receivables arising from overseas operations
Over 6 months	100%	Applicable to other receivables arising from overseas operations

10. Inventories

Inventories include raw materials, work-in-progress, finished goods, materials for construction-in-progress and materials sub-contracted for processing, etc. Inventories are finished goods or merchandise held by an enterprise for sale in the ordinary course of business, or work in progress in the process of production for such sale, or in the form of materials or supplies to be consumed in the production process or in the rendering of services.

Inventories are recorded at actual costs and recognised using the weighted moving average method when dispatched. Cost of finished products and work in progress comprise direct materials, direct labour and an appropriate proportion of manufacturing overheads.

Inventories are valued using the perpetual inventories system. Inventories at the end of the year were stated at the lower of cost or net realizable value. Provision for impairment of inventories was made on the basis of individual categories in respect of any shortfall where the net realizable value was lower than cost. Net realizable values represent estimated selling prices less any estimated costs to be incurred to completion, estimated selling expenses and relevant tax amounts.

Pursuant the Reply on Accounting for Expenses by Technology Research and Development Projects Designated by the State (Cai Kuai Bian [2002] No.36) issued by the Accounting Department of the Ministry of Finance, expenses incurred by the Company in the research and development of products designated by the State using government grants shall be deemed as pooling of costs and expenses of products manufactured by the Company and accounted for as technology development costs.

NOTES TO FINANCIAL STATEMENTS

(Prepared under PRC GAAP)
(All amounts in RMB'000 unless otherwise stated)
(English translation for reference only)

II. PRINCIPAL ACCOUNTING POLICIES, ACCOUNTING ESTIMATES AND CONSOLIDATION OF FINANCIAL STATEMENTS (continued)

11. Construction contract works

The amount of construction contract works represents costs incurred to date and recognised gross profit (loss) less progress billings. Contract costs incurred comprise direct materials, the costs of subcontracting, direct labor, construction machinery costs, other direct costs and an appropriate proportion of construction overheads. The amount of contract costs incurred to date plus recognised gross profit (loss) in excess of progress billings is recognised as an asset; whereas, the amount of progress billings in excess of contract costs incurred to date plus recognised gross profit (loss) is recognised as liabilities.

The proportion of construction contract work completion is the contract costs incurred to date as a percentage of estimated total contract costs.

Provision for anticipated contract losses is made in respect of contracts for which the amount of estimated total contract costs exceeded estimated total contract revenue to the extent of the difference between the amount of estimated total contract costs in excess of estimated total contract revenue and recognised losses.

Upon the realization of anticipated contract losses in contracts for which estimated losses had been provided for, the estimated contract losses provided for would be written back and the actual amount of loss would be recognised.

12. Long-term investments

Long-term equity investments are recorded at initial investment cost on acquisition.

The cost method is used in accounting for long-term equity investments where the Company has no control or jointly-control or significant influence over the investee company; the equity method is used in accounting for long-term equity investments where the Company has control or jointly-control or significant influence over the investee company.

When the equity method is adopted, the amount of initial cost of the investment in excess of the investor's share of the owner's equity in the investee company is regarded as an equity investment, the difference is amortized over a period of no more than 10 years (including the 10th year). The amount of initial cost of the investment falling short of the investor's share of the owner's equity in the investee company is credited to the capital reserve. In the event where the corresponding investment took place before 17 March 2003, it is included in the difference of long-term equity investments and amortized by equal installments over a period of no less than 10 years.

When the equity method is adopted, the Group should, after the acquisition of the equity investment, adjust the book value of the investment according to its attributable share of the investee enterprise's net profit or loss and recognise it accordingly, either as an investment income or a loss in the current period. The Group recognise net losses incurred by the investee enterprise to the extent that the book value of the investment was reduced to zero.

When the cost method is adopted, profit or cash dividends declared to be distributed by the investee enterprise should be recognised as an investment income in the current period after the investment was acquired by the Group. The excess should be treated as a recovery of investment cost.

NOTES TO FINANCIAL STATEMENTS

(Prepared under PRC GAAP)
(All amounts in RMB'000 unless otherwise stated)
(English translation for reference only)

II. PRINCIPAL ACCOUNTING POLICIES, ACCOUNTING ESTIMATES AND CONSOLIDATION OF FINANCIAL STATEMENTS (continued)

12. Long-term investments (continued)

At the end of the year, long-term investments were measured at the lower of the book value and the recoverable amount. Provision for impairment of long-term investments is made on the basis of individual categories in respect of any shortfall where the recoverable amount is lower than cost and set-off against the equity investment component in the capital reserve. Shortfall would be dealt with in the current profit and loss.

13. Fixed assets

Fixed assets represent tangible assets held for the purposes of production of products, provision of services, leasing or operational use. They are of relatively high value and have useful lives exceeding 1 year.

Fixed assets are recognised at cost. The cost of purchasing fixed assets comprise the purchase price, tax payments (such as value-added tax and import tariffs) and other expenses incurred in bringing fixed assets to the expected state for use that are directly attributable to the asset, such as transportation and installation fees. Subsequent expenses relating to fixed assets are charged to fixed assets to the extent of the excess of possible inflow of economic benefits into the enterprise resulting from such expenses over original estimates.

Depreciation is provided on fixed assets using the straight-line method, the estimated useful lives, estimated residual value and annual depreciation rate of each category of fixed assets are as follows:

	Estimated useful life	Estimated residual value	Annual depreciation rate
Leasehold improvement	5 years	0%	20%
Buildings (excluding temporary plants)	30 years	5%	3.17%
Buildings — temporary plants	3 years	5%	31.67%
Machinery equipment	5–10 years	5%	9.5%–19%
Electronic equipment	5 years	5%	19%
Motor vehicles	10 years	5%	9.5%
Other equipment	5 years	5%	19%

At the end of the period, fixed assets are measured at the lower of the book value and the recoverable amount. The difference between the recoverable amount and the book value of the fixed asset is recognised as an impairment provision and charged to the current period's profit and loss. Recoverable amount referred to the higher of the net selling price and the value in use of the fixed asset. Value in use referred to the present value of estimated future cash flows expected to arise from the continuing use of the fixed asset and from its disposal at the end of its useful life. Impairment provisions for fixed assets were made on an individual basis.

14. Construction in progress

Construction in progress represents the necessary costs incurred in the purchase and construction of fixed assets in bringing construction from its preparation stage to its working condition. Costs comprise direct materials, direct labor, equipment cost, installation and management fee, net profit or loss from trial run and borrowing costs for capitalization.

NOTES TO FINANCIAL STATEMENTS

(Prepared under PRC GAAP)
(All amounts in RMB'000 unless otherwise stated)
(English translation for reference only)

II. PRINCIPAL ACCOUNTING POLICIES, ACCOUNTING ESTIMATES AND CONSOLIDATION OF FINANCIAL STATEMENTS (continued)

14. Construction in progress (continued)

Until such time as the assets are completed and put into operational use, construction-in-progress is recognised as a fixed asset.

Provision for construction-in-progress impairment should be made and be recognised in the income statement in the event that construction has stopped already for a long time and is estimated not to be restarted in the next 3 years or; economic return on the construction was ultimately uncertain with inferior construction quality and backward technology.

15. Intangible assets

Intangible assets are recorded at the actual cost on acquisition.

Intangible assets are amortized by equal installments over its estimated useful lives, the beneficial period stipulated by the related contract or the effective period stipulated by applicable laws (whichever the shorter). The amortization periods of intangible assets are as follows:

Category	Amortization period
Patent technology	10 years
Operating concession	20 years
Land use rights	50 years
Software	5 years

At the end of the year, intangible assets are measured at the lower of the book value and the recoverable amount. Any excess of the book value of the asset over the expected recoverable amount is recognised as an impairment provision and is charged to the income statement in the current year.

16. Recognition of revenue

Telecommunications systems contracts

Operating income from telecommunications systems contracts is recognised by reference to the estimated completion based on the proportion of costs incurred to date to the estimated total cost of the relevant contract and costs would be accounted for where the total revenue and total costs could be measured reliably and where transaction-related amounts are allowed to pass into the Company, and costs would be accounted for accordingly.

Sales of goods:

Revenue from sales of goods is recognised when the significant risks in connection with the ownership of the product and the payment has been transferred to the buyer, and the Group no longer has custody and control over the product if the economic benefits flowed to the Group.

NOTES TO FINANCIAL STATEMENTS

(Prepared under PRC GAAP)
(All amounts in RMB'000 unless otherwise stated)
(English translation for reference only)

II. PRINCIPAL ACCOUNTING POLICIES, ACCOUNTING ESTIMATES AND CONSOLIDATION OF FINANCIAL STATEMENTS (continued)

16. Recognition of revenue (continued)

Supply of labor service:

The revenue from labor service is recognised when the supply of labor service has been completed within one accounting year since its commencement; if the commencement and completion of supply of labor service did not take place in the same accounting year, when transaction result of the supply of labor service could be measured reliably, related revenue from labor service is recognised according to the percentage of completion on the balance sheet date, otherwise revenue is recognised only to the extent of cost incurred that are expected to be recoverable.

The revenue from contracts involving multiple deliverables including sales of goods, construction of telecommunication systems, supply of labor services, etc. is recognised at the respective fair value based on the sales recognition methods mentioned above accordingly.

17. Provision

The Group recognise as liability an obligation that fulfils the following criteria and is related to contingent matters: the obligation in question is a present obligation of the Group that could be reliably measured and would probably result in an outflow of economic resources.

18. Income tax

The Group adopt the tax-effect accounting method and the liability method in case of changes in the income tax rates.

19. Subsidy income

The Group's subsidy income was mainly derived from refunds of VAT and contributions to development fund, as well as financial subsidy for new products, and was recorded as subsidy income upon the actual receipt.

20. Related parties

A party is deemed to be a related party of the Group if it directly or indirectly controls or is controlled by, is in common control of or under common control with, or if it exercises significant influence on or under the significant influence of the Group in financial and operational decisions. A party is also deemed to be a related party of the Group if they are subject to the control of the same party together with the other party or parties.

NOTES TO FINANCIAL STATEMENTS

(Prepared under PRC GAAP)
(All amounts in RMB'000 unless otherwise stated)
(English translation for reference only)

II. PRINCIPAL ACCOUNTING POLICIES, ACCOUNTING ESTIMATES AND CONSOLIDATION OF FINANCIAL STATEMENTS (continued)

21. Share incentive scheme

In accordance with the first phase of the share incentive scheme, the Company has granted to its directors, management and key employees 47,980,000 ordinary shares, among which 4,798,000 shares has been reserved for both the personnel who have made significant contributions and the talents the Company need to employ. The equity settled share expense is measured by reference to the fair value of the stock on the granting day, approximately RMB36.81, which was determined by Towers Perrin Shenzhen Branch, an external valuer. The cost of equity-settled transactions is recognised, together with a corresponding increase in equity, over the period in which the performance and/or service conditions are fulfilled, ending on the date on which the relevant employees become fully entitled to the award.

22. Preparation of consolidated financial statements

Consolidated financial statements are prepared in accordance with relevant provisions of the Provisional Regulations Governing Consolidated Financial statements (Cai Kuai Zi [1995] No. 11) issued by the Ministry of finance and the Enterprise Accounting System.

Consolidated statements comprise the financial statements of a listed company with limited liability together with its subsidiaries. A subsidiary is a company in which the listed company with limited liability owned 50% or above of the voting capital.

Results of the Group's associates are not consolidated on a pro-rata basis when the Company prepared its consolidated financial statements, but were recognised using the equity accounting method, as the associates did not have any significant impact on the Group's financial position and operating results.

Results of subsidiaries were included in the consolidated statements upon the acquisition of effective control by the Company up to the date on which such control was transferred out of the Group.

On combination, reporting years and accounting policies consistent with those adopted by the parent would be adopted in respect of the financial statements of subsidiaries. All intra-group transactions and balances (including any unrealized profit) are eliminated in full on combination.

Please refer to Note IV to these financial statements for details of subsidiaries consolidated on 31 December 2006.

NOTES TO FINANCIAL STATEMENTS

(Prepared under PRC GAAP)
(All amounts in RMB'000 unless otherwise stated)
(English translation for reference only)

III TAXATION

The principal tax items and tax rates applicable to the Group are as follows:

Value-added tax	Payable on income generated from domestic sales of products and equipment repair services at a tax rate of 17% after deducting the current balance of tax credit available for offsetting
Business tax	In accordance with relevant PRC tax regulations, business tax is payable by the Group at tax rates of 3% and 5%, respectively, on its sales income and service income which are subject to business tax.
City maintenance and construction tax	In accordance with relevant PRC tax regulations and local regulations, city maintenance and construction tax is payable according to rates stipulated by the State based on individual situations of the branches and subsidiaries of the Group
Education surcharge	In accordance with relevant PRC tax regulations and local regulations, education surcharge is payable according to rates stipulated by the State based on individual situations of the branches and subsidiaries of the Group.
Individual income tax	In accordance with relevant PRC tax regulations, the Group withhold income tax from its salary payments to employees based on progressive tax rates
Enterprise income tax	In accordance with the PRC Provisional Regulations on Enterprise Income Tax, enterprise income tax is payable by the Group on its taxable income.
Overseas tax	Overseas taxes are payable in accordance with tax laws of various countries and regions.

The Company was registered in Shenzhen Special Economic Zone (SEZ), hence its enterprise income tax rate is 15%.

Taxation policy of some of the Company's subsidiaries was as follows:

Pursuant to the Approval Notice for Deduction and Exemption of Tax (Document Shen Guo Shui Yan Jian Mian (2005) No. 004) issued by the Shenzhen State Tax Bureau, it was agreed that ZTE Microelectronics Technology Co. Ltd., as an enterprise, was entitled to enterprise income tax exemption in the first and second profitable years and was entitled to a 50% reduction in enterprise income tax from the third to the fifth year. The current year was its third profitable year and the company was subject to a reduced enterprise income tax of 7.5%.

Wuxi Zhongxing Optoelectronics Technologies Company, Limited was registered at Wuxi State's High-tech Industrial Development Zone and was subject to an enterprise income tax rate of 15% in 2006.

Pursuant to the Approval Notice for Deduction and Exemption of Tax (Document Shen Guo Shui Nan Jian Mian (2005) No. 0098) issued by the Nanshan State Tax Bureau in Shenzhen, Shenzhen Zhongxing Telecom Equipment Technology & Service Company, Limited, as a SEZ enterprise engaged in the servicing industry, was entitled to enterprise income tax exemption in the first profitable year and a 50% reduction of enterprise income tax in the second and third years. As the company had yet to record a profitable year, it was exempted from enterprise income tax.

NOTES TO FINANCIAL STATEMENTS

(Prepared under PRC GAAP)
(All amounts in RMB'000 unless otherwise stated)
(English translation for reference only)

III TAXATION (continued)

Pursuant to the Document Shen Di Shui San Han (2003) No. 199 issued by the Local Tax Bureau of Shenzhen, ZTE Mobile Tech Co., Ltd., as a manufacturing enterprise, was entitled to enterprise income tax exemption in the first and second profitable years and a 50% reduction of enterprise income tax from the third to the fifth year. As the current year was the fourth profitable year for the company, it was subject to a reduced enterprise income tax rate of 7.5%.

Pursuant to the Approval Notice for Deduction and Exemption of Tax (Document Shen Guo Shui Nan Jian Mian (2004) No. 0372) issued by the Nanshan State Tax Bureau in Shenzhen, ZTE Integration Telecom Ltd, as a manufacturing enterprise, was entitled to enterprise income tax exemption in the first and second profitable years and a 50% reduction of enterprise income tax from the third to the fifth year. As it was the second profitable year for the company, it was exempted from enterprise income tax.

Pursuant to the Income Tax Concession Approval Notice (Document Pu Shui Suo (2005) No. 672) issued by the Shanghai Pudong New Area State Tax Bureau and the Shanghai Pudong New Area Local Tax Bureau, Shanghai Zhongxing Telecom Equipment Technology & Service Company, Limited, as a hi-tech enterprise, was exempted from domestic enterprise income tax for a two-year period commencing 1 January 2005.

Pursuant to the Approval Notice for Deduction and Exemption of Tax (Document Shen Guo Shui Nan Zi (2004) No. 0034) issued by the Nanshan State Tax Bureau in Shenzhen, it was agreed that Shenzhen Zhongxing Software Company, Limited, as a software enterprise, was entitled to enterprise income tax exemption in the first and second profitable years and a 50% reduction in enterprise income tax from the third to the fifth year. The current year was the fourth profitable year and hence, the company was subject to a reduced enterprise income tax rate of 7.5%.

Pursuant to the Approval Notice for Deduction and Exemption of Tax (Document Shen Guo Shui Nan Zi (2004) No. 0002) issued by the Nanshan State Tax Bureau in Shenzhen, it was agreed that Shenzhen Lead Communication Equipment Company, Limited, as a manufacturing enterprise, was entitled to enterprise income tax exemption in the first and second profitable years and a 50% reduction in enterprise income tax from the third to the fifth year. The current year was the fourth profitable year. Hence, the company was subject to a reduced enterprise income tax rate of 7.5%.

Pursuant to the Approval Notice for Deduction and Exemption of Tax (Document Shen Guo Shui Nan Zi (2004) No. 0381) issued by the Nanshan State Tax Bureau in Shenzhen, it was agreed that Shenzhen Ruide Electronic Industrial Company, Limited, as a manufacturing enterprise, was entitled to enterprise income tax exemption in the first and second profitable years and a 50% reduction in enterprise income tax from the third to the fifth year. The current year was the third profitable year and the company was subject to a reduced enterprise income tax rate of 7.5%.

Pursuant to the Approval Notice for Deduction and Exemption of Tax (Document Shen Guo Shui Nan Zi (2004) No. 0036) issued by the Nanshan State Tax Bureau in Shenzhen, it was agreed that Shenzhen Kangquan Electromechanical Company, Limited, as a manufacturing enterprise, was entitled to enterprise income tax exemption in the first and second profitable years and a 50% reduction in enterprise income tax from the third to the fifth year. The current year was the third profitable year and the company was subject to a reduced enterprise income tax rate of 7.5%.

Pursuant to the Document Shen Guo Shui Nan Jian Mian (2005) No. 0217 issued by the Nanshan State Tax Bureau in Shenzhen, Shenzhen Zhongxing Liwei Technology Company, Limited was entitled to enterprise income tax exemption in the first and second profitable years and a 50% reduction of enterprise income tax from the third to the fifth year. As the current year was the second profitable year for the company, it was exempted from enterprise income tax.

NOTES TO FINANCIAL STATEMENTS

(Prepared under PRC GAAP)
(All amounts in RMB'000 unless otherwise stated)
(English translation for reference only)

III TAXATION (continued)

Pursuant to the Document Shen Guo Shui Nan Jian Mian (2006) No. 0002 issued by the Nanshan State Tax Bureau in Shenzhen, Shenzhen Zhongxing Special Equipment Company, Limited was entitled to enterprise income tax exemption in the first and second profitable years and a 50% reduction of enterprise income tax from the third to the fifth year. As the current year was the second profitable year for the company, it was exempted from enterprise income tax.

Yangzhou Zhongxing Mobile Telecom Equipment Co., Limited, Anhui Wantong Post and Telecommunications Company, Limited., Guangdong New Pivot Technology & Service Company, Limited were subject to an enterprise income tax rate of 33%.

Shenzhen Guoxin Electronics Development Company Limited, Shenzhen Changfei Investment Company, Limited and Shenzhen Xingfei Technology Co., Ltd. were subject to an enterprise income tax rate of 15%.

IV CONTROLLING SUBSIDIARIES, JOINTLY-CONTROLLED ENTITIES AND ASSOCIATES

Except for the notes (1) and (2) below, the scope of consolidated financial statements was the same as the previous year.

(1) Subsidiaries acquired during the year

Name of investee company	Registered Capital '000	Scope of business	Investment by the Company '000	Percentage of equity interests
南京中興軟創軟件有限公司	RMB5,000	Development, manufacture and sales of all kinds of communications equipment system drivers, software for the service sector, and provision of technical consultation	RMB5,000	100%
西安中興軟件有限責任公司	RMB30,000	Development, manufacture and sales of all kinds of communications equipment system drivers, software for the service sector, and provision of technical consultation	RMB30,000	100%
上海中興軟件有限責任公司	RMB50,000	Development, manufacture and sales of all kinds of communications equipment system drivers, software for the service sector, and provision of technical consultation	RMB50,000	100%
南京中興軟件有限責任公司	RMB50,000	Development, manufacture and sales of all kinds of communications equipment system drivers, software for the service sector, and provision of technical consultation	RMB50,000	100%
成都中興軟件有限責任公司	RMB50,000	Development, manufacture and sales of all kinds of communications equipment system drivers, software for the service sector, and provision of technical consultation	RMB50,000	100%
深圳市中軟海納技術有限公司	RMB8,000	Development, manufacture and sales of all kinds of communications equipment system drivers, software for the service sector, and provision of technical consultation	RMB8,000	100%
ZTE India R&D Center Private Limited.	INR100	Researching operation of VAT production	INR100	100%
ZTE Korea Limited	KRW50,000	Sales of telecommunication products, provision of after-sales services and technical support	USD53.5	100%
ZTE Singapore PTE. Ltd.	SGD50	Sales of telecommunication products, provision of after-sales services and technical support	USD32.5	100%
ZTE CZECH,s.r.o	ILS200	Sales of telecommunication products, provision of after-sales services and technical support	USD10	100%

NOTES TO FINANCIAL STATEMENTS

(Prepared under PRC GAAP)
(All amounts in RMB'000 unless otherwise stated)
(English translation for reference only)

IV CONTROLLING SUBSIDIARIES, JOINTLY-CONTROLLED ENTITIES AND ASSOCIATES (continued)

(1) Subsidiaries acquired during the year (continued)

Name of investee company	Registered Capital '000	Scope of business	Investment by the Company '000	Percentage of equity interests
ZHONGXING CORPORATION S.A. DE C.V.	USD11.42857	Sales of telecommunication products, provision of after-sales services and technical support	USD11.42857	100%
ZTE Energy (Cayman) Co., Limited	USD10,000	Development, manufacture, sales of products and investment in the area of energy sources.	USD4,200	100%
ZTE investment Limited Liabilities Company	USD335	Sales of telecommunication products, provision of after-sales services and technical support	USD100	51%
ZTE Norway AS	NOK100	Sales of telecommunication products, provision of after-sales services and technical support	NOK100	100%
ZTE Mauritius Ltd	USD10	Sales of telecommunication products, provision of after-sales services and technical support.	USD10	100%
中興能源技術(武漢)有限公司	HKD14,700	Research, development and sales of new technologies and products regarding reproductive resources; and provision of corresponding technical services.	HKD5,000	100%
深圳市中興力維軟件有限公司	RMB1,000	Development, sales of software products and provision of after-sales services and technical support	RMB900	90%
中興能源(湖北)有限公司	USD5,000	Research, development and sales of new technologies and products regarding reproductive resources; and provision of corresponding technical services.	USD3,500	70%

(2) Disposal of subsidiaries during the year

Name of investee company	Registered Capital '000	Scope of business	Investment by the Company	Percentage of equity interests
Shenzhen Zhongxing Mobile Telecom Equipment Co., Limited. (Note 1)	RMB10,000	Development, manufacture, sales of the CDMA telecommunication products.	RMB10,000	100%
Shanghai Xingfei Science and Technology Company, Limited. (Note 2)	RMB1,000	Manufacture, sales of electronic products and provision of after-sales services, and management consulting.	RMB800	80%
WANAAG COMMUNICATIONS Limited. (Note 3)	USD200	Provision of overseas call diversion services in Africa	USD100	100%

Note (1): In June 2006, the Board of Directors of the Company approved the deregistration of Shenzhen Zhongxing Mobile Telecom Equipment Co., Limited.("Mobile Telecom"). The deregistration of Mobile Telecom was completed in July, 2006.

Note (2): In March 2006, the Board of Directors of Shenzhen Changfie Investment Company, Limited. approved the deregistration of Shanghai Xingfei Science and Technology Company, Limited. ("Shanghai Xingfei"). The deregistration of Shanghai Xingfei was completed in August 2006.

Note (3): In August 2006, Newinfo Holding Limited, Abdulratrman Ali HAILE and Unigrow International Limited approved the additional investment in WANAAG COMMUNICATIONS ("WANAAG"). The Company's shareholding in WANAAG was reduced to 45% in August 2006 following the completion of the capital increase.

NOTES TO FINANCIAL STATEMENTS

(Prepared under PRC GAAP)
(All amounts in RMB'000 unless otherwise stated)
(English translation for reference only)

IV CONTROLLING SUBSIDIARIES, JOINTLY-CONTROLLED ENTITIES AND ASSOCIATES (continued)

(2) Disposal of Subsidiaries during the year (continued)

Operating results of subsidiaries disposed of during the year were included in the Group's consolidated statements from 1 January 2006 to the date of disposal/deregistration, as shown in the following:

	Mobile Telecom 1 January to 27 July 2006	**Shanghai Xingfei 1 January to 3 August 2006**	**WANAAG 1 January to 15 August 2006**
Revenue from principal operations	—	—	35
Profit from principal operations	—	—	(70)
Total profit	18	(6)	(260)
Income tax	(2)	—	—
Net profit	16	(6)	(260)

Assets and liabilities of subsidiaries disposed of during the year as at the date of disposal/deregistration were as follows:

	Mobile Telecom 27 July 2006	**Shanghai Xingfei 3 August 2006**	**WANAAG 15 August 2006**
Current assets	10,330	2	440
Total assets	10,330	2	440
Current Liabilities	(3)	—	(75)
Total liabilities	(3)	—	(75)

NOTES TO FINANCIAL STATEMENTS

(Prepared under PRC GAAP)
(All amounts in RMB'000 unless otherwise stated)
(English translation for reference only)

IV CONTROLLING SUBSIDIARIES, JOINTLY-CONTROLLED ENTITIES AND ASSOCIATES (continued)

(3) Subsidiaries included in the scope of consolidation

Full name of subsidiaries	Place of registration	Registered capital '000	Shareholding percentage of the Company Direct	Indirect	Effective	Investment of the Group '000	Principal operation
ZTE Kangxun Telecom Co., Ltd.	Shenzhen	RMB50,000	90%	—	90%	RMB45,000	Manufacture of electronics products and related parts (excluding restricted items)
ZTE Microelectronics Technology Co. Ltd.	Shenzhen	RMB15,000	—	90%	90%	RMB13,500	Design, manufacture and sales of integrated circuit products
Zhongxing Telecom Pakistan (Private) Limited	Islamabad, Pakistan	PKR37,919	93%	—	93%	USD654.7	Assembling and manufacture of digital remote control switch
Yangzhou Zhongxing Mobile Telecom Company, Limited	Yangzhou	RMB6,000	65%	—	65%	RMB3,900	R&D, manufacture and sales of electronics, computer and communications products
Shenzhen Zhongxing Mobile Technology Co., Ltd.	Shenzhen	RMB33,333	95%	—	95%	RMB31,666	Development and sales of telecommunications products; manufacture of handset batteries, chargers and ear phones.
Congo-Chine Telecom S.A.R.L	The Democratic Republic of Congo	USD17,450	51%	—	51%	USD8,900	Construction of telephone network in Congo, provision of telecom services and manufacture of communications equipment
Congo-Chine Telecom International Network (CCTNET)	The Democratic Republic of Congo	USD100	—-	100%	100%	USD100	Manufacture of telecommunication products and provision of telecom services.
南京中興軟創科技有限責任公司	Nanjing	USD7,231	76%	—	76%	RMB45,040	Development, manufacture and sales of software products, telecommunication equipment and provision of related services
Guangzhou Nanfang Telecommunications System Software Co. Ltd.	Guangzhou	RMB12,430	—	84%	84%	RMB11,500	Development, manufacture and sales of software products, telecommunication equipment and provision of related services.
Shenzhen Zhongxing Software Company Limited	Shenzhen	RMB50,000	73%	25%	98%	RMB49,000	Development, manufacture and sales of all kinds of communications equipment system drivers, software for the service sector, and provision of technical consultation
Shenzhen Guoxin Electronics Development Company, Limited	Shenzhen	RMB13,000	90%	10%	100%	RMB33,000	Purchase and sales of electronics components; domestic business, supply and sale of materials; promotion of a variety of industries
Wuxi Zhongxing Optoelectronics Technologies Company, Limited	Wuxi	RMB10,000	65%	—	65%	RMB6,500	Development of optoelectronics technologies and manufacture and sales of related products and provision of technical services.

NOTES TO FINANCIAL STATEMENTS

(Prepared under PRC GAAP)
(All amounts in RMB'000 unless otherwise stated)
(English translation for reference only)

IV CONTROLLING SUBSIDIARIES, JOINTLY-CONTROLLED ENTITIES AND ASSOCIATES (continued)

(3) Subsidiaries included in the scope of consolidation (continued)

Full name of subsidiaries	Place of registration	Registered capital '000	Shareholding percentage of the Company Direct	Indirect	Effective	Investment of the Group '000	Principal operation
Shenzhen Force Science and Technology Company, Limited	Shenzhen	RMB3,000	—	80%	80%	RMB2,400	Development of optoelectronics technologies and manufacture and sales of related products and provision of technical services
Anhui Wantong Posts and Telecommunications Company, Limited	Hefei	RMB22,214.4	51%	—	51%	RMB11,329.3	Manufacture of communications wireline equipment and accessories, PDF and switch equipment, manufacture and installation of towers, and design and installation of communications projects
Anhui Wantong Information System Integration Company, Limited	Hefei	RMB3,000	—	95%	95%	RMB2,850	Design, manufacture and sales of communications projects
Anhui Wantong Tower Integration Company, Limited	Hefei	RMB2,000	—	90%	90%	RMB1,800	Installation of towers
Anhui Yalong communications Technology Company, Ltd.	Hefei	RMB6,000	—	90%	90%	RMB5,400	Manufacturing, installation, maintenance of telecommunication equipment and design and construction and telecommunication projects
ZTE (H.K.) Limited	Hong Kong	HKD50,000	100%	—	100%	HKD50,000	Procurement and sales of communications products and provision of technical services
ZTE Portugal Projectos de Telecommunicacoes, Unipessoal, Lda	Portugal	EUR50	—	100%	100%	EUR50	Sales of communications products and provision of after-sale services
ZTE (USA) Inc.	Edison, United States of America	USD20	100%	—	100%	USD650	Sales of communications products
Shenzhen Special Equipment Company, Limited	Shenzhen	RMB1,000	54%	—	54%	RMB540	Technical development, services, consultation and purchase and sales of communications products
Telrise (Cayman) Telecom Ltd.	Cayman Islands	USD50	52.85%	47.15%	100%	USD4,350	R&D of softswitch technologies
Telrise INC.	Cayman Islands	USD1,609	—	100%	100%	USD1,609	R&D of softswitch technologies
Telrise Nanjing Telecom Limited	Nanjing	USD100	—	100%	100%	USD100	R&D of softswitch technologies
ZTE (UK) Ltd.	London, United Kingdom	GBP604	51%	—	51%	USD372.3	Sales of communications products and provision of after-sale services and technical support

NOTES TO FINANCIAL STATEMENTS

(Prepared under PRC GAAP)
(All amounts in RMB'000 unless otherwise stated)
(English translation for reference only)

IV CONTROLLING SUBSIDIARIES, JOINTLY-CONTROLLED ENTITIES AND ASSOCIATES (continued)

(3) Subsidiaries included in the scope of consolidation (continued)

Full name of subsidiaries	Place of registration	Registered capital '000	Shareholding percentage of the Company Direct	Indirect	Effective	Investment of the Group '000	Principal operation
ZTE Do Brasil LTDA	Brazil	USD200	100%	—	100%	USD900	Sales of communications products and provision of after-sale services and technical support
ZTE Holdings (Thailand) Co., Ltd	Thailand	THB100	49%	—	49%	THB49	Investment holding
ZTE (Thailand) Co., Ltd	Thailand	THB50,000	49%	51%	100%	THB20,000	Sales of communications products and provision of after-sale services and technical support
ZTE Corporation Mexico S. DE R. L DE C. V.	Mexico	USD5	100%	—	100%	USD28.115	Sales of communications products and provision of after-sale services and technical support
ZTE Integration Telecom Ltd.	Shenzhen	RMB55,000	75%	5%	80%	RMB44,000	Research and manufacture, production and sales of digital integrated system products and provision of related consultation services
ZTEIT USA Inc.	United States of America	USD950	—	100%	100%	USD475	Design and development of all kinds of communications products
ZTE – Communication Technologies, Ltd.	Russia	USD760	100%	—	100%	USD760	Sales of telecommunications products and provision of after-sale services and technical support
ZTE Wistron Telecom AB	Sweden	SEK1,000	100%	—	100%	USD3,137.4	Operation of telecommunications related businesses as R&D base and technical support platform of the sector
Shenzhen Changfei Investment Company, Limited	Shenzhen	RMB30,000	51%	—	51%	RMB15,300	Investment and promotion of industries, and sales of electronics and communications parts and components
Shenzhen Lead Communications Company, Limited	Shenzhen	RMB10,000	—	62.5%	62.5%	RMB6,250	Sales of electronics products, communications products, apparatus and instruments and related accessories
Shenzhen Ruide Electronic Industrial Company Limited	Shenzhen	RMB8,700	—	57.47%	57.47%	RMB5,500	Manufacture and sales of handset accessories; sales of electronics products; operation of I/E businesses
Shenzhen Kangquan Electromechanical	Shenzhen	RMB16,000	—	57.5%	57.5%	RMB9,200	Manufacture and sales of handset case and accessories; purchase and sales of electronics products; self operation of I/E businesses
深圳市興飛科技有限公司	Shenzhen	RMB5,000	—	80%	80%	RMB4,000	Four technical services of electronic products, manufacturing, sales and after-sales services of electronic products and corporate management consultancy

NOTES TO FINANCIAL STATEMENTS

(Prepared under PRC GAAP)
(All amounts in RMB'000 unless otherwise stated)
(English translation for reference only)

IV CONTROLLING SUBSIDIARIES, JOINTLY-CONTROLLED ENTITIES AND ASSOCIATES (continued)

(3) Subsidiaries included in the scope of consolidation (continued)

Full name of subsidiaries	Place of registration	Registered capital '000	Shareholding percentage of the Company Direct	Indirect	Effective	Investment of the Group '000	Principal operation
Shenzhen Zhongxing Telecom Equipment Technology & Service Company, Limited	Shenzhen	RMB50,000	90%	10%	100%	RMB50,000	Technical development of computer networks, software, electronics equipment and communications products; domestic supply and sales of materials and resources; information consultancy
Shanghai Zhongxing Telecom Equipment Technology & Service Company, Limited	Shanghai	RMB10,000	51%	—	51%	RMB5,100	R&D of communications technologies, design, research, development, manufacture and sales of software and hardware for communications products and provision of related technical services
Guangdong New Pivot Technology & Service Company Limited	Guangzhou	RMB5,000	90%	—	90%	RMB4,500	Development, design and integration of computer software, hardware and data equipment; sales and technical assignment of related products and provision of related services
Closed Joint Stock Company TK Mobile	Tadzjikistan	USD4,000	51%	—	51%	RMB16,870.8	Manufacture of CDMA800 mobile voice and related value-added services, maintenance of CDMA telecom networks and provision of consultation services
ZTE Telecom Company India Private Ltd.	India	USD22.2	99.99%	0.01%	100%	RMB1,654	Assembling and integration of telecom systems equipment and terminal equipment in India; investment in and establishment of local manufacturing joint-venture
ZTE Romania S.R.L	Romania	USD100	100%	—	100%	RMB827	Sales and marketing of the Company's products in Romania and provision of corresponding engineering, after-sale services, technical support, consultation and trainings
ZTE (Malaysia) Corporation SDN. BHD	Malaysia	USD60	100%	—	100%	RMB496.2	Sales and marketing of the Company's products in Malaysia and provision of corresponding engineering, after-sale services, technical support, consultation and trainings
ZiMax (Cayman) Holding Ltd.	Cayman Islands	USD5,500	100%	—	100%	RMB45,485	R&D investment in all kinds of communications products

NOTES TO FINANCIAL STATEMENTS

(Prepared under PRC GAAP)
(All amounts in RMB'000 unless otherwise stated)
(English translation for reference only)

IV CONTROLLING SUBSIDIARIES, JOINTLY-CONTROLLED ENTITIES AND ASSOCIATES (continued)

(3) Subsidiaries included in the scope of consolidation (continued)

Full name of subsidiaries	Place of registration	Registered capital '000	Shareholding percentage of the Company Direct	Indirect	Effective	Investment of the Group '000	Principal operation
Shenzhen Hongde Battery Company, Limited	Shenzhen	RMB15,000	—	83%	83%	RMB12,500	Manufacture and sales of batteries, sale of battery raw materials and electronics products (excluding franchised, state-controlled and monopolized merchandises and restricted items); operate import and export businesses
ZTE (Saudi Arabia) Ltd.	Saudi Arabia	USD534.76	—	100%	100%	USD534.76	Sales of communications products, provision of after-sale services and technical support
ZTE Nigeria Investment Limited	Nigeria	USD39	—	100%	100%	USD540	Import and export of raw materials, manufacture, testing, sales, installation, development, user training and after-sale services of telecommunications products
ZTE Sweden AB	Sweden	USD360	—	100%	100%	USD360	Sales of communications products, provision of after-sale services and technical support
PT. ZTE Indonesia	Indonesia	USD200	99.5%	0.5%	100%	USD200	Sales of communications products, provision of after-sale services and technical support
ZTE Istanbul Trading Ltd. Co.	Turkey	USD50	—	100%	100%	USD49.5	Sales of communications products, provision of after-sale services and technical support
ZTE Hrvatska D.O.O.	Croatia	EUR3	—	100%	100%	EUR3	Sales of communications products, provision of after-sale services and technical support
ZTE Corporation Bulgaria Ltd.	Bulgaria	USD3.5	—	100%	100%	USD3.5	Sales of communications products, provision of after-sale services and technical support
ZTE Deutschland GmbH	Germany	EUR150	—	100%	100%	EUR150	Sales of communications products, provision of after-sale services and technical support
ZTE Poland Sp.zo.o.	Poland	USD50	—	100%	100%	USD50	Sales of communications products, provision of after-sale services and technical support
深圳中興力維技術有限公司	Shenzhen	RMB20,000	30%	50%	80%	RMB16,000	Design and development of operating environment and status monitoring and management systems for network base station and electronic equipment and electronic system equipment, sales of proprietary products and provision of technical services

NOTES TO FINANCIAL STATEMENTS

(Prepared under PRC GAAP)
(All amounts in RMB'000 unless otherwise stated)
(English translation for reference only)

IV CONTROLLING SUBSIDIARIES, JOINTLY-CONTROLLED ENTITIES AND ASSOCIATES (continued)

(3) Subsidiaries included in the scope of consolidation (continued)

Full name of subsidiaries	Place of registration	Registered capital '000	Shareholding percentage of the Company Direct	Indirect	Effective	Investment of the Group '000	Principal operation
西安中興精誠通訊有限公司	Xi'an	RMB15,000	70%	—	70%	RMB11,390	Installation, testing and technical services; development and sales of computer application software and systems integration, technical protection works and the development, production and sales of security products
ZiMax Technologies, Inc	United States	USD20,000	—	100%	100%	USD5,379.7	R&D of wireless communication technology
Netwinfo Holdings Limited	Hong Kong	USD50	—	100%	100%	USD4.299	Acquisition, shareholding and investment of telecom carriers
ZTE Canada Inc.	Canada	USD200	—	100%	100%	USD38	Sales of communications products, provision of after-sale services and technical support
ZTE Netherlands B.V.	Holland	EUR90	—	100%	100%	EUR18	Sales of communications products, provision of after-sale services and technical support
ZTE Ghana Limited	Ghana	USD300	—	100%	100%	USD300	Sales of communications products, provision of after-sale services and technical support
ZTE (Australia) Pty Ltd.	Australia	USD200	—	100%	100%	USD200	Sales of communications products, provision of after-sales and technical support
深圳中興無線通信有限公司	Shenzhen	RMB5,000	—	100%	100%	RMB750	Development, production and sales of GSM and PHS telecommunication equipment
南京中興軟創軟件有限公司	Nanjing	RMB5,000	5%	95%	100%	RMB5,000	Development, manufacture, and sales of the software products and provision of after-sales services
ZHONGXING CORPORATION S.A. DE C.V.	Salvador	USD11.42857	—	100%	100%	USD11.42857	Sales of communications products, provision of after-sale services and technical support
ZTE Energy (Cayman) Co., Limited	Cayman	USD10,000	—	100%	100%	USD4,200	R&D, manufacture, sales and investment in resource area
ZTE INVESTMENT Limited Liabilities Company	Uzbekistan	USD335	—	51%	51%	USD100	Manufacture and sales of mobile phone products and data system, etc.
ZTE Norway AS	Norway	NOK100	—	100%	100%	NOK100	Sales of communication products and provision of after sales services and technical support
ZTE Mauritius LTD.	Mauritius	USD10	—	100%	100%	USD10	Sales of communication products and provision of after sale services and technical support

NOTES TO FINANCIAL STATEMENTS

(Prepared under PRC GAAP)
(All amounts in RMB'000 unless otherwise stated)
(English translation for reference only)

IV CONTROLLING SUBSIDIARIES, JOINTLY-CONTROLLED ENTITIES AND ASSOCIATES (continued)

(3) Subsidiaries included in the scope of consolidation (continued)

Full name of subsidiaries	Place of registration	Registered capital '000	Shareholding percentage of the Company Direct	Indirect	Effective	Investment of the Group '000	Principal operation
中興能源技術(武漢)有限公司	Wuhan	HKD14,700	—	100%	100%	HKD5,000	R&D, promoting the technology and products of renewable resources and provision of related services
深圳市中興力維軟件有限公司	Shenzhen	RMB1,000	—	90%	90%	RMB900	R&D, manufacture and sales of the software products and provision of services
中興能源(湖北)有限公司	Jingzhou	USD5,000	—	70%	70%	USD3,500	R&D and promotion of the technology and products of renewable resources and provision of related services
ZTE SINGAPORE PTE.LTD.	Singapore	SGD50	—	100%	100%	USD32.5	Sales of communications products; provision of after-sales services technical support
ZTE Korea Limited	Korea	KRW50,000	—	100%	100%	USD53.5	Sales of communications products and provision of after-sales services and technical support
ZTE CZECH,s.r.o.	Czech	CZK200	—	100%	100%	USD10	Sales of communications products and provision of after-sales services and technical support
ZTE India R&D Center Private Limited	India	Rupee 100	—	100%	100%	Rupee 100	Sales of communication products and provision of after sale services and technical support
西安中興軟件有限責任公司	Xi'an	RMB30,000	—	100%	100%	RMB30,000	Development, manufacture and sales of all kinds of communications equipment system drivers, software for the service sector, and provision of technical consultation
南京中興軟件有限責任公司	Nanjing	RMB50,000	—	100%	100%	RMB50,000	Development, manufacture and sales of all kinds of communications equipment system drivers, software for the service sector, and provision of technical consultation
上海中興軟件有限責任公司	Shanghai	RMB50,000	—	100%	100%	RMB50,000	Development, manufacture and sales of all kinds of communications equipment system drivers, software for the service sector, and provision of technical consultation
成都中興軟件有限責任公司	Chengdu	RMB50,000	—	100%	100%	RMB50,000	Development, manufacture and sales of all kinds of communications equipment system drivers, software for the service sector, and provision of technical consultation
深圳市中軟海納技術有限公司	Shenzhen	RMB8,000	—	100%	100%	RMB8,000	Development, manufacture and sales of all kinds of communications equipment system drivers, software for the service sector, and provision of technical consultation

NOTES TO FINANCIAL STATEMENTS

(Prepared under PRC GAAP)
(All amounts in RMB'000 unless otherwise stated)
(English translation for reference only)

IV CONTROLLING SUBSIDIARIES, JOINTLY-CONTROLLED ENTITIES AND ASSOCIATES (continued)

(4) Jointly-controlled entities

Full name of jointly-controlled entities	Place of registration	Registered capital '000	Shareholding percentage of the Company Direct	Indirect	Effective	Investment of the Group '000	Principal operation
Bestel Communications Ltd.	Republic of Cyprus	CYP600	—	50%	50%	CYP150	Sales of communications products and provision of after-sale services
Beijing Zhongxingxin Communication Equipment Company, Limited	Beijing	RMB5,000	50%	—	50%	RMB2,500	Sales of communications equipment (excluding radio transmitter), electronics computer and related external devices, and provision of technical consultation services

(5) Associates

Full name of associates	Place of registration	Registered capital '000	Shareholding percentage of the Company Direct	Indirect	Effective	Investment of the Group '000	Principal operation
ZTE IC Design Co., Ltd	Shenzhen	RMB64,000	40%	—	40%	RMB34,400	Design, development, production and marketing of various ICs and related electronic applications
WuXi Kaier Technology Co., Ltd	Wuxi	RMB10,000	—	30.88%	30.88%	RMB3,500	R&D and manufacture of optoelectronics products, development of optoelectronics technologies, sales of self-produced products and provision of related services
Shenzhen Zhongxing Xinyu FPC Company, Limited	Shenzhen	RMB11,000	—	22.7%	22.7%	RMB2,500	Development, manufacture and sales of single-layered, double-layered, multi-layered and rigid-flexible reflexible printed integrated circuits; import and export of goods and technologies (excluding items prohibited and restricted under the laws, constitutions and as decided by the State Council)
Shenzhen Weigao Semiconductor Company, Limited	Shenzhen	RMB10,000	—	40%	40%	RMB4,000	Development, design and sales of semi-conductor circuit package; domestic business and supply of materials and resources (excluding franchised, state-controlled and monopolized merchandises and restricted items); promotion of industries (separate declaration was required for specific items)
Beijing Zhongxing Yuanjing Technology Co., Ltd	Beijing	RMB10,000	30%	—	30%	RMB3,000	R&D and manufacture of software products of the data centre and metropolitan campus networks

NOTES TO FINANCIAL STATEMENTS

(Prepared under PRC GAAP)
(All amounts in RMB'000 unless otherwise stated)
(English translation for reference only)

IV CONTROLLING SUBSIDIARIES, JOINTLY-CONTROLLED ENTITIES AND ASSOCIATES (continued)

(5) Associates (continued)

Full name of associates	Place of registration	Registered capital '000	Shareholding percentage of the Company Direct	Indirect	Effective	Investment of the Group '000	Principal operation
KAZNURTEL Limited Liability Company	Kazakstan	USD3,000	49%	—	49%	RMB3,988.4	Manufacture and sales of telecom equipment and provision of corresponding technical support, after-sale services, trainings and consultation; installation and construction of CDMA45MWLL and provision of corresponding telecom services and value-added services
Shenzhen Smart Electronics Company, Limited.	Shenzhen	HKD30,000	—	30%	30%	HKD5,000	Development and production of parts and components for novel instruments
中興軟件技術(南昌)有限公司	Nanchang	RMB15,000	30%	—	30%	RMB4,500	Development and application of software technology, systems integration, network engineering, technology consultancy and services
深圳市聚飛光電有限公司	Shenzhen	RMB15,000	—	30%	30%	RMB4,500	Development, production and sales of optoelectronic components, sensitive components, sensors, diodes, SM DLED, LED and optoelectronic component application products; sales of electronic components; export and import of goods and technology
深圳市富德康電子有限公司	Shenzhen	RMB6,000	—	30%	30%	RMB1,800	Manufacture and sales of electronic products; import and export of goods and technologies
深圳市鼎力網絡有限公司	Shenzhen	RMB10,000	—	35%	35%	RMB3,500	Development, sales, purchase and maintenance of telecommunication products and related components; provision of value-added services and advertising services
WANAAG COMMUNICATIONS LIMITED	Hongkong	USD100	—	45%	45%	USD45	Provision of overseas call diversion services in Africa
Shenzhen Decang Technology Company Limited	Shenzhen	RMB2,500	—	40%	40%	RMB1,000	Development, manufacture and sales of optoelectronic and telecommunication products; import and export of goods and technologies

NOTES TO FINANCIAL STATEMENTS

(Prepared under PRC GAAP)
(All amounts in RMB'000 unless otherwise stated)
(English translation for reference only)

V EXPLANATORY NOTES TO MAJOR ITEMS IN THE CONSOLIDATED FINANCIAL STATEMENTS (THE FOLLOWING REPRESENTS GROUP FIGURES UNLESS OTHERWISE STATED)

1. Cash in banks and on hands

		2006			2005		
Item		**Original currency**	**Exchange rate**	**RMB equivalent**	Original currency	Exchange rate	RMB equivalent
Cash	MRO	**55,424**	**0.0293**	**1,624**	—	—	—
	INR	**6,349**	**0.1757**	**1,116**	—	—	—
	RMB	**285**	**1.0000**	**285**	387	1.0000	387
	HKD	**95**	**1.0047**	**95**	125	1.0403	130
	USD	**1,004**	**7.8087**	**7,840**	1,138	8.0702	9,184
	BRL	**16**	**3.6523**	**58**	1	3.4522	3
	THB	**460**	**0.2178**	**100**	1,540	0.1968	303
	FEC	**—**	**—**	**—**	69	7.3633	508
	GBP	**3**	**15.5549**	**47**	—	—	—
	PKR	**871**	**0.1283**	**112**	574	0.1350	77
	SAR	**179**	**2.0879**	**374**	92	2.1521	198
	SOS	**—**	**—**	**—**	42	2.5225	106
	Others			**395**			150
	Subtotal			**12,046**			11,046

NOTES TO FINANCIAL STATEMENTS

(Prepared under PRC GAAP)
(All amounts in RMB'000 unless otherwise stated)
(English translation for reference only)

V EXPLANATORY NOTES TO MAJOR ITEMS IN THE CONSOLIDATED FINANCIAL STATEMENTS (THE FOLLOWING REPRESENTS GROUP FIGURES UNLESS OTHERWISE STATED) (continued)

1. Cash in banks and on hands (continued)

Item		**2006** Original currency	Exchange rate	RMB equivalent	2005 Original currency	Exchange rate	RMB equivalent
Bank deposits	LYD	**185**	**6.1005**	**1,129**	—	—	—
	TJR	**1,833**	**2.2789**	**4,177**	—	—	—
	VND	**5,698,348**	**0.0005**	**2,849**	—	—	—
	VEB	**1,248,802**	**0.0036**	**4,496**	—	—	—
	ARS	**1,781**	**2.5271**	**4,501**	—	—	—
	RMB	**1,888,669**	**1.0000**	**1,888,669**	3,609,771	1.0000	3,609,771
	HKD	**183,311**	**1.0047**	**184,173**	33,408	1.0403	34,754
	USD	**196,734**	**7.8087**	**1,536,237**	154,588	8.0702	1,247,556
	BRL	**1,565**	**3.6523**	**5,716**	8,858	3.4522	30,580
	PKR	**296,881**	**0.1283**	**38,090**	651,989	0.1350	88,019
	EGP	**9,777**	**1.3699**	**13,394**	65,376	1.4035	91,755
	GBP	**236**	**15.5549**	**3,671**	945	14.1349	13,357
	SEK	**17,503**	**1.1418**	**19,985**	2,442	1.0154	2,480
	DZD	**199,541**	**0.1132**	**22,588**	35,070	0.0897	3,146
	IDR	**6,473,322**	**0.0009**	**5,826**	—	—	—
	COP	**1,543,200**	**0.0035**	**5,401**	5,334,654	0.0035	18,671
	IQD	**786,017**	**0.0062**	**4,873**	—	—	—
	CEDI	**—**	**—**	**—**	3,509,473	0.0008	2,808
	EUR	**23,042**	**10.2665**	**236,561**	19,778	9.5797	189,467
	NGN	**—**	**—**	**—**	334,439	0.0576	19,264
	THB	**25,727**	**0.2178**	**5,603**	2,747	0.1968	541
	JPY	**70,798**	**0.0656**	**4,644**	—	—	—
	INR	**98,549**	**0.1757**	**17,315**	—	—	—
	SAR	**213**	**2.0879**	**445**	1,514	2.1521	3,258
	SOS	**—**	**—**	**—**	613	2.5225	1,546
	RUB	**66,092**	**0.3003**	**19,847**	38,287	0.2803	10,732
	AUD	**10,451**	**6.1559**	**64,335**	—	—	—
	Others			**9,391**	—	—	1,452
	Subtotal			**4,103,916**			5,369,157
Other currency	RMB	**183,511**	**1.0000**	**183,511**	79,435	1.0000	79,435
	USD	**1,063**	**7.8087**	**8,301**	1,400	8.0702	11,298
	HKD	**4**	**1.0047**	**4**	14,700	1.0403	15,292
	PKR				54,131	0.1350	7,308
	XOF				5,543,000	0.0143	79,265
	JPY	**49,986**	**0.0656**	**3,279**	—	—	—
	Others			**3**			331
	Subtotal			**195,098**			192,929
	Total			**4,311,060**			5,573,132

At 31 December 2006, except for pledge bank deposits amounting to RMB31,000,000 were frozen for a litigation proceeding. (Details are given in Note VIII to the financial statements, *Contingent event*), and pledged bank deposits, amounting to RMB137,997,000 were for bank facilities.

NOTES TO FINANCIAL STATEMENTS

(Prepared under PRC GAAP)
(All amounts in RMB'000 unless otherwise stated)
(English translation for reference only)

V EXPLANATORY NOTES TO MAJOR ITEMS IN THE CONSOLIDATED FINANCIAL STATEMENTS (THE FOLLOWING REPRESENTS GROUP FIGURES UNLESS OTHERWISE STATED) (continued)

2. Short-term Investment

	2006			2005		
	Investment Cost	**Provision for impairment**	**Balance at the end of the year**	Investment Cost	Provision for impairment	Balance at the end of the year
Equity investment-stock	**16,693**	**—**	**16,693**	—	—	—

The market value of the investment in stocks amounted to RMB33,288,000 on 31 December 2006. The market value for reference was the closing price of the same day of Hong Kong Exchanges and Clearing Limited. The management deemed that there was no significant restriction relating to the realization of the short-term investment.

3. Notes receivables

	2006	2005
Bank acceptance bills	**461,300**	448,693
Commercial acceptance bills	**1,197,106**	796,160
	1,658,406	1,244,853

No outstanding amount due from shareholders holding 5% or more in the shares as at the end of the year.

The balance of notes receivable at year-end increased by 33% compared to that at the beginning of the year. The increase was mainly attributable to the increased commercial bills due from domestic operators.

NOTES TO FINANCIAL STATEMENTS

(Prepared under PRC GAAP)
(All amounts in RMB'000 unless otherwise stated)
(English translation for reference only)

V EXPLANATORY NOTES TO MAJOR ITEMS IN THE CONSOLIDATED FINANCIAL STATEMENTS (THE FOLLOWING REPRESENTS GROUP FIGURES UNLESS OTHERWISE STATED) (continued)

4. Trade receivables

Aging analysis of trade receivables was as follows:

The Group

	2006				2005			
	Balance	Percentage of the total balance	Provision for bad debts	Percentage of provision	Balance	Percentage of the total balance	Provision for bad debts	Percentage of provision
Within one year	**5,321,442**	**85.02%**	**87,201**	**1.64%**	3,535,496	84.28%	109,961	3.11%
Between one to two years	**746,133**	**11.92%**	**297,550**	**39.88%**	545,333	13.00%	232,046	42.55%
Between two to three years	**106,137**	**1.70%**	**93,013**	**87.63%**	47,377	1.13%	36,826	77.73%
Over three years	**85,476**	**1.36%**	**79,093**	**92.53%**	66,628	1.59%	66,413	99.68%
	6,259,188	**100%**	**556,857**		4,194,834	100%	445,246	
Less: accounts due within one year	**5,886,485**	**94.05%**	**556,857**		3,887,168	92.67%	445,246	
Long-term portion	**372,703**	**5.95%**	**—**		307,666	7.33%	—	

Of the balance of trade receivables as at the end of the year, RMB2,074,000 was due from shareholders holding 5% or more in the shares. Please refer to Note VII to the financial statements, Relationship with connected parties and connected transactions.

The top five balances amounted to RMB2,108,159,000, accounting for 34% of the total balance of trade receivables.

The balance of trade receivables increased by 54.84% compared with that of the beginning of the year, which was mainly due to that the Group granted longer credit terms to the customers.

Bad debt provision of trade receivables was as follows:

	2006	2005
Balance at the beginning of the year	**445,246**	429,605
Provision for the year	**284,493**	217,537
Reversal for the year	**(172,882)**	(201,896)
Balance at the end of the year	**556,857**	445,246

NOTES TO FINANCIAL STATEMENTS

(Prepared under PRC GAAP)
(All amounts in RMB'000 unless otherwise stated)
(English translation for reference only)

V EXPLANATORY NOTES TO MAJOR ITEMS IN THE CONSOLIDATED FINANCIAL STATEMENTS (THE FOLLOWING REPRESENTS GROUP FIGURES UNLESS OTHERWISE STATED) (continued)

4. Trade receivables (continued)

The Company

	2006				2005			
	Balance	Percentage of the total balance	Provision for bad debts	Percentage of provision	Balance	Percentage of the total balance	Provision for bad debts	Percentage of provision
Within one year	5,602,594	85.53%	74,589	1.33%	4,426,106	84.78%	97,303	2.20%
Between one to two years	627,764	9.58%	252,269	40.19%	648,024	12.42%	219,505	33.87%
Between two to three years	205,237	3.13%	70,022	34.12%	46,038	0.88%	34,166	74.21%
Over three years	115,007	1.76%	72,348	62.91%	100,487	1.92%	60,763	60.47%
	6,550,602	100%	469,228		5,220,655	100%	411,737	
Less: accounts due within one year	6,222,436	95.00%	469,228		4,893,533	93.73%	411,737	
Long-term portion	328,166	5.00%	—		327,122	6.27%	—	

The top five balances of trade receivables amounted to RMB2,195,129,000, accounting for 34% of the total balance of trade receivables at the end of the year.

Of the balance of trade receivables as at the end of the year, RMB142,000 was due from shareholders holding 5% or more in the shares.

Bad debt provision of trade receivables was as follows:

	2006	2005
Balance at the beginning of the year	411,737	420,598
Provision for the year	226,157	193,035
Reversal for the year	(168,666)	(201,896)
Balance at the end of the year	469,228	411,737

NOTES TO FINANCIAL STATEMENTS

(Prepared under PRC GAAP)
(All amounts in RMB'000 unless otherwise stated)
(English translation for reference only)

V EXPLANATORY NOTES TO MAJOR ITEMS IN THE CONSOLIDATED FINANCIAL STATEMENTS (THE FOLLOWING REPRESENTS GROUP FIGURES UNLESS OTHERWISE STATED) (continued)

5. As at 31 December 2006, the Company and its subsidiaries entered into an agreement with a bank during the year, trade receivables amounting to RMB1,552,054,000 were factored to obtain bank advances. According to the factoring agreement, if the client delayed repayment, the Company and its subsidiary would be obliged to pay interests in respect of the delayed repayment. In accordance with the Provision Regulation on Accounting Treatment of Creditor Financing between Enterprises and Banks/Financial Institutions issued by the Ministry of Finance, the factored trade receivables and bank advances on factored trade receivables of the Group were reflected in the balance sheet based on the principle that "substance over form," as the risks and rewards associated with the creditor rights had not been fully transferred.

The balance of short-term and long-term factored trade receivables increased by 110% compared with that of the beginning of the year, which was mainly attributed to that more receivables were factored to banks during the year.

6. Other receivables

Aging analysis of other receivables was as follows:

The Group

	2006				2005			
	Balance	Percentage of the total balance	Provision for bad debts	Percentage of provision	Balance	Percentage of the total balance	Provision for bad debts	Percentage of provision
Within one year	830,837	62.44%	543,514	65.42%	712,063	70.65%	487,678	68.49%
Between one to two years	296,228	22.26%	151,678	51.20%	122,012	12.10%	82,721	67.80%
Between two to three years	48,990	3.68%	40,959	83.61%	83,238	8.26%	71,825	86.29%
Over three years	154,593	11.62%	154,593	100%	90,627	8.99%	85,741	94.61%
	1,330,648	100%	890,744		1,007,940	100%	727,965	

Bad debt provision for other receivables was as follows:

	2006	2005
Balance at the beginning of the year	727,965	477,493
Provision for the year	413,251	487,678
Reversal for the year	(250,472)	(237,206)
Balance at the end of the year	890,744	727,965

The top five balances of other receivables amounted to RMB102,539,000, accounting for 7.71% of the total balance of other receivables of the Group at the end of the year.

No outstanding amount due from shareholders holding 5% or more in the shares as at the end of the year.

NOTES TO FINANCIAL STATEMENTS

(Prepared under PRC GAAP)
(All amounts in RMB'000 unless otherwise stated)
(English translation for reference only)

V EXPLANATORY NOTES TO MAJOR ITEMS IN THE CONSOLIDATED FINANCIAL STATEMENTS (THE FOLLOWING REPRESENTS GROUP FIGURES UNLESS OTHERWISE STATED) (continued)

6. Other receivables (continued)

The balance of other receivables increased by 57.12% compared with that of the beginning of the year, which was mainly due to the rises of daily operating borrowings and deposits resulting from the expansion of the Group's business scale.

The balance of other receivables included two loan receivables to potential customers granted by the Group. A loan of USD1,777,000 (Approximately RMB13,941,000) bore no interest and no security, which would be repayable in September 2007. The executive directors had taken necessary measures with the potential customers to recover the loans receivables, and were of the opinion that no provision was necessary for the loan receivable. The other loan of EUR787,500 (Approximately RMB8,085,000) bore an annual interest of STIBOR + 1% to 3%, repayable in February 2007. Subsequent to the balance sheet date, the loan was repaid on the due date.

The Company

	2006				2005			
	Balance	**Percentage**	**Provision for bad debts**	**Percentage of provision**	Balance	Percentage	Provision for bad debts	Percentage of provision
Within one year	**579,916**	**28.08%**	**511,987**	**88.29%**	1,058,754	54.55%	481,644	45.49%
Between one to two years	**691,790**	**33.50%**	**148,813**	**21.51%**	656,484	33.83%	82,103	12.51%
Between two to three years	**570,066**	**27.61%**	**40,392**	**7.09%**	102,262	5.27%	62,013	60.64%
Over three years	**223,229**	**10.81%**	**143,711**	**64.38%**	123,248	6.35%	84,636	68.67%
	2,065,001	**100%**	**844,903**		1,940,748	100%	710,396	

Bad debt provision for other receivables is as follows:

	2006	2005
Balance at the beginning of the year	**710,396**	465,367
Provision for the year	**616,152**	481,644
Reversal for the year	**(481,645)**	(236,615)
Balance at the end of the year	**844,903**	710,396

The top five balances of other receivables amounted to RMB862,165,000, accounting for 41.75% of the total balance of other receivables of the Company at the end of the year.

No outstanding amount due from shareholders holding 5% or more in the shares as at the end of the year.

NOTES TO FINANCIAL STATEMENTS

(Prepared under PRC GAAP)
(All amounts in RMB'000 unless otherwise stated)
(English translation for reference only)

V EXPLANATORY NOTES TO MAJOR ITEMS IN THE CONSOLIDATED FINANCIAL STATEMENTS (THE FOLLOWING REPRESENTS GROUP FIGURES UNLESS OTHERWISE STATED) (continued)

7. Accounts prepaid

Aging analysis of accounts prepaid was as follows:

	2006		2005	
	Balance	**Percentage**	Balance	Percentage
Within one year	**49,749**	**96.12%**	150,991	99.88%
Between one to two years	**2,008**	**3.88%**	53	0.03%
Between two to three years	**—**	**—**	130	0.09%
	51,757	**100%**	151,174	100%

No outstanding amount due from shareholders holding 5% or more in the shares as at the end of the year.

The balance of accounts prepaid decreased by 65.76%, which was mainly due to that fewer purchases of raw materials and fixed assets with terms of accounts prepaid were rendered during the year.

8. Inventories

	2006	2005
Raw materials	**1,313,470**	1,221,858
Materials under sub-contract processing	**58,215**	102,958
Work-in-progress	**713,127**	538,703
Finished goods	**845,005**	892,766
Science and technology R&D cost*	**279,840**	279,220
Less: impairment provision	**448,662**	515,958
	2,760,995	2,519,547

Pursuant the Reply on Accounting for Expenses by Technology Research and Development Projects Designated by the State (Cai Kuai Bian [2002] No.36) issued by the Accounting Department of the Ministry of Finance, expenses incurred by the Company in the research and development of products designated by the State using government grants shall be deemed as pooling of costs and expenses of products manufactured by the Company and accounted for as technology development costs. The balance of technology development at the end of the period represented costs and expenses pooled in respect of designated projects funded by the State prior to the completion or inspection for acceptance of such projects. Upon completion of the project designated by the state using government grants, science and technology R&D costs would be set off against specific payables in respect of the project.

An analysis of inventories provision was as follows:

	2006	2005
Balance at the beginning of the year	**515,958**	419,773
Provision for the year	**115,058**	96,185
Reversal for the year	**(182,354)**	—
Balance at the end of the year	**448,662**	515,958

NOTES TO FINANCIAL STATEMENTS

(Prepared under PRC GAAP)
(All amounts in RMB'000 unless otherwise stated)
(English translation for reference only)

V EXPLANATORY NOTES TO MAJOR ITEMS IN THE CONSOLIDATED FINANCIAL STATEMENTS (THE FOLLOWING REPRESENTS GROUP FIGURES UNLESS OTHERWISE STATED) (continued)

9. Construction contracts

	2006	2005
Amount due from customers for contract work	5,833,480	4,689,157
Amount due to customers for contract work	(996,275)	(733,455)
	4,837,205	3,955,702
Contract costs incurred plus recognised profits less recognised losses to date	21,619,372	19,420,235
Less: progress billings	(16,782,167)	(15,464,533)
	4,837,205	3,955,702

Category

	2006	2005
Construction work	3,094,588	2,420,118
Goods delivered	1,742,617	1,535,584
	4,837,205	3,955,702

The amount due to customers for contract work increased by 35.83% compared with that at the beginning of the year as a result of the rise of receipt in advance for telecommunication system contracts.

10. Long-term investments

The Group

		2006	2005
Long-term equity investments			
Equity investments under cost method	(1)	43,488	43,288
Equity investments under equity method			
Equity interest in associates	(2)	51,257	35,583
Equity interest in jointly-controlled entities	(3)	5,936	6,588
Difference in equity investment	(4)	13,036	13,036
		113,717	98,495
Less: Provision for impairment of long-term investments	(5)	13,036	13,036
		100,681	85,459

NOTES TO FINANCIAL STATEMENTS

(Prepared under PRC GAAP)
(All amounts in RMB'000 unless otherwise stated)
(English translation for reference only)

V EXPLANATORY NOTES TO MAJOR ITEMS IN THE CONSOLIDATED FINANCIAL STATEMENTS (THE FOLLOWING REPRESENTS GROUP FIGURES UNLESS OTHERWISE STATED) (continued)

10. Long-term investments (continued)

The Group (continued)

(1) *Equity investments under cost method*

Name of investee	Share of registered capital	Initial investment	Opening balance	Increase during the period	Decrease during the period	Closing balance
深圳市創新投資集團有限公司	0.33%	5,000	5,000	—	—	5,000
北京中視聯數字系統有限公司	7.59%	3,240	3,240	—	—	3,240
中移鼎訊通信股份有限公司	16%	32,000	32,000	—	—	32,000
Beijing Zhongxing Intelligent Transportation Systems Ltd.	19%	1,024	1,024	—	—	1,024
SunTop Technologies Ltd	26.54%	24	24	—	—	24
杭州中興發展有限公司	10%	2,000	2,000	—	—	2,000
貴州艾瑪特信息超市項目開發有限公司	10%	200	—	200	—	200
		43,488	43,288	200	—	43,488

(2) *Equity interest in associates*

Name of investee	Share of registered capital	Initial investment	Opening balance	Increase/decrease of investment cost during the period	Increase/decrease of equity during the period	Closing balance
深圳市富德康電子有限公司	30%	1,800	—	1,800	(275)	1,525
ZTE IC Design Co., Ltd	40%	30,000	13,218	—	2,608	15,826
Beijing Yuanjing Technology Co., Ltd.	30%	3,000	283	—	33	316
Kaznurte Limited Liability Company	49%	1,012	2,477	—	—	2,477
WuXi KaiEr Technology Company, Limited	30.88%	3,500	3,598	—	1,264	4,862
Shenzhen Zhongxing Xinyu FPC Company, Limited	22.73%	2,500	2,375	—	1,455	3,830
Shenzhen Weigao Semiconductor Company, Limited	40%	4,000	2,976	—	(260)	2,716
Shenzhen Decang Technology Company Limited	40%	1,000	811	—	4,004	4,815
深圳市聚飛光電有限公司	30%	4,500	4,348	—	(168)	4,180
中興軟件技術(南昌)有限公司	30%	4,500	2,354	—	939	3,293
Shenzhen Smart Electronics Company, Limited.	30%	3,335	3,143	1,843	(849)	4,137
Shenzhen Dingli Net Co., Ltd.	35%	3,500	—	3,500	(313)	3,187
WANAAG Communications Limited	45%	351	—	351	(258)	93
		62,998	35,583	7,494	8,180	51,257

(3) *Equity interest in jointly-controlled entities*

Name of investee	Share of registered capital	Initial investment	Opening balance	Increase/decrease of investment cost during the period	Increase/decrease of equity during the period	Closing balance
Beijing Zhonxingxin Communication Equipment Company Limited	50%	2,500	4,613	—	(797)	3,816
Bestel Communications Ltd.	50%	2,050	1,975	—	145	2,120
		4,550	6,588	—	(652)	5,936

NOTES TO FINANCIAL STATEMENTS

(Prepared under PRC GAAP)
(All amounts in RMB'000 unless otherwise stated)
(English translation for reference only)

V EXPLANATORY NOTES TO MAJOR ITEMS IN THE CONSOLIDATED FINANCIAL STATEMENTS (THE FOLLOWING REPRESENTS GROUP FIGURES UNLESS OTHERWISE STATED) (continued)

10. Long-term investments (continued)

The Group (continued)

(4) *Difference in equity investment*

Name of investee	Opening and closing balance
Shenzhen Guoxin Electronics development Company, Limited	13,036

(5) *Provision for impairment of long-term investment*

Item	Opening and closing balance
Shenzhen Guoxin Electronics Development Company, Limited	13,036

There was no significant restriction relating to the realisation of the Group's long-term investments.

The Company

		2006	2005
Long-term equity investments			
Equity investments under cost method			
Subsidiaries	(6)	**2,573,949**	2,779,384
Jointly-controlled entities	(7)	**3,816**	4,613
Associates	(8)	**21,913**	18,336
Equity investments under cost method	(9)	**41,488**	41,288
Differences in equity investment	(10)	**4,439**	2,720
		2,645,605	2,846,341
Less: Provision for impairment of long-term investments	(11)	**13,036**	13,036
		2,632,569	2,833,305

NOTES TO FINANCIAL STATEMENTS

(Prepared under PRC GAAP)
(All amounts in RMB'000 unless otherwise stated)
(English translation for reference only)

V EXPLANATORY NOTES TO MAJOR ITEMS IN THE CONSOLIDATED FINANCIAL STATEMENTS (THE FOLLOWING REPRESENTS GROUP FIGURES UNLESS OTHERWISE STATED) (continued)

10. Long-term investments (continued)

The Company (continued)

(6) *Subsidiaries*

Investee	Share of registered capital	Opening balance	Increase/ decrease of investment cost during the period	Increase/ decrease of equity during the period	Cash bonus for the year	Closing balance
ZTE Kangxun Telecom Co., Ltd.	90%	1,303,114	—	152,019	—	1,455,133
Shenzhen Zhongxing Mobile Telecom Equipment Co., Ltd	90%	9,414	(9,430)	16	—	—
ZTE (USA) Inc.	100%	(9,290)	—	(73,171)		(82,461)
Wuxi Zhongxing Optoelectronics Technologies Company, Limited	65%	31,617	—	11,460	(1,300)	41,777
ZTE (H.K) Limited	100%	454,727	—	578,334	(803,736)	229,325
Anhui Wantong Posts and Telecommunications Company, Limited	51%	22,787	—	5,698	(2,266)	26,219
Telrise (Cayman) Telecom Ltd	52.85%	2,923	—	(218)	—	2,705
深圳市國鑫電子發展有限公司	90%	3,356	—	—	—	3,356
Congo-Chine Telecom S.A.R.L.	51%	24,256	31,502	13,225	—	68,983
Yangzhou Zhongxing Mobile Telecom Equipment Co., Limited	65%	(28,912)	—	(2,103)	—	(31,015)
ZTE Mobile Tech Co., Limited	95%	29,129	—	38,945	—	68,074
南京中興軟創科技有限責任公司	76%	103,676	—	58,743	—	162,419
ZTE (UK) Limited	51%	(16,647)	—	(17,033)	—	(33,680)
ZTE do Brasil Ltda	100%	(10,345)	—	(32,739)	—	(43,084)
Shenzhen Zhongxing Software Company, Limited	73%	697,581	9,749	1,397,722	(1,536,448)	568,604
ZTE Integration Telecom Ltd	75%	78,258	—	(41,905)	—	36,353
ZTE Wistron Telecom AB	100%	2,616	—	(238)	—	2,378
ZTE-Communication Technologies, Ltd.	100%	5,110	—	5,426	—	10,536
ZTE Corporation Mexico S.DE R.L DE C.V.	100%	(13,325)	—	(6,577)	—	(19,902)
Shenzhen Changfei Investment Company Limited	51%	49,655	—	11,486	—	61,141
Zhongxing Telecom Parkistan (Private) Limited	93%	(33,902)	—	79,297	—	45,395
Guangdong New Pivot Technology & Service Company, Limited	90%	9,280	4,500	909	—	14,689
Shenzhen Zhongxing Telecom Equipment Technology & Service Company Limited	90%	34,378	—	(159,772)	—	(125,394)
Shanghai Zhongxing Telecom Equipment Technology & Service Company Limited	51%	10,589	—	7,863	(510)	17,942
ZTE Holdings (Thailand) Co., Ltd	49%	(12)	—	(12)	—	(24)
ZTE (Thailand) Co., Ltd.	49%	(1,022)	1,840	207	—	1,025
Shenzhen Special Equipment Company Limited	54%	1,850	—	2,869	—	4,719
ZTE Telecom India Private Ltd.	100%	(52,142)	—	(16,417)	—	(68,559)
ZTE Romania S.R.L	100%	(7,483)	—	(6,269)	—	(13,752)
ZTE (Malaysia) Corporation SDH.BHD.	100%	(2,579)	—	(5,211)	—	(7,790)
ZiMAX (Cayman) Holdings Ltd.	100%	33,167	—	12,165	—	45,332
西安中興精誠通訊有限公司	70%	12,298	—	1,732	(1,050)	12,980
Closed Joint Stock Company TK Mobile	51%	14,329	—	(3,120)	—	11,209
PT. ZTE Indonesia	99.5%	5,577	—	68,280	—	73,857
深圳中興力維技術有限公司	30%	15,356	—	21,603	(1,500)	35,459
		2,779,384	38,161	2,103,214	(2,346,810)	2,573,949

* RMB2,102,454,000 included in Increase/decrease of equity during the year was current year's equity.

NOTES TO FINANCIAL STATEMENTS

(Prepared under PRC GAAP)
(All amounts in RMB'000 unless otherwise stated)
(English translation for reference only)

V EXPLANATORY NOTES TO MAJOR ITEMS IN THE CONSOLIDATED FINANCIAL STATEMENTS (THE FOLLOWING REPRESENTS GROUP FIGURES UNLESS OTHERWISE STATED) (continued)

10. Long-term investments (continued)

The Company (continued)

(7) *Jointly-controlled entities*

Investee	Share of registered capital	Opening balance	Increase/ decrease of equity during the year	Dividends of cash during the year	Closing balance
Beijing Zhongxingxin Communication Equipment Company Limited	50%	4,613	(797)	—	3,816

(8) *Associates*

Investee	Share of registered capital	Opening balance	Increase/ decrease of investment cost during the year	Increase/ decrease of equity during the year	Closing balance
北京中興遠景科技有限公司	30%	286	—	30	316
KAZNURTEL Limited Liability Company	49%	2,478	—	—	2,478
中興軟件技術(南昌)有限公司	30%	2,354	—	939	3,293
ZTE IC Design Co., Ltd	40%	13,218	—	2,608	15,826
		18,336	—	3,577	21,913

(9) *Equity investments under cost method*

Investee	Share of registered capital	Opening balance	Increase/ decrease of investment cost during the year	Closing balance
深圳市創新投資集團有限公司	0.33%	5,000	—	5,000
北京中視聯數字系統有限公司	7.59%	3,240	—	3,240
SunTop Technologies Ltd.	26.54%	24	—	24
Beijing Zhongxing Intelligent Transportation Systems Ltd	19%	1,024	—	1,024
中移鼎訊通信股份有限公司	16%	32,000	—	32,000
貴州艾瑪特信息超市項目開發有限公司	10%	—	200	200
		41,288	200	41,488

(10) *Difference in equity investments*

Investee	Opening balance	Amortization in Current year	Increase/ decrease of investment cost during the year	Closing balance
Congo-Chine Telecom S.A.R.L.	(10,316)	1,719	—	(8,597)
Shenzhen guoxin Electronics Development Company Limited	13,036	—	—	13,036
	2,720	1,719	—	4,439

(11) *Provision for impairment of long-term investment:*

	Opening and closing balance
Shenzhen Guoxin Electronics Development Company Limited	13,036

There was no significant restriction relating to the Group's realization of investment.

NOTES TO FINANCIAL STATEMENTS

(Prepared under PRC GAAP)
(All amounts in RMB'000 unless otherwise stated)
(English translation for reference only)

V EXPLANATORY NOTES TO MAJOR ITEMS IN THE CONSOLIDATED FINANCIAL STATEMENTS (THE FOLLOWING REPRESENTS GROUP FIGURES UNLESS OTHERWISE STATED) (continued)

11. Fixed assets

	Buildings	Leasehold improvement	Motor Vehicles	Machinery equipment	Electronic equipment	Other equipment	Total
Cost:							
Opening balance	917,623	51,631	210,369	1,009,942	1,419,878	14,497	3,623,940
Additions	584	10,482	40,399	208,510	424,238	5,600	689,813
Transferred from Construction in progress	17,587	9,591	—	—	33,374	—	60,552
Disposal and retirement	—	—	(12,375)	(21,704)	(92,846)	(1,401)	(128,326)
Exchange realignments	(469)	—	(349)	(873)	(9,893)	179	(11,405)
Closing balance	935,325	71,704	238,044	1,195,875	1,774,751	18,875	4,234,574
Accumulated depreciation:							
Opening balance	110,451	28,046	64,229	331,685	607,436	6,942	1,148,789
Provision	33,943	19,327	23,589	132,769	290,035	3,638	503,301
Disposal and retirement	—	—	(7,502)	(10,704)	(74,478)	(858)	(93,542)
Exchange realignments	(35)	—	(105)	(79)	(2,582)	(33)	(2,834)
Closing balance	144,359	47,373	80,211	453,671	820,411	9,689	1,555,714
Fixed assets, net:							
31 December, 2006	790,966	24,331	157,833	742,204	954,340	9,186	2,678,860
31 December, 2005	807,172	23,585	146,140	678,257	812,442	7,555	2,475,151
Provision for impairment:							
31 December, 2006	7,708	—	—	1,475	77,819	—	87,002
31 December, 2005	7,708	—	—	1,475	85,797	—	94,980
Fixed assets, net:							
31December, 2006	783,258	24,331	157,833	740,729	876,521	9,186	2,591,858
31 December, 2005	799,464	23,585	146,140	676,782	726,645	7,555	2,380,171

As at the balance sheet date, the buildings of which the net book value amounted to RMB100,189,722 had been frozen as a means of guarantee to the interest of the plaintiff in a legal issue. Further details are given in Note VIII to the financial statements, Contingent liabilities.

Book value at cost of fixed assets in continued use for which full depreciation had been made was RMB229,981,000. Book value of retired fixed assets or fixed assets pending for disposal was RMB0.

NOTES TO FINANCIAL STATEMENTS

(Prepared under PRC GAAP)
(All amounts in RMB'000 unless otherwise stated)
(English translation for reference only)

V EXPLANATORY NOTES TO MAJOR ITEMS IN THE CONSOLIDATED FINANCIAL STATEMENTS (THE FOLLOWING REPRESENTS GROUP FIGURES UNLESS OTHERWISE STATED) (continued)

12. Construction in progress

Name of construction project	Budget	Opening balance	Increase/ (decrease) during the year	Transfer to fixed assets during the year	Closing Balance	Source of funds	Status of project
Science and Technology Park R&D Center	300,000	12,195	15,003	27,198	—	Internal resources	Completed
Liuxiandong ZTE Industrial Park	1,300,000	46,665	145,153	—	191,818	Internal resources	Work in progress
New plant in Wuxi	16,000	14,589	2,998	17,587	—	Internal resources	Completed
IT chamber of R&D complex	—	9,440	—	9,440	—	Internal resources	Completed
Equipment installment	—	34,129	26,618	—	60,747	Internal resources	Work in progress
Nanjing II phase	—	6,008	84,449	—	90,457	Internal resources	Work in progress
Shanghai II phase	—	1,162	91,505	—	92,667	Internal resources	Work in progress
Others	—	2,553	37,721	6,327	33,947	Internal resources	Work in progress
	1,616,000	126,741	403,447	60,552	469,636		

The balance of construction in progress at year end increased dramatically by 270% compared with that at the beginning of the year, which was mainly attributable to the increased investment in the construction of Nanjing, Shanghai research and development centers and Liuxiandong ZTE Industrial Park.

13. Intangible assets

	Initial amount	Method of possession	Opening balance	Increase (decrease) during the year	Amortization during the year	Accumulated amortization	Closing balance	Remaining years for amortization
Software	272,443	Acquisition	108,993	42,234	45,700	166,916	105,527	5
Patent technology	1,354	Acquisition	1,354	—	316	316	1,038	1–10
Land use rights	14,866	Acquisition	12,859	1,533	366	840	14,026	50
Operating concession	103,006	Acquisition	64,014	(1,608)	3,182	43,782	59,224	19
			187,220	42,159	49,564	211,854	179,815	

NOTES TO FINANCIAL STATEMENTS

(Prepared under PRC GAAP)
(All amounts in RMB'000 unless otherwise stated)
(English translation for reference only)

V EXPLANATORY NOTES TO MAJOR ITEMS IN THE CONSOLIDATED FINANCIAL STATEMENTS (THE FOLLOWING REPRESENTS GROUP FIGURES UNLESS OTHERWISE STATED) (continued)

13. Intangible assets (continued)

Provision for impairment of intangible assets is as follows:

	Opening balance	Addition during the year	Diminution during the year: Increase in value	Diminution during the year: Other transfer	Closing balance
Software	12,884	—	—	—	12,884
Land use rights	6,322	—	—	—	6,322
Operating concession	7,750	—	—	—	7,750
	26,956	—	—	—	26,956

14. The Group entered into an international construction contract with Algeria Telecom for the provision of telecommunications equipment. Pursuant to the agreement, a subsidiary of the Group will share certain portion of the operating revenue of Algeria Telecom for the five years after the commissioning of the project, and the ownership of these telecommunications equipments shall be transferred to Algeria Telecom after 5 years at nil consideration. As at 31 December 2006, part of the project was completed. Such assets would be amortized over a period of 5 years since the commissioning of the project in current year.

Item	Original cost	Opening balance	Increase during the year	Amortization during the year	Accumulated amortization	Closing Balance
Algeria Broadband network construction project	48,499	13,996	34,503	8,083	8,083	40,416

The balance of long-term deferred assets at the end of the year increased by 189% compared with that at the beginning of the year, which was mainly due to the increase of investment is the aforesaid project.

15. Deferred tax debit

	2006	2005
Unrealized profit of stock	**7,298**	4,474
Provision for maintenance	**34,562**	37,350
Tax Losses	**51,141**	
Overseas tax	**87,516**	—
Inventories provision	**53,166**	39,069
Deferred tax debit	**233,683**	80,893

The balance of deferred tax debit at year end increased substantially by 189% compared with that at the beginning of the year. It was a result of the rise of deferred corporate income tax, which would be levied in the coming financial years.

NOTES TO FINANCIAL STATEMENTS

(Prepared under PRC GAAP)
(All amounts in RMB'000 unless otherwise stated)
(English translation for reference only)

V EXPLANATORY NOTES TO MAJOR ITEMS IN THE CONSOLIDATED FINANCIAL STATEMENTS (THE FOLLOWING REPRESENTS GROUP FIGURES UNLESS OTHERWISE STATED) (continued)

16. Short-term loans

	2006		2005	
	Original currency	RMB equivalent	Original currency	RMB equivalent
Credit loans	RMB78,900	78,900	RMB52,000	52,000
	USD95,000	741,826	—	—
Pledged loans	RMB125,000	125,000	PKR353,300	47,695
		945,726		99,695

The balance of short-term loans at year end increased dramatically by 849% compared with that at the beginning of the year, owing to the increase in loans denominated in United Sates dollars in order to facilitate the need of liquid capital.

17. Notes payable

No outstanding amount due to shareholders holding 5% or more in the shares as at the year end.

18. Trade payables

Of the balance of accounts payable, RMB147,860,000 was due from shareholders holding 5% or more in the shares of the Company. Please refer to Note VII to the financial statements, *Relationship with connected parties and connected transactions.*

19. Advances from customers

No outstanding amount of shareholders holding 5% or more in the shares of the Company.

20. Dividend payable

	2006	2005
Holders of State-owned corporate shares	—	3,186
Holders of domestic corporate shares/domestic investors	83,941	159,822
	83,941	163,008

The balance of dividend payable at year-end decreased by RMB79,067,000 compared to that at the beginning of the year. The decrease was mainly a result of less dividend payment having been paid by the subsidiaries of the Company to minority Shareholders.

NOTES TO FINANCIAL STATEMENTS

(Prepared under PRC GAAP)
(All amounts in RMB'000 unless otherwise stated)
(English translation for reference only)

V EXPLANATORY NOTES TO MAJOR ITEMS IN THE CONSOLIDATED FINANCIAL STATEMENTS (THE FOLLOWING REPRESENTS GROUP FIGURES UNLESS OTHERWISE STATED) (continued)

21. Taxes payable

	2006	2005
Value-added tax ("VAT")	**(1,023,281)**	(802,209)
Business tax	**4,752**	5,508
City maintenance and construction tax	**6,000**	(794)
Income tax		
PRC tax	**67,950**	42,020
Overseas tax	**229,963**	72,652
Property tax	**22**	18
Individual income tax	**14,936**	12,523
	(699,658)	(670,282)

The bases of calculation of taxes and tax rate of taxes payable are set out in Note III to the financial statements, *Tax*.

22. Other payables

The balance of the account comprised RMB361,000 payable to shareholders holding 5% or more in the shares of the Company. Please refer to Note VII to the financial statements, *Relationship with connected parties and connected transactions*.

23. Accrued expenses

	2006	2005
Interest expenses	**664**	395
Rent and water and electricity charges	**2,332**	4,541
Work installation expenses	**35,984**	14,972
Product maintenance fee	**230,417**	248,998
After-sale service fee	**25,735**	8,924
Promotion expenses	**23,264**	7,960
Others	**69,223**	60,878
	387,619	346,668

24. Provision

	2006	2005
Provision of guarantees for external parties	**4,035**	4,035
Guarantees for quality of products	**31,645**	16,000
	35,680	20,035

NOTES TO FINANCIAL STATEMENTS

(Prepared under PRC GAAP)
(All amounts in RMB'000 unless otherwise stated)
(English translation for reference only)

V EXPLANATORY NOTES TO MAJOR ITEMS IN THE CONSOLIDATED FINANCIAL STATEMENTS (THE FOLLOWING REPRESENTS GROUP FIGURES UNLESS OTHERWISE STATED) (continued)

25. Long-term loans due within one year

	Notes	2006	2005
Long-term loans	26	—	500,000

26. Long-term loans

	2006			2005		
	Original currency		RMB equivalent	Original currency		RMB equivalent
Credit loans	RMB	900,026	900,026		—	—
	USD	55,000	429,479		—	—
Guaranteed loans	USD	9,648	80,000	USD	9,648	80,000
				RMB	500,000	500,000
Pleged loans	USD	34,543	269,737		—	—
Less:long-term loans due within one year		—	—			500,000
			1,679,242			80,000

The balance of long-term loans increased dramatically by 2000% compared with that at the beginning of the year. The increase mainly resulted from the need for operating and construction capital.

27. Specific payables

	2006	2005
Technology appropriations	425,669	405,511

NOTES TO FINANCIAL STATEMENTS

(Prepared under PRC GAAP)
(All amounts in RMB'000 unless otherwise stated)
(English translation for reference only)

V EXPLANATORY NOTES TO MAJOR ITEMS IN THE CONSOLIDATED FINANCIAL STATEMENTS (THE FOLLOWING REPRESENTS GROUP FIGURES UNLESS OTHERWISE STATED) (continued)

28. Share capital

The Company has registered and paid-in capital of RMB959,521,650 with a par value of RMB1 each. Shares were classified and structured as follows:

		Opening balance		Increase (decrease) during the year	Closing balance	
		Number of Shares	Percentage	Others	Number of Shares	Percentage
I.	Circulating shares					
(I)	Restricted Shares					
1.	State owned corporate shares	392,080	40.86%	(81,097)	310,983	32.41%
2.	Other domestic shares	12,714	1.32%	(11,433)	1,281	0.13%
	Including					
	Domestic corporate shares	11,433	1.19%	(11,433)	—	—
	Domestic natural person shares	1,281	0.13%	—	1,281	0.13%
3.	Foreign shares					
	Foreign corporate shares	18,291	1.91%	(18,291)	—	—
	Total number of restricted shares	423,085	44.09%	(110,821)	312,264	32.54%
(II)	Unrestricted shares					
1.	RMB ordinary shares	376,286	39.22%	110,821	487,107	50.77%
2.	Overseas listed foreign shares	160,151	16.69%	—	160,151	16.69%
	Total number of unrestricted shares	536,437	55.91%	110,821	647,258	67.46%
Total circulating shares		959,522	100.00%	—	959,522	100.00%
II.	Total of shares	959,522	100.00%	—	959,522	100.00%

NOTES TO FINANCIAL STATEMENTS

(Prepared under PRC GAAP)
(All amounts in RMB'000 unless otherwise stated)
(English translation for reference only)

V EXPLANATORY NOTES TO MAJOR ITEMS IN THE CONSOLIDATED FINANCIAL STATEMENTS (THE FOLLOWING REPRESENTS GROUP FIGURES UNLESS OTHERWISE STATED) (continued)

29. Capital reserve

	Opening balance	Increase during the year	Decrease during the year	Closing balance
Equity settled share expense	—	2,480	—	2,480
Share premium	5,462,657	—	—	5,462,657
Provision for equity investments	38,398	—	—	38,398
Provision for acceptance of non-cash asset donation	62	—	—	62
Other capital reserve*	5,307	762	—	6,069
	5,506,424	3,242	—	5,509,666

* Other capital reserve represented the disposal of accounts payable overdue for 3 years by the Group.

30. Surplus reserves

	Opening balance	Increase during the year	Decrease during the year	Closing balance
Surplus reserves	1,264,060	66,999	—	1,331,059

In accordance with the Company Law of the PRC and the articles of associations, the Company and certain of its subsidiaries are required to allocate 10% of their profit after tax, as determined in accordance with PRC accounting standards and regulations applicable to these companies, to the statutory surplus reserve (the ''SSR'') until such reserves reach 50% of the registered capitals of these companies. Part of the SSR may be capitalised as these companies' share capitals, provided that the remaining balances after the capitalisation are not less than 25% of the registered capitals of these companies.

In previous years, the Company and certain of its subsidiaries are required to transfer 5% to 10% of their profit after tax, as determined in accordance with PRC accounting standards and regulations applicable to these companies, to statutory public welfare fund (the ''PWF''). According to the ''Company Law of the People's Republic of China (2005 revised)'' that took effect as of 1 January 2006, and the modified articles of associations, the Company and its subsidiaries will not allocate the PWF starting from 2006. The balance of PWF as at 31 December 2005 was transferred to the SSR. Certain of the Company's subsidiaries are Chinese-foreign equity joint ventures. In accordance with the ''Law of the People's Republic of China on Chinese-Foreign Equity Joint Ventures'' and their respective articles of associations, these subsidiaries are required to allocate certain of their profit after tax as determined in accordance with PRC accounting standards and related regulations to enterprise determined by their respective board of directors.

NOTES TO FINANCIAL STATEMENTS

(Prepared under PRC GAAP)
(All amounts in RMB'000 unless otherwise stated)
(English translation for reference only)

V EXPLANATORY NOTES TO MAJOR ITEMS IN THE CONSOLIDATED FINANCIAL STATEMENTS (THE FOLLOWING REPRESENTS GROUP FIGURES UNLESS OTHERWISE STATED) (continued)

31. Undistributed profit

	Opening balance	Increase during the year	Decrease during the year	Closing balance
Undistributed profit	2,171,190	807,353	(210,927)	2,767,616

The decrease during the year comprised the payment of RMB1.5 in cash for every 10 share or an aggregate of RMB143,928,000 on the basis of the total share capital as at 31 December 2006 according to the 2006 profit distribution plan declared by the second meeting of the fourth session of the Board of Directors of the Company and transfers to the statutory reserve. Profit available for distribution to owners was carried at the lower of the financial statements prepared under PRC GAAP and those under HKFRSs.

32. Revenue and cost of sales

Revenue from principal operations refers to the revenue from sales of products and labour services. Segment information of the Group and the Company is set out in the business and geographical segments given in Note VI.

Sales to the top five customers of the Group generated revenue of RMB9,171,419,000 and RMB10,124,082,000 in 2006 and 2005 respectively, accounting for 39.82% and 46.92% of the sales revenue of the Group respectively.

33. Taxes and surcharges

	2006	2005
Business tax	**33,277**	16,499
City maintenance and construction tax	**20,785**	20,260
Education surcharge	**30,930**	44,632
Others	**26,368**	24,269
	111,360	105,660

34. Profit from other operations

	2006	2005
Rental of equipment lease	**27,813**	—
Technology service and consultation fee	**39,633**	15,379
Others	**1,706**	400
	69,152	15,779

Profit from other operations increased by 338% compared with last year, which was mainly attributable to the increase in both the equipment rental income and the technology service income.

NOTES TO FINANCIAL STATEMENTS

(Prepared under PRC GAAP)
(All amounts in RMB'000 unless otherwise stated)
(English translation for reference only)

V EXPLANATORY NOTES TO MAJOR ITEMS IN THE CONSOLIDATED FINANCIAL STATEMENTS (THE FOLLOWING REPRESENTS GROUP FIGURES UNLESS OTHERWISE STATED) (continued)

35. Finance Expenses

	2006	2005
Interest expenses	**153,694**	175,884
Less: Interest income	**49,050**	54,870
Gain/losses on exchange	**29,422**	48,390
Cash discounts and interest subsidy	**41,018**	59,746
Bank charges	**64,533**	59,601
	239,617	288,751

36. Investment income

The Group

	2006	2005
Gain from stock investment	**24,326**	—
Share of net gain/losses of jointly-controlled entities	**8,175**	(2,968)
Share of net gain/losses of associates	**(652)**	(1,716)
Gain on transfer of equity investment	**—**	1,598
Amortisation of differences in equity investment	**—**	(812)
Writing off of long-term investments	**—**	(55,456)
	31,849	(59,354)

As at the balance sheet date, the Group was not subject to significant restrictions in remitting its investment income.

The amount of investment income increased by RMB91,203,000, which was mainly attributable to the increased gain from stock investment as well as the decrease in long-term investment impairment of the Group.

The Company

	2006	2005
Share of net gain/losses of subsidiaries	**2,102,454**	925,160
Share of net gain/losses of associates	**(797)**	(1,698)
Share of net gain/losses of jointly-controlled entities	**3,577**	(1,381)
Gain/losses on transfer of equity investment	**—**	1,598
Amortisation of differences in equity investment	**1,719**	907
Writing off of long-term investments	**—**	(4,873)
	2,106,953	919,713

As at the balance sheet date, the Company was not subject to significant restrictions in remitting its investment income.

NOTES TO FINANCIAL STATEMENTS

(Prepared under PRC GAAP)
(All amounts in RMB'000 unless otherwise stated)
(English translation for reference only)

V EXPLANATORY NOTES TO MAJOR ITEMS IN THE CONSOLIDATED FINANCIAL STATEMENTS (THE FOLLOWING REPRESENTS GROUP FIGURES UNLESS OTHERWISE STATED) (continued)

37. Subsidies income

Item	2006	2005
Refund of VAT on software products*	**547,027**	435,326
Financial subsidies on essential new products	**—**	8,900
Preferential financial subsidies on new products	**12,872**	3,500
Others	**52,264**	10,288
	612,163	458,014

* Refund of VAT on software products represents the refund upon payment of VAT according to the portion of any effective VAT rate in excess of 3% in respect of software product sales by a subsidiary of the Company, pursuant to the principles of Certain Policies to Encourage the Development of Software Enterprise and the IC Industry and the approval reply of the State taxation authorities in Shenzhen.

The amount of subsidies income for the current year increased by 33.66% compared with that of last year, which was mainly due to the increase of value-added tax refund for software products of the Group.

38. Non-operating income

	2006	2005
Gains from disposal of fixed assets	**2,660**	909
Income from penalty payment	**4,260**	9,367
Income from compensation payment	**9,200**	10,000
Reward income	**7,747**	5,107
Others	**141**	2,244
	24,008	27,627

39. Non-operating expenses

	2006	2005
Provision for impairment of intangible assets	**—**	2
Net loss on writing off of fixed assets and intangible assets	**17,545**	7,072
Donations	**329**	2,218
Penalties	**7,226**	5,638
Others	**1,051**	1,792
	26,151	16,722

The amount of non-operating expenses increased by 56.39% compared with that of last year, which was mainly a result of the increase in net loss on writing off fixed assets.

40. Other cash outflow from operating activities

Other cash outflow from operating activities in the consolidated cash flow statement at 31 December 2006 was RMB2,225,655,000, comprising mainly operating expenses and administrative expenses.

NOTES TO FINANCIAL STATEMENTS

(Prepared under PRC GAAP)
(All amounts in RMB'000 unless otherwise stated)
(English translation for reference only)

VI SEGMENT INFORMATION BY INDUSTRY AND REGION

The Group

Items of principal operations	Revenue from principal operations 2006	Revenue from principal operations 2005	Costs of sales 2006	Costs of sales 2005	Gross profit 2006	Gross profit 2005
Communication system construction income	**16,874,334**	17,016,057	**10,345,808**	10,208,099	**6,528,526**	6,807,958
Communication terminal equipment income	**5,778,546**	4,333,082	**4,562,979**	3,574,985	**1,215,567**	758,097
Telecommunications service income	**378,804**	226,781	**263,010**	161,713	**115,794**	65,068
Total	**23,031,684**	21,575,920	**15,171,797**	13,944,797	**7,859,887**	7,631,123

Geographical segments	Revenue from principal operations 2006	Revenue from principal operations 2005	Costs of sales 2006	Costs of sales 2005	Gross profit 2006	Gross profit 2005
Domestic	**12,801,765**	13,874,309	**8,553,924**	9,364,085	**4,247,841**	4,510,224
Overseas	**10,229,919**	7,701,611	**6,617,873**	4,580,712	**3,612,046**	3,120,899
Total	**23,031,684**	21,575,920	**15,171,797**	13,944,797	**7,859,887**	7,631,123

The Company

Items of principal operations	Revenue from principal operations 2006	Revenue from principal operations 2005	Costs of sales 2006	Costs of sales 2005	Gross profit 2006	Gross profit 2005
Communication system construction income	**15,476,765**	16,408,812	**13,600,610**	13,175,302	**1,876,155**	3,233,510
Communication terminal equipment income	**5,738,818**	4,156,240	**5,245,984**	3,496,520	**492,834**	659,720
Total	**21,215,583**	20,565,052	**18,846,594**	16,671,822	**2,368,989**	3,893,230

Geographical segments	Revenue from principal operations 2006	Revenue from principal operations 2005	Costs of sales 2006	Costs of sales 2005	Gross profit 2006	Gross profit 2005
Domestic	**11,951,417**	13,439,004	**10,599,837**	10,925,688	**1,351,580**	2,513,316
Overseas	**9,264,166**	7,126,048	**8,246,757**	5,746,134	**1,017,409**	1,379,914
Total	**21,215,583**	20,565,052	**18,846,594**	16,671,822	**2,368,989**	3,893,230

NOTES TO FINANCIAL STATEMENTS

(Prepared under PRC GAAP)
(All amounts in RMB'000 unless otherwise stated)
(English translation for reference only)

VII RELATIONSHIP WITH CONNECTED PARTIES AND CONNECTED TRANSACTIONS

1. Connected parties with controlling relationship

Name of corporation	Principal operations	Place of registration	Relationship with the company	Percentage of Shares or equities	Economic nature or category	Legal representative
Shenzhen Zhongxingxin Telecommunications Equipment Company, Limited	Production of programmed switchboard cabinets, telephones and related components, and electronic products; import and export operations	Shenzhen, Guangdong	Controlling shareholder of the Company	37.41%	State-owned	Zhang Taifeng

2. Registered capital of connected parties with controlling relationship and its movements

Name of corporation	Opening balance	Addition During the year	Reduction during the year	Closing balance
Shenzhen Zhongxingxin Telecommunications Equipment Company, Limited	10,000	90,000	—	100,000

The balance was RMB10,000,000 at the end of the year. An addition of RMB90,000,000 was recorded during the year.

3. Movements in shares or equity held by connected parties with controlling relationship:

Name of corporation	Opening balance	%	Addition during the year	%	Reduction during the year	%	Closing balance	%
Shenzhen Zhongxingxin Telecommunications Equipment Company, Limited	358,959	37.41%	—	—	—	—	358,959	37.41%

NOTES TO FINANCIAL STATEMENTS

(Prepared under PRC GAAP)
(All amounts in RMB'000 unless otherwise stated)
(English translation for reference only)

VII RELATIONSHIP WITH CONNECTED PARTIES AND CONNECTED TRANSACTIONS (continued)

4. Relationship with connected parties with non-controlling relationship:

Details for connected parties with non-controlling relationship were as follow:

Name of related companies	Relationship with the Company
Shenzhen Zhongxing WXT Equipment Company, Ltd.	Shareholder of the Company's controlling shareholder
Xi'an Microelectronics Technology Research Institute	Shareholder of the Company's controlling shareholder
Shenzhen Zhongxing Information Technology Co., Ltd.	Partially holding company of the shareholder of the Company's controlling shareholder
Beijing Yuanjing Technology Co., Ltd.	Associate
深圳市聚飛光電有限公司	Associate
Wuxi KaiEr Technology Company, Limited	Associate
Shenzhen Weigao Semiconductor Company, Limited	Associate
ZTE IC Design Co., Ltd	Associate
Shenzhen Decang Technology Company Limited	Associate
Shenzhen Smart Electronics Company, Limited.	Associate
Shenzhen Zhongxing Xinyu FPC Company, Limited	Associate
Shenzhen Zhongxing Xindi Telecommunications Equipment Company, Limited	Under the same controlling shareholder as the Company
Lishan Microelectronics Research Institute	Shareholder of the Company
吉林省郵電器材總公司	Shareholder of the Company
湖南南天集團有限公司	Shareholder of the Company
Beijing Zhongxingxin Communication Equipment Company, Limited	Subsidiary jointly-controlled by the Company
中興軟件技術(南昌)有限公司	Associate
Shenzhen Gaodonghua Communication Technology Co., Ltd.	Partially holding company of the shareholder of the Company's controlling shareholder
Shenzhen Zhongxing Development Co., Ltd.	Partially holding company of the shareholder of the Company's controlling shareholder
Chung Hing (Hong Kong) Development Limited	Company controlled by key management personnel of the Company
中太數據通訊(深圳)有限公司	Company controlled by key management personnel of the Company
深圳市中興新舟成套設備有限公司	Under the same controlling shareholder as the Company

NOTES TO FINANCIAL STATEMENTS

(Prepared under PRC GAAP)
(All amounts in RMB'000 unless otherwise stated)
(English translation for reference only)

VII RELATIONSHIP WITH CONNECTED PARTIES AND CONNECTED TRANSACTIONS (continued)

5. Major transactions between the Group and related companies during the year were as follow:

(1) Sales of goods to the connected parties:

Item	Names of companies	2006	2005
Sales of goods	Shenzhen Zhongxing Information Technology Co., Ltd.	1,704	7,910
	Shenzhen Zhongxingxin Telecommunications Equipment Company, Limited	3,682	545
	Beijing Zhongxingxin Communication Equipment Company Limited	38	3,248
	Beijing Zhongxing Yuanjing Technology Co., Ltd	862	2,815
	ZTE IC Design Co., Ltd	16,889	9,025
	Shenzhen Zhongxing WXT Equipment Company, Ltd.	5,632	5,233
	Shenzhen Zhongxing Xindi Telecommunications Equipment Company, Limited	915	13
	深圳市中興新舟成套設備有限公司	302	—
	Shenzhen Decang Technology Company Limited	351	—
	中興軟件技術(南昌)有限公司	31,910	—
	Shenzhen Zhongxing Development Co., Ltd.	364	—

(2) Purchase of raw materials from connected parties:

Item	Names of companies	2006	2005
Purchase of raw materials	Shenzhen Zhongxingxin Telecommunications Equipment Company, Limited	359,439	311,970
	Shenzhen Zhongxing WXT Equipment Company, Ltd.	133,646	184,326
	Shenzhen Zhongxing Xindi Telecommunications Equipment Company, Limited	76,558	84,327
	Shenzhen Zhongxing Information Technology Co., Ltd	6,821	16,163
	Xi' an Microelectronics Technology Research Institute	5,524	7,718
	Shenzhen Zhongxing Xinyu FPC Company, Limited	16,217	41,623
	Chung Hing (Hong Kong) Development Limited	217	8,166
	ZTE IC Design Co., Ltd.	66,144	36,380
	WuXi KaiEr Science and Technology Company, Limited	19,342	11,957
	Shenzhen Decang Technology Company, Limited	12,974	5,874
	深圳市新舟成套設備有限公司	14,604	—
	深圳市聚飛光電有限公司	6,625	—
	深圳思碼特電子有限公司	774	—

NOTES TO FINANCIAL STATEMENTS

(Prepared under PRC GAAP)
(All amounts in RMB'000 unless otherwise stated)
(English translation for reference only)

VII RELATIONSHIP WITH CONNECTED PARTIES AND CONNECTED TRANSACTIONS (continued)

5. Major transactions between the Group and related companies during the year were as follow: (continued)

(3) Other major related transaction:

Item	2006	2005
Conversion of equities	—	1,024

Notes:

(1) Sales of goods to connected parties: Goods were sold to connected parties by the Group at market price during the year.

(2) Purchase of materials from connected parties: Raw materials, parts and ancillary materials were purchased by the Group from connected parties at market price during the year.

6. Amounts due from/to connected parties

Items	Name of connected parties	Closing balance	Opening balance
Trade payables	Shenzhen Smart Electronics Company, Limited.	73	—
	深圳市中興新舟成套設備有限公司	9,833	—
	Shenzhen Zhongxingxin Telecommunication Equipment Company, Limited	147,860	104,563
	Shenzhen Zhongxin WXT Equipment Company, Ltd.	34,365	65,870
	Shenzhen Zhongxing Information Technology Co., Ltd.	2,133	14,910
	Shenzhen Zhonxing Xinyu FPC Company, Limited	2,241	6,005
	Shenzhen Zhongxing Xindi Telecommunications Equipment Company, Limited	21,879	27,490
	Shenzhen Gaodonghua Communication Technology Co., Ltd.	792	1,408
	Beijing Zhongxingxin Communication Equipment Company Limited	301	182
	Xi'an Microelectronics Technology Research Institute	—	2,616
	Chung Hing (Hong Kong) Development Limited	66	954
	ZTE IC Design Co., Ltd	9,348	11,067
	Shenzhen Decang Technology Company Limited	1,487	3,156
	WuXi KaiEr Science and Technology Company, Limited	6,768	—
Other payables	Shenzhen Zhongxingxin Telecommunications Equipment Company, Limited	361	313
	Lishan Microelectronics Research Institute	65	—
	Shenzhen Zhongxing WXT Equipment Company, Ltd.	12	—
	Beijing Zhongxingxin Communication Equipment Company Limited	—	1,024
	Shenzhen Zhongxing Xindi Telecommunications Equipment Company, Limited	—	132
	吉林省郵電器材總公司	65	—
	Shenzhen Zhongxing Information Technology Co., Ltd.	48	—
	Shenzhen Smart Electronic Company, Ltd.	300	—
	湖南南天集團有限公司	130	—

NOTES TO FINANCIAL STATEMENTS

(Prepared under PRC GAAP)
(All amounts in RMB'000 unless otherwise stated)
(English translation for reference only)

VII RELATIONSHIP WITH CONNECTED PARTIES AND CONNECTED TRANSACTIONS (continued)

6. Amounts due from/to connected parties (continued)

Items	Name of connected parties	Closing balance	Opening balance
Notes payable	Shenzhen Zhongxing Xindi Telecommunications Equipment Company, Limited	58	—
	Shenzhen Zhongxing WXT Equipment Company, Ltd.	—	3,040
	Shenzhen Zhongxing Xinyu FPC Company, Limited	—	3,173
	Shenzhen Zhongxing Information Technology Co., Ltd.	—	401
	ZTE IC Design Co., Ltd	1,660	775
	Shenzhen Decang Technology Company Limited	2,772	559
Accounts prepaid	ZTE IC Design Co., Ltd	182	—
	中太數據通信(深圳)有限公司	75	—
	Shenzhen Zhongxing Information Technology Co., Ltd.	3,608	3,464
Other receivables	Beijing Zhongxing Information Technology Co., Ltd.	—	1,038
Trade receivables	Shenzhen Zhongxingxin Telecommunications Equipment Company, Limited	2,074	177
	Shenzhen Zhongxing WXT Equipment Company, Ltd.	—	9,053
	Shenzhen Zhongxing Information Technology Co., Ltd.	146	3,062
	Beijing Zhongxingxin Communication Equipment Company Limited	1,560	2,070
	Xi'an Microelectronics Technology Research Institute	9	—
	Shenzhen Zhongxing Development Co., Ltd.	32	—
	ZTE IC Design Co., LTD	2,459	2,150
	中興軟件技術(南昌)有限公司	7,314	—
	Shenzhen Zhongxing Xindi Telecommunications Equipment Company, Limited	362	—
	深圳市中興新舟成套設備有限公司	129	—
	Shenzhen Decang Technology Company, Limited	410	—
Advances from customers	Xi'an Microelectronics Technology Research Institute	—	154
	Beijing Zhonxing Yuanjing Technology Co., Ltd.	—	765
	Shenzhen Weigao Semiconductor Company, Limited	4,644	—
Dividend receivables	Shenzhen Zhongxing Xinyu FPC Company, Limited	1,136	—
Dividends payable	Shenzhen Zhongdxing WXT Equipment Company, Ltd.	—	14,837
	Lishan Microelectronics Research Institute	—	936
	Shenzhen Zhongxingxin Telecommunications Equipment Company, Limited	—	2,250
	Shenzhen Zhongxing Xindi Telecommunications Equipment Company, Limited	—	2,299
Notes receivable	Shenzhen Zhongxing Information Technology Co., Ltd.	—	700
	Shenzhen Zhongxing Xindi Telecommunications Equipment Company, Limited	—	499

Amounts due from/to connected parties were interest-free, unsecured and had no fixed terms of repayment.

NOTES TO FINANCIAL STATEMENTS

(Prepared under PRC GAAP)
(All amounts in RMB'000 unless otherwise stated)
(English translation for reference only)

VIII. CONTINGENT EVENTS

1. In November 2005, a Higher People's Court (''the Court'') action was commenced by a customer against a subsidiary of the Group and the Company in respect of a claim for return of advance payment, accrued interests and compensation for losses of approximately RMB71 million in aggregate. As at the date of approval of these financial statements, no decision had been made in the court proceedings. Meanwhile, RMB31 million of the Group's cash had been frozen and RMB117.2 million worth of properties had been pledged as a means by which the Court guarantee the interests of the plaintiff's. In the opinion of the directors, based on legal advice from the Company's lawyer engaged in this action, the subsidiary of the Group and the Company had valid defences against such claims and any resulting liabilities would not have any material adverse impact on the Group's financial position. Therefore, no provision in respect of such claims was made in the financial statements.

2. On 16 December 2005, an arbitration was commenced by a foreign supplier against the Company in respect of claims for breach of contract and infringement of intellectual property rights in the amount of approximately USD36,450,000 (equivalent to approximately RMB294.2 million) in aggregate.

   As at the approval date of these financial statements, no arbitral award or other decision by the tribunal had been made on the claims. In the opinion of the directors, based on legal advice from the Company's lawyer engaged in the action, the Company had valid defences against the claims brought in the arbitration. The directors currently believed that the outcome of the arbitration would not have a material adverse impact on the Group's financial position. Therefore, no provision in respect of such claims was made in the financial statements.

3. On 18 August 2005, the Company received a notice of arbitration from a foreign consultant in respect of a claim for consultancy fee, agency fee and compensation fee for undue delay in honouring payment which totalled approximately USD1,714,000 (equivalent to approximately RMB13,384,000). Subsequently, the foreign consultant raised their claim to approximately USD2,143,000 (equivalent to approximately RMB16,734,000).

   As at the approval date of these financial statements, no decision had been made in the arbitration. In the opinion of the directors, based on legal advice from the Company's lawyer engaged for this action, the Company had valid defences against such claims and any resulting liabilities would not have material adverse impact on the Group's financial position. Therefore, no provision in respect of such claims was made in the financial statements.

4. During the year, ZTE Pakistan private Limited, the subsidiary of the Group in Pakistan had commenced a defence action against the Collectorate of Customs, Sales Tax and Central Excise (Adjudication/Appeals), Rawalpindi in respect of a claim by the latter for additional custom duties of approximately Rs.177 million (equivalent to approximately RMB23.9 million), which was subsequently raised to approximately Rs.240 million (equivalent to approximately RMB31.2 million) and a penalty of approximately Rs.2.4 billion (equivalent to approximately RMB324 million) for an alleged misdeclaration of imported goods in the Customs, Central Excise and Sales Tax Appellate Tribunal, Islamabad, Pakistan. The Central Board of Revenue referred all disputes between the parties to the Alternate Dispute Resolution Committee (''the Committee'') for resolution and on 5 September 2005, the Committee had recommended in favour of the subsidiary of the Group.

   As at the approval date of these financial statements, no decision had been made in the Tribunal. The directors estimated that the maximum financial impact to the Group relating to additional custom duties would be in the order of approximately Rs.36 million (equivalent to approximately RMB4.8 million) and had made an accrual of RMB4 million accordingly in the Group's financial statements for the year ended 31 December 2006. In the opinion of the directors, based on legal advice from the Company's lawyer engaged for this action, the subsidiary of the Group had valid defences, against the aforesaid claims and any resulting liabilities would not have material adverse impact on the Group's financial position. Therefore, no further provision in respect of custom duties penalty was considered necessary to be made in the financial statements.

NOTES TO FINANCIAL STATEMENTS

(Prepared under PRC GAAP)
(All amounts in RMB'000 unless otherwise stated)
(English translation for reference only)

VIII. CONTINGENT EVENTS (continued)

5. In August 2006, a foreign customer requested an arbitration for a claim against the Company, for Rs.762,982,000 (equivalent to approximately RMB97,980,000), in respect of the failure by the Company to honour a contract. As at the approval date of these financial statements, the arbitration body had not made any decision regarding the case; while in return, the Company launched a claim against the foreign customer for failure in honouring the contract. As at the approval date of these financial statements, no decision had been made in the arbitration and neither did the Company pay any compensation regarding the arbitration. Based on the legal advice from the Company's lawyer engaged for this action, the directors reckoned the case would not have any material and adverse impact on the Group's financial position.

6. As at 31 December 2006, the Group had outstanding bank guarantees amounting to RMB5,200,588,000.

IX. COMMITMENTS

	2006	2005
Capital commitments		
Contracted but not provided for	**795,991**	231,561
Lease commitments	**201,371**	183,425
Investment commitments	**80,331**	21,065
	1,077,693	436,051

X. POST BALANCE SHEET EVENT

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

XII. APPROVAL OF FINANCIAL STATEMENTS

The financial statements were resolved and approved by the Board of Directors of the Company on 18 April 2007.

APPENDIX I

(All amounts in RMB'000 unless otherwise stated)
(English translation for reference only)

1. RECONCILIATION OF DIFFERENCES BETWEEN FINANCIAL STATEMENTS PREPARED UNDER PRC AND HONG KONG FINANCIAL REPORTING STANDARDS

Major differences between the financial statements prepared under PRC Accounting Rules and Regulations ('PRC GAAP') and the financial statements prepared under the Hong Kong Financial Reporting Standards are as follow:

	2006		2005	
	Net profit	**Net asset**	Net profit	Net asset
Under PRC GAAP	**807,353**	**10,678,911**	1,194,343	10,125,095
Differences in accounting standards				
Technology grants and research expenses under different accounting standards	**(50,234)**	**126,946**	106,740	177,182
Provision for retirement benefits under accounting standards generally accepted in Hong Kong	**(1,599)**	**(32,058)**	(1,536)	(30,459)
Recognition of excess over the cost of business combination	**—**	**—**	9,460	—
Deferred tax debit	**(1,454)**	**(22,760)**	(21,306)	(21,306)
Adjustments to previous financial statements as a result of changes in accounting estimates	**16,595**	**16,595**	—	—
Financial guarantee contract expenses	**(3,689)**	**(3,689)**	—	—
Prepared under Hong Kong financial reporting standards	**766,972**	**10,763,945**	1,287,701	10,250,512

2. FULLY DILUTED AND WEIGHTED AVERAGE NET RETURN ON ASSETS AND EARNINGS PER SHARE

		Return on net assets		**Earnings per share**	
	Profit for the reporting period	**Fully diluted**	**Weighted average**	**Fully diluted**	**Weighted average**
Profit from principal operations	7,748,527	72.56%	74.44%	8.08	8.08
Operating profit	427,748	4.01%	4.11%	0.45	0.45
Net profit	807,353	7.56%	7.76%	0.84	0.84
Net profit after extraordinary items	753,809	7.06%	7.24%	0.79	0.79

APPENDIX I

(All amounts in RMB'000 unless otherwise stated)
(English translation for reference only)

2. FULLY DILUTED AND WEIGHTED AVERAGE NET RETURN ON ASSETS AND EARNINGS PER SHARE (continued)

Net profit after extraordinary items is listed below:

		2006
Net profit		**807,353**
Add (less):	Subsidy income	**(65,136)**
	Non-operating income	**(24,008)**
	Non-operating expenses	**26,151**
	Income tax effect on extraordinary items	**9,449**
Net profit after extraordinary items		**753,809**

The Company recognised extraordinary items in accordance with the Rule No.1 of Questions and Answers for Information Disclosure and Report Compilation by Companies with Public Listed Securities under Kuai Ji Zi [2004] No.4 promulgated by the China Securities Regulatory Commission.

3. BREAKDOWN OF PROVISIONS FOR ASSET IMPAIRMENT

		Opening balance	Addition during the year	Reduction during the year	Closing balance
I.	Provision of bad debt	1,173,211	697,744	(423,354)	1,447,601
	Including: Trade receivables	445,246	284,493	(172,882)	556,857
	Other receivables	727,965	413,251	(250,472)	890,744
II.	Provision for impairment of inventories	515,958	115,058	(182,354)	448,662
	Including: Raw materials	86,161	65,124	(20,114)	131,171
	Materials under sub-contract processing	1,599	—	(1,599)	—
	Work in progress	5,779	4,147	(1,349)	8,577
	Finished goods	422,419	45,787	(159,292)	308,914
III.	Provision for impairment of long-term investments	13,036	—	—	13,036
	Including: Long-term equity investment	13,036	—	—	13,036
	Long-term bond investment	—	—	—	—
IV.	Provision for impairment of fixed assets	94,980	—	(7,978)	87,002
	Including: Buildings	7,708	—	—	7,708
	Machinery	1,475	—	—	1,475
	Electronic equipment	85,797	—	(7,978)	77,819
V.	Provision for impairment of intangible assets	26,956	—	—	26,956
	Including: Land use rights	6,322	—	—	6,322
	Software	12,884	—	—	12,884
	Operating concession	7,750	—	—	7,750

APPENDIX II

Statement of reconciliation of differences between shareholders' equity prepared in accordance with the current and the new PRC Accounting Standards and the auditors' review report (All amounts in RMB'000 unless otherwise stated)
(English translation for reference only)

ZTE Corporation

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

Ernst & Young Hua Ming (2007) Zhuan Zi No. 60438556-H01

To ZTE Corporation:

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

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

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

Ernst & Young Hua Ming

Xie Feng
Chinese certified public Accountant

Beijing, the People's Republic of China

Li Di
Chinese Certified Public Accountant

18 April 2007

APPENDIX II

Statement of reconciliation of differences between shareholders' equity prepared in accordance with the current and the new PRC Accounting Standards and the auditors' review report (All amounts in RMB'000 unless otherwise stated)
(English translation for reference only)

Important information:

On 1 January 2007 the Company adopted the "Accounting Standards for Business Enterprises" issued by the Ministry of Finance (the "MOF") in 2006 (the "New Accounting Standards"). Currently the Company is assessing the impact of adoption of the New Accounting Standards on its financial position, operating results and cash flow. After taking into consideration any further explanation provided by the MOF, the Company may adjust the relevant accounting policies or material assertions when it prepares the 2007 financial statements and the statement of reconciliation of differences between shareholders' equity prepared in accordance with the current and the new PRC Accounting Standards (the "Reconciliation Statement"). This may cause a difference in shareholders' equity between the reported amount in this Reconciliation Statement at 1 January 2007 and the one to be reported in the 2007 financial statements.

Statement of reconciliation of differences between shareholders' equity prepared in accordance with the current and the new PRC Accounting Standards and the auditors' review report (All amounts in RMB'000 unless otherwise stated)

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

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

The accompanying notes to the Reconciliation Statement form part of this Statement.

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

APPENDIX II

Statement of reconciliation of differences between shareholders' equity prepared in accordance with the current and the new PRC Accounting Standards and the auditors' review report (All amounts in RMB'000 unless otherwise stated)
(English translation for reference only)

Notes for the statement of reconciliation of differences between shareholders' equity prepared in accordance with the current and the new PRC Accounting Standards

1. Purpose of preparation

The Company will adopt the New Accounting Standards from 1 January 2007. For analysis and disclosure of the impact of adoption of the New Accounting Standards on the financial position of listed companies, the China Securities Regulatory Commission ("CSRC") issued in November 2006 a "Pronouncement on proper disclosure of financial information in accordance with the New Accounting Standards" ("CSRC" (2006) No.136, the "Pronouncement"). The Pronouncement requires listed companies to disclose material reconciliation in the form of reconciliation statement in their 2006 financial statements as "supplementary information" in accordance with the "Accounting Standards for Business Enterprises No. 38 — First time adoption of Accounting Standards for Business Enterprises" and the relevant regulations in the Pronouncement.

2. Basis of preparation

In accordance with the "Accounting Standards for Business Enterprises No.38 — First time adoption of Accounting Standards for Business Enterprises" paragraph 5 to 19, the relevant regulations in the Pronouncement and "the Expert Group Opinions about the implementation issue of the Accounting Standards for Business Enterprises" issued by the MOF on 1 February 2007 (the "Expert Group Opinion"), the Reconciliation Statement is prepared based on the 2006 consolidated financial statements by applying the materiality principle and taking into consideration the Company's/Group's characteristics and conditions. The Company has prepared the statement of reconciliation of differences between shareholders' equity prepared in accordance with the current and the new PRC Accounting Standards (the "Reconciliation Statement") in accordance with the above mentioned requirements.

In addition, the Reconciliation Statement is prepared according to the following principles:

(1) For subsidiaries, associates and jointly controlled entities, adjustments are made in accordance with paragraphs 5 to 19 of the "Accounting Standards for Business Enterprises No.38 — First time adoption of Accounting Standards for Business Enterprises". For those events which affect the Company's retained profits and its share of net assets, the Company would adjust the retained profits or capital reserve accordingly.

(2) Where consolidation is required, the Company adjusts the minority interests in accordance with the New Accounting Standards and reflects them as a separate component in the Reconciliation Statement.

(3) The provision for retirement benefits was recognised in accordance with the "Accounting Standards for Business Enterprises No. 9 — Employee compensation".

Notes for the statement of reconciliation of differences between shareholders' equity prepared in accordance with the current and the new PRC Accounting Standards (continued)

3. Notes for Key Items

(1) The amount of the consolidated shareholders' equity extracted from the consolidated balance sheet as at 31 December 2006 which is prepared in accordance with the current Accounting Standards for Business Enterprises, the Accounting System for Financial Institutions and other relevant regulations applicable to the Company and the Group (the "Current Accounting Standards"). The financial statements have been audited by Ernst & Young Hua Ming with an unqualified audit opinion issued on 17 April 2007 (Ernst & Young Hua Ming (2007) Zhuan Zi No.60438556-H01). Please refer to the Company's financial statements for 2006 for the relevant basis of preparation and significant accounting policies.

(2) The cost of provision for retirements benefit is recognised on an actuarial basis, which is expensed when the employees are on the post. The adjustment brings about a decrease of the shareholders' equity, approximating RMB32,058,000.

(3) The amount of financial assets at fair value through profit or loss represents the fair value gains on an equity investment by the subsidiaries of the Group, which brings about an increase of the shareholders' equity, amounting to RMB16,595,000.

(4) The amount of other financial liabilities represents the recognition of a financial guarantee contract measured at fair value, which brings about a decrease of the shareholders' equity, amounting to RMB3,689,000.

(5) The amount of recognition of government grants is the grants obtained by the Group from the government for specific research and development projects through profit and loss for the current period. The adjustment brings about a decrease of shareholders' equity, approximating RMB2,803,000.

(6) Minority interests of RMB561,892,000 are separately presented in the consolidated balance sheet from liabilities and equity under the Current Accounting Standards. Under the New Accounting Standards it is disclosed separately as a component under equity.

APPENDIX III

Statement of Changes in Shareholders' Equity
(Prepared under PRC GAAP)
(All amounts in RMB'000 unless otherwise stated)
(English translation for reference only)

		2006	2005
I.	Share capital		
	Opening balance	**959,522**	959,522
	Addition during the year	**—**	—
	Including: Transfer from capital reserve	**—**	—
	Transfer from surplus reserve	**—**	—
	Transfer from profit allocation	**—**	—
	Share capital as enlarged by issue of new shares	**—**	—
	Bonus share issue	**—**	—
	Reduction during the year	**—**	—
	Closing balance	**959,522**	959,522
II.	Capital reserve		
	Opening balance	**5,506,424**	5,491,658
	Addition during the year	**3,242**	14,766
	Including: Share capital premium	**—**	—
	Appreciation from asset valuation	**—**	—
	Receipt of non-cash assets as donation	**—**	—
	Exchange difference in respect of capital denominated in foreign currency	**—**	—
	Provision for equity investment	**—**	9,459
	Equity settled share expense	**2,480**	—
	Others	**762**	5,307
	Reduction during the year	**—**	—
	Including: transfer to share capital	**—**	—
	Closing balance	**5,509,666**	5,506,424
III.	Statutory and discretionary surplus reserves		
	Opening balance	**1,264,060**	733,350
	Addition during the year	**66,999**	530,710
	Including: Appropriations from net profit	**66,999**	185,802
	Transfer from statutory public welfare fund	**—**	344,908
	Reduction during the year	**—**	—
	Including: making up of losses	**—**	—
	Transfer to share capital	**—**	—
	Distribution of cash dividend	**—**	—
	Distribution of scrip dividend	**—**	—
	Closing balance	**1,331,059**	1,264,060
	Including: Statutory surplus reserve	**986,151**	919,152
IV.	Undistributed profits		
	Undistributed profit at the beginning of the year	**2,171,190**	1,495,431
	Net profit for the year	**807,353**	1,194,343
	Profit distribution for the year	**(210,927)**	(518,584)
	Undistributed profits at the end of the year	**2,767,616**	2,171,190

INDEPENDENT AUDITORS' REPORT

ERNST & YOUNG
安永會計師事務所

To the shareholders of ZTE Corporation
(Incorporated in the People's Republic of China with limited liability)

We have audited the financial statements of ZTE Corporation set out on pages 174 to 247, which comprise the consolidated and company balance sheets as at 31 December 2006, and the consolidated income statement, the consolidated statement of changes in equity and the consolidated cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory notes.

Directors' responsibility for the financial statements

The directors of the Company are responsible for the preparation and the true and fair presentation of these financial statements in accordance with Hong Kong Financial Reporting Standards issued by the Hong Kong Institute of Certified Public Accountants and the disclosure requirements of the Hong Kong Companies Ordinance. This responsibility includes designing, implementing and maintaining internal control relevant to the preparation and the true and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

Auditors' responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. Our report is made solely to you, as a body, and for no other purpose. We do not assume responsibility towards or accept liability to any other person for the contents of this report.

We conducted our audit in accordance with Hong Kong Standards on Auditing issued by the Hong Kong Institute of Certified Public Accountants. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance as to whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditors' judgement, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditors consider internal control relevant to the entity's preparation and true and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by the directors, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements give a true and fair view of the state of affairs of the Company and of the Group as at 31 December 2006 and of the Group's profit and cash flows for the year then ended in accordance with Hong Kong Financial Reporting Standards and have been properly prepared in accordance with the disclosure requirements of the Hong Kong Companies Ordinance.

Certified Public Accountants
Hong Kong
18 April 2007

CONSOLIDATED INCOME STATEMENT

(Prepared under Hong Kong financial reporting standards)
Year ended 31 December 2006

	Notes	2006 RMB'000	2005 RMB'000
REVENUE	5	**23,031,684**	21,575,920
Cost of sales		**(15,250,453)**	(14,101,720)
Gross profit		**7,781,231**	7,474,200
Other income and gains	5	**792,124**	681,646
Research and development costs		**(2,832,685)**	(1,959,543)
Selling and distribution costs		**(3,274,699)**	(3,186,442)
Administrative expenses		**(1,097,615)**	(1,095,400)
Other expenses		**(191,495)**	(128,605)
Finance costs	7	**(153,694)**	(175,884)
Share of profits and losses of:			
Jointly-controlled entities		**(652)**	(1,198)
Associates		**8,175**	(2,969)
PROFIT BEFORE TAX	6	**1,030,690**	1,605,805
Tax	10	**(127,078)**	(179,851)
PROFIT FOR THE YEAR		**903,612**	1,425,954
Attributable to:			
Equity holders of the parent	11	**766,972**	1,287,701
Minority interests		**136,640**	138,253
		903,612	1,425,954
DIVIDEND			
Proposed final	12	**143,928**	239,880
EARNINGS PER SHARE ATTRIBUTABLE TO ORDINARY EQUITY HOLDERS OF THE PARENT	13		
Basic		**RMB0.80**	RMB1.34
Diluted		**RMB0.80**	N/A

CONSOLIDATED BALANCE SHEET

(Prepared under Hong Kong financial reporting standards)
31 December 2006

	Notes	2006 RMB'000	2005 RMB'000
NON-CURRENT ASSETS			
Property, plant and equipment	15	**3,053,019**	2,470,965
Prepaid land premiums/land lease payments	16	**55,146**	55,062
Intangible assets	17	**274,905**	335,835
Investments in jointly-controlled entities	19	**5,936**	6,588
Investments in associates	20	**51,257**	35,583
Available-for-sale investments	21	**43,488**	43,288
Long-term trade receivables	24	**372,703**	307,666
Factored long-term trade receivables	25	**1,399,206**	687,765
Deferred tax assets	36	**210,923**	59,587
Total non-current assets		**5,466,583**	4,002,339
CURRENT ASSETS			
Prepaid land premiums/land lease payments	16	**1,449**	1,418
Inventories	22	**2,481,155**	2,240,327
Amount due from customers for contract work	23	**5,833,480**	4,689,157
Trade and bills receivables	24	**6,988,034**	4,686,775
Factored trade receivables	25	**152,848**	36,416
Prepayments, deposits and other receivables	26	**1,497,323**	1,188,313
Loan receivables	27	**22,026**	46,165
Equity investments at fair value through profit or loss	28	**33,288**	—
Pledged bank deposits	29	**168,997**	175,899
Cash and cash equivalents	29	**4,142,063**	5,397,233
Total current assets		**21,320,663**	18,461,703
CURRENT LIABILITIES			
Trade and bills payables	30	**6,991,665**	6,269,792
Amount due to customers for contract work	23	**996,275**	733,455
Other payables and accruals	31	**2,732,572**	2,900,137
Interest-bearing bank borrowings	32	**945,726**	599,695
Bank advances on factored trade receivables	25	**152,848**	36,416
Tax payable		**297,913**	114,672
Dividend payables		**83,941**	163,008
Total current liabilities		**12,200,940**	10,817,175
NET CURRENT ASSETS		**9,119,723**	7,644,528
TOTAL ASSETS LESS CURRENT LIABILITIES		**14,586,306**	11,646,867

continued/...

CONSOLIDATED BALANCE SHEET

(Prepared under Hong Kong financial reporting standards)
31 December 2006

	Notes	2006 RMB'000	2005 RMB'000
TOTAL ASSETS LESS CURRENT LIABILITIES		**14,586,306**	11,646,867
NON-CURRENT LIABILITIES			
Interest-bearing bank borrowings	32	**1,679,242**	80,000
Bank advances on factored long-term trade receivables	25	**1,399,206**	687,765
Financial guarantee contract	42(g)	**3,689**	—
Provision for retirement benefits	33	**32,058**	30,459
Other long-term payables	34	**146,274**	127,402
Total non-current liabilities		**3,260,469**	925,626
Net assets		**11,325,837**	10,721,241
EQUITY			
Equity attributable to equity holders of the parent			
Issued capital	37	**959,522**	959,522
Reserves	39(a)	**9,660,495**	9,051,110
Proposed final dividend	12	**143,928**	239,880
		10,763,945	10,250,512
Minority interests		**561,892**	470,729
Total equity		**11,325,837**	10,721,241

Hou Weigui
Director

Yin Yimin
Director

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

(Prepared under Hong Kong financial reporting standards)
Year ended 31 December 2006

	Note	Attributable to equity holders of the parent								
		Issued capital	Capital reserve	Statutory reserves	Exchange fluctuation reserve	Retained profits	Proposed final dividend	Total	Minority interests	Total equity
	Note	RMB'000	RMB'000	RMB'000	RMB'000	RMB'000	RMB'000	RMB'000	RMB'000	RMB'000
At 1 January 2005		959,522	5,462,515	985,356	3,786	1,566,093	239,880	9,217,152	478,380	9,695,532
Exchange realignments and other income recognised directly in equity		—	5,306	—	(19,767)	—	—	(14,461)	(3,111)	(17,572)
Total income and expense for the year recognised directly in equity		—	5,306	—	(19,767)	—	—	(14,461)	(3,111)	(17,572)
Profit for the year		—	—	—	—	1,287,701	—	1,287,701	138,253	1,425,954
Total income and expense for the year		—	5,306	—	(19,767)	1,287,701	—	1,273,240	135,142	1,408,382
Final 2004 dividend declared		—	—	—	—	—	(239,880)	(239,880)	—	(239,880)
Acquisition of subsidiaries		—	—	—	—	—	—	—	19,115	19,115
Disposal of subsidiaries		—	—	—	—	—	—	—	(11,555)	(11,555)
Acquisition of minority interests		—	—	—	—	—	—	—	(9,704)	(9,704)
Dividends declared to and paid to minority shareholders		—	—	—	—	—	—	—	(165,876)	(165,876)
Capital contributions by minority shareholders		—	—	—	—	—	—	—	25,227	25,227
Transfer from retained profits		—	38,603	278,704	—	(317,307)	—	—	—	—
Proposed final 2005 dividend	12	—	—	—	—	(239,880)	239,880	—	—	—
At 31 December 2005		959,522	5,506,424	1,264,060	(15,981)	2,296,607	239,880	10,250,512	470,729	10,721,241

continued/...

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

(Prepared under Hong Kong financial reporting standards)
Year ended 31 December 2006

		Attributable to equity holders of the parent									
	Notes	Issued capital RMB'000	Capital reserve RMB'000	Share incentive scheme reserve RMB'000	Statutory reserves RMB'000	Exchange fluctuation reserve RMB'000	Retained profits RMB'000	Proposed final dividend RMB'000	Total RMB'000	Minority interests RMB'000	Total equity RMB'000
At 1 January 2006		959,522	5,506,424	—	1,264,060	(15,981)	2,296,607	239,880	10,250,512	470,729	10,721,241
Exchange realignments and other income recognised directly in equity		—	760	—	—	(16,899)	—	—	(16,139)	(7,429)	(23,568)
Total income and expense for the year recognised directly in equity		—	760	—	—	(16,899)	—	—	(16,139)	(7,429)	(23,568)
Profit for the year		—	—	—	—	—	766,972	—	766,972	136,640	903,612
Total income and expense for the year		—	760	—	—	(16,899)	766,972	—	750,833	129,211	880,044
Final 2005 dividend declared		—	—	—	—	—	—	(239,880)	(239,880)	—	(239,880)
Disposal of subsidiaries		—	—	—	—	—	—	—	—	(100)	(100)
Acquisition of minority interests		—	—	—	—	—	—	—	—	(31,069)	(31,069)
Dividends declared to minority shareholders		—	—	—	—	—	—	—	—	(37,245)	(37,245)
Capital contributions by minority shareholders		—	—	—	—	—	—	—	—	30,366	30,366
Transfer from retained profits		—	—	—	66,999	—	(66,999)	—	—	—	—
Proposed final 2006 dividend	12	—	—	—	—	—	(143,928)	143,928	—	—	—
Equity settled share expense	38	—	—	2,480	—	—	—	—	2,480	—	2,480
At 31 December 2006		959,522	5,507,184*	2,480*	1,331,059*	(32,880)*	2,852,652*	143,928	10,763,945	561,892	11,325,837

* These reserve accounts comprise the consolidated reserves of approximately RMB9,660,495,000 (2005: RMB9,051,110,000) in the consolidated balance sheet.

CONSOLIDATED CASH FLOW STATEMENT

(Prepared under Hong Kong financial reporting standards)
Year ended 31 December 2006

	Notes	2006 RMB'000	2005 RMB'000
CASH FLOWS FROM OPERATING ACTIVITIES			
Profit before tax		**1,030,690**	1,605,805
Adjustments for:			
Finance costs	7	**153,694**	175,884
Share of profits and losses of jointly-controlled entities		**652**	1,198
Share of profits and losses of associates		**(8,175)**	2,969
Bank and other interest income	5	**(49,050)**	(54,870)
Government grants	5	**(22,544)**	(139,491)
Depreciation	6	**510,333**	386,859
Recognition of prepaid land lease payments	16	**1,418**	1,317
Write-down of inventories to net realisable value	6	**52,781**	96,185
Impairment of trade receivables	6	**111,611**	15,642
Impairment of goodwill	6	**—**	56,267
Amortisation of intangible assets	6	**101,558**	82,735
Loss on disposal of items of property, plant and equipment	6	**13,933**	6,163
Loss on disposal of intangible assets	6	**952**	70
Loss on disposal of interests in subsidiaries	6	**—**	2,057
Gain on deemed disposal of interests in a subsidiary	5	**—**	(3,655)
Gain on disposal of an equity investment at fair value through profit or loss	5	**(24,326)**	—
Fair value gain on an equity investment at fair value through profit or loss	5	**(16,595)**	—
Recognition of financial guarantee contracts	6	**3,689**	—
Excess over the cost of business combinations	5	**—**	(12,236)
Equity settled share expense	6	**2,480**	—
		1,863,101	2,222,899
Increase in long-term trade receivables		**(65,037)**	(307,578)
Increase in inventories		**(293,609)**	(733,796)
Increase in amount due from customers for contract work		**(1,144,323)**	(1,937,133)
Decrease/(increase) in trade and bills receivables		**(2,412,870)**	1,217,673
Increase in prepayments, deposits and other receivables		**(309,464)**	(526,433)
Decrease/(increase) in loan receivables		**24,139**	(46,165)
Increase in trade and bills payables		**721,873**	1,943,636
Increase/(decrease) in amount due to customers for contract work		**262,820**	(1,585,276)
Increase/(decrease) in other payables and accruals		**(194,162)**	121,791
Increase in factored trade receivables		**(116,432)**	(36,416)
Increase in factored long-term trade receivables		**(711,441)**	(687,765)
Bank advances on factored trade receivables		**827,873**	724,181
Cash generated from/(used in) operations		**(1,547,532)**	369,618
Interest received		**49,050**	54,870
Interest and other finance costs paid		**(153,694)**	(175,884)
Hong Kong profits tax paid		**(2,929)**	(6,588)
PRC taxes paid		**(82,400)**	(217,663)
Overseas taxes paid		**(12,591)**	(26,553)
Dividends paid		**(239,880)**	(239,880)
Dividends paid to minority shareholders		**(116,312)**	(43,789)
Net cash outflow from operating activities		**(2,106,288)**	(285,869)

continued/...

CONSOLIDATED CASH FLOW STATEMENT

(Prepared under Hong Kong financial reporting standards)
Year ended 31 December 2006

	Notes	2006 RMB'000	2005 RMB'000
CASH FLOWS FROM INVESTING ACTIVITIES			
Purchase of leasehold land		**(1,533)**	(3,341)
Purchases of items of property, plant and equipment		**(1,135,742)**	(803,781)
Proceeds from disposal of items of property, plant and equipment		**20,851**	3,727
Additions to intangible assets		**(43,887)**	(206,768)
Receipt of government grants		**41,416**	133,999
Purchases of available-for-sale investments		**—**	(1,999)
Acquisition of an equity investment at fair value through profit or loss		**(39,459)**	—
Proceeds from disposal of an equity investment at fair value through profit or loss		**46,031**	—
Acquisition of associates		**(7,134)**	(16,307)
Acquisition of subsidiaries		**—**	(51,449)
Acquisition of minority interests		**(2,401)**	(3,200)
Disposal of subsidiaries	40	**(289)**	(31,224)
Decrease/(increase) in pledged bank deposits		**6,902**	(86,921)
Net cash outflow from investing activities		**(1,115,245)**	(1,067,264)
CASH FLOWS FROM FINANCING ACTIVITIES			
Capital contributions by minority shareholders		**30,366**	25,227
New bank loans		**3,093,148**	108,695
Repayment of bank loans		**(1,147,875)**	(868,967)
Net cash inflow/(outflow) from financing activities		**1,975,639**	(735,045)
NET DECREASE IN CASH AND CASH EQUIVALENTS		**(1,245,894)**	(2,088,178)
Cash and cash equivalents at beginning of year		**5,397,233**	7,509,245
Effect of foreign exchange rate changes, net		**(9,276)**	(23,834)
CASH AND CASH EQUIVALENTS AT END OF YEAR		**4,142,063**	5,397,233
ANALYSIS OF BALANCES OF CASH AND CASH EQUIVALENTS			
Cash and bank balances	29	**3,168,658**	4,178,498
Non-pledged time deposits with original maturity of less than three months when acquired		**973,405**	1,218,735
		4,142,063	5,397,233

BALANCE SHEET

(Prepared under Hong Kong financial reporting standards)
31 December 2006

	Notes	2006 RMB'000	2005 RMB'000
NON-CURRENT ASSETS			
Property, plant and equipment	15	**1,965,507**	1,718,547
Prepaid land premiums/land lease payments	16	**48,106**	49,406
Intangible assets	17	**207,692**	268,427
Investments in subsidiaries	18	**442,314**	408,868
Investments in jointly-controlled entities	19	**2,500**	2,500
Investments in associates	20	**27,314**	24,707
Available-for-sale investments	21	**41,488**	41,288
Long-term trade receivables	24	**328,166**	327,122
Factored long-term trade receivables	25	**1,394,970**	683,598
Deferred tax assets	36	**194,547**	55,113
Total non-current assets		**4,652,604**	3,579,576
CURRENT ASSETS			
Prepaid land premiums/land lease payments	16	**1,300**	1,300
Inventories	22	**1,179,105**	1,278,092
Amount due from customers for contract work	23	**5,809,647**	4,440,842
Trade and bills receivables	24	**7,370,341**	5,690,947
Factored trade receivables	25	**275,830**	5,007
Prepayments, deposits and other receivables	26	**2,858,750**	2,239,947
Pledged bank deposits	29	**35,201**	46,126
Cash and cash equivalents	29	**2,922,719**	4,212,810
Total current assets		**20,452,893**	17,915,071
CURRENT LIABILITIES			
Trade and bills payables	30	**8,891,921**	8,457,453
Amount due to customers for contract work	23	**991,612**	688,876
Other payables and accruals	31	**2,202,881**	2,590,981
Interest-bearing bank borrowings	32	**741,827**	500,000
Bank advances on factored trade receivables	25	**275,830**	5,007
Tax payable		**162,004**	63,974
Dividend payables		**378**	928
Total current liabilities		**13,266,453**	12,307,219
NET CURRENT ASSETS		**7,186,440**	5,607,852
TOTAL ASSETS LESS CURRENT LIABILITIES		**11,839,044**	9,187,428

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BALANCE SHEET

(Prepared under Hong Kong financial reporting standards)
31 December 2006

	Notes	2006 RMB'000	2005 RMB'000
TOTAL ASSETS LESS CURRENT LIABILITIES		**11,839,044**	9,187,428
NON-CURRENT LIABILITIES			
Interest-bearing bank borrowings	32	**1,329,478**	—
Bank advances on factored long-term trade receivables	25	**1,394,970**	683,598
Financial guarantee contract	42(g)	**3,689**	—
Provision for retirement benefits	33	**32,058**	30,459
Other long-term payables	34	**94,404**	81,111
Total non-current liabilities		**2,854,599**	795,168
Net assets		**8,984,445**	8,392,260
EQUITY			
Issued capital	37	**959,522**	959,522
Reserves	39(b)	**7,880,995**	7,192,858
Proposed final dividend	12	**143,928**	239,880
Total equity		**8,984,445**	8,392,260

Hou Weigui
Director

Yin Yimin
Director

NOTES TO FINANCIAL STATEMENTS

(Prepared under Hong Kong financial reporting standards)
31 December 2006

1. CORPORATE INFORMATION

ZTE Corporation (the "Company") is a limited liability company incorporated in the People's Republic of China (the "PRC").

The registered office of the Company is located at ZTE Plaza, Keji Road South, Hi-Tech Industrial Park, Nanshan District, Shenzhen 518057, the PRC.

During the year, the Company and its subsidiaries (the "Group") were principally involved in the design, development, manufacture and sale of telecommunications systems equipment and solutions.

In the opinion of the directors, the holding company and the ultimate holding company of the Group is Shenzhen Zhongxingxin Telecommunications Equipment Company, Limited ("Zhongxingxin"), a limited liability company registered in the PRC.

2.1 BASIS OF PREPARATION

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

Basis of consolidation

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

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

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

NOTES TO FINANCIAL STATEMENTS

(Prepared under Hong Kong financial reporting standards)
31 December 2006

2.2 IMPACT OF NEW AND REVISED HONG KONG FINANCIAL REPORTING STANDARDS

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

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

The principal changes in accounting policies are as follows:

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

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

(b) HKAS 39 *Financial Instruments: Recognition and Measurement*

(i) Amendment for financial guarantee contracts

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

(ii) Amendment for the fair value option

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

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

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

NOTES TO FINANCIAL STATEMENTS

(Prepared under Hong Kong financial reporting standards)
31 December 2006

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

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

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

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

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

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

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

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

2.4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Subsidiaries

A subsidiary is an entity whose financial and operating policies the Company controls, directly or indirectly, so as to obtain benefits from its activities.

The results of subsidiaries are included in the Company's income statement to the extent of dividends received and receivable. The Company's investments in subsidiaries are stated at cost less any impairment losses.

NOTES TO FINANCIAL STATEMENTS
(Prepared under Hong Kong financial reporting standards)
31 December 2006

2.4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Joint ventures

A joint venture is an entity set up by contractual arrangement, whereby the Group and other parties undertake an economic activity. The joint venture company operates as a separate entity in which the Group and the other parties have an interest.

The joint venture agreement between the venturers stipulates the capital contributions of the joint venture parties, the duration of the joint venture entity and the basis on which the assets are to be realised upon its dissolution. The profits and losses from the joint venture's operations and any distributions of surplus assets are shared by the venturers, either in proportion to their respective capital contributions, or in accordance with the terms of the joint venture agreement.

A joint venture is treated as:

(a) a subsidiary, if the Group/Company has unilateral control, directly or indirectly, over the joint venture;

(b) a jointly-controlled entity, if the Group/Company does not have unilateral control, but has joint control, directly or indirectly, over the joint venture;

(c) an associate, if the Group/Company does not have unilateral or joint control, but holds, directly or indirectly, generally not less than 20% of the joint venture's registered capital and is in a position to exercise significant influence over the joint venture; or

(d) an equity investment accounted for in accordance with HKAS 39, if the Group/Company holds, directly or indirectly, less than 20% of the joint venture's registered capital and has neither joint control of, nor is in a position to exercise significant influence over, the joint venture.

Jointly-controlled entities

A jointly-controlled entity is a joint venture that is subject to joint control, resulting in none of the participating parties having unilateral control over the economic activity of the jointly-controlled entity.

The Group's share of the post-acquisition results and reserves of jointly-controlled entities is included in the consolidated income statement and consolidated reserves, respectively. The Group's investments in jointly-controlled entities are stated in the consolidated balance sheet at the Group's share of net assets under the equity method of accounting, less any impairment losses.

The results of jointly-controlled entities are included in the Company's income statement to the extent of dividends received and receivable. The Company's investments in jointly-controlled entities are treated as non-current assets and are stated at cost less any impairment losses.

Associates

An associate is an entity, not being a subsidiary or a jointly-controlled entity, in which the Group has a long-term interest of generally not less than 20% of the equity voting rights and over which it is in a position to exercise significant influence.

NOTES TO FINANCIAL STATEMENTS

(Prepared under Hong Kong financial reporting standards)
31 December 2006

2.4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Associates (continued)

The Group's share of the post-acquisition results and reserves of associates is included in the consolidated income statement and consolidated reserves, respectively. The Group's investments in associates are stated in the consolidated balance sheet at the Group's share of net assets under the equity method of accounting, less any impairment losses.

The results of associates are included in the Company's income statement to the extent of dividends received and receivable. The Company's investments in associates are treated as non-current assets and are stated at cost less any impairment losses.

Goodwill

Goodwill arising on acquisition of subsidiaries represents the excess of the cost of the business combination over the Group's interest in the net fair value of the acquirees' identifiable assets acquired, and liabilities and contingent liabilities assumed as at the date of acquisition.

Goodwill on acquisitions for which the agreement date is on or after 1 January 2005

Goodwill arising on acquisition is recognised in the consolidated balance sheet as an asset, initially measured at cost and subsequently at cost less any accumulated impairment losses.

The carrying amount of goodwill is reviewed for impairment annually or more frequently if events or changes in circumstances indicate that the carrying value may be impaired.

For the purpose of impairment testing, goodwill acquired in a business combination is, from the acquisition date, allocated to each of the Group's cash-generating units, or groups of cash-generating units, that are expected to benefit from the synergies of the combination, irrespective of whether other assets or liabilities of the Group are assigned to those units or groups of units. Each unit or group of units to which the goodwill is so allocated:

- represents the lowest level within the Group at which the goodwill is monitored for internal management purposes; and

- is not larger than a segment based on either the Group's primary or the Group's secondary reporting format determined in accordance with HKAS 14 *Segment Reporting*.

Impairment is determined by assessing the recoverable amount of the cash-generating unit (group of cash-generating units), to which the goodwill relates. Where the recoverable amount of the cash-generating unit (group of cash-generating units) is less than the carrying amount, an impairment loss is recognised.

Where goodwill forms part of a cash-generating unit (group of cash-generating units) and part of the operation within that unit is disposed of, the goodwill associated with the operation disposed of is included in the carrying amount of the operation when determining the gain or loss on disposal of the operation. Goodwill disposed of in this circumstance is measured based on the relative values of the operation disposed of and the portion of the cash-generating unit retained.

An impairment loss recognised for goodwill is not reversed in a subsequent period.

NOTES TO FINANCIAL STATEMENTS

(Prepared under Hong Kong financial reporting standards)
31 December 2006

2.4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Excess over the cost of business combinations

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

Impairment of non-financial assets other than goodwill

Where an indication of impairment exists, or when annual impairment testing for an asset is required (other than inventories, construction contract assets, deferred tax assets, financial assets and goodwill), the asset's recoverable amount is estimated. An asset's recoverable amount is calculated as the higher of the asset's or cash-generating unit's value in use and its fair value less costs to sell, and is determined for an individual asset, unless the asset does not generate cash inflows that are largely independent of those from other assets or groups of assets, in which case, the recoverable amount is determined for the cash-generating unit to which the asset belongs.

An impairment loss is recognised only if the carrying amount of an asset exceeds its recoverable amount. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. An impairment loss is charged to the income statement in the period in which it arises in those expense categories consistent with the function of the impaired asset.

An assessment is made at each reporting date as to whether there is any indication that previously recognised impairment losses may no longer exist or may have decreased. If such indication exists, the recoverable amount is estimated. A previously recognised impairment loss of an asset other than goodwill is reversed only if there has been a change in the estimates used to determine the recoverable amount of that asset, however not to an amount higher than the carrying amount that would have been determined (net of any depreciation/amortisation), had no impairment loss been recognised for the asset in prior years. A reversal of such impairment loss is credited to the income statement in the period in which it arises.

Related parties

A party is considered to be related to the Group if:

(a) the party, directly or indirectly through one or more intermediaries, (i) controls, is controlled by, or is under common control with, the Group; (ii) has an interest in the Group that gives it significant influence over the Group; or (iii) has joint control over the Group;

(b) the party is an associate;

(c) the party is a jointly-controlled entity;

(d) the party is a member of the key management personnel of the Group or its parent;

(e) the party is a close member of the family of any individual referred to in (a) or (d);

(f) the party is an entity that is controlled, jointly controlled or significantly influenced by or for which significant voting power in such entity resides with, directly or indirectly, any individual referred to in (d) or (e); or

(g) the party is a post-employment benefit plan for the benefit of the employees of the Group, or of any entity that is a related party of the Group.

NOTES TO FINANCIAL STATEMENTS

(Prepared under Hong Kong financial reporting standards)
31 December 2006

2.4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Property, plant and equipment and depreciation

Property, plant and equipment, other than construction in progress, are stated at cost less accumulated depreciation and any impairment losses. The cost of an item of property, plant and equipment comprises its purchase price and any directly attributable costs of bringing the asset to its working condition and location for its intended use. Expenditure incurred after items of property, plant and equipment have been put into operation, such as repairs and maintenance, is normally charged to the income statement in the period in which it is incurred. In situations where it can be clearly demonstrated that the expenditure has resulted in an increase in the future economic benefits expected to be obtained from the use of an item of property, plant and equipment and where the cost of the item can be measured reliably, the expenditure is capitalised as an additional cost of that asset or as a replacement.

Depreciation is calculated on the straight-line basis to write off the cost of each item of property, plant and equipment to its residual value over its estimated useful life. The principal annual rates used for this purpose are as follows:

Buildings	2 to 30 years
Leasehold improvements	Over the shorter of the lease terms and 10 years
Machinery, computer and office equipment	5 to 10 years
Motor vehicles	5 to 10 years

Where parts of an item of property, plant and equipment have different useful lives, the cost of that item is allocated on a reasonable basis among the parts and each part is depreciated separately.

Residual values, useful lives and the depreciation method are reviewed, and adjusted if appropriate, at each balance sheet date.

An item of property, plant and equipment is derecognised upon disposal or when no future economic benefits are expected from its use or disposal. Any gain or loss on disposal or retirement recognised in the income statement in the year the asset is derecognised is the difference between the net sales proceeds and the carrying amount of the relevant asset.

Construction in progress represents buildings, plant and machinery and other fixed assets under construction or installation, which is stated at cost less any impairment losses, and is not depreciated. Cost comprises the direct costs of construction and installation during the period of construction. Construction in progress is reclassified to the appropriate category of property, plant and equipment when completed and ready for use.

Intangible assets (other than goodwill)

The useful lives of intangible assets are assessed to be either finite or indefinite. Intangible assets with finite lives are amortised over the useful economic life and assessed for impairment whenever there is an indication that the intangible asset may be impaired. The amortisation period and the amortisation method for an intangible asset with a finite useful life are reviewed at least at each balance sheet date.

Technology know-how

Purchased technology know-how is stated at cost, less any impairment losses, and is amortised on the straight-line basis over its estimated useful life of not more than 10 years.

NOTES TO FINANCIAL STATEMENTS
(Prepared under Hong Kong financial reporting standards)
31 December 2006

2.4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Intangible assets (other than goodwill) (continued)

Computer software

Purchased computer software is stated at cost less any impairment losses and is amortised on the straight-line basis over its estimated useful life of five years.

Operating concession

Operating concession represents the right to operate a telecommunications operator, and is stated at cost less accumulated amortisation and any impairment losses. Amortisation is provided on the straight-line basis over 20 years, being the period that the operating concession granted to the Group.

Research and development costs

All research costs are charged to the income statement as incurred.

Expenditure incurred on projects to develop new products is capitalised and deferred only when the Group can demonstrate the technical feasibility of completing the intangible asset so that it will be available for use or sale, its intention to complete and its ability to use or sell the asset, how the asset will generate future economic benefits, the availability of resources to complete the project and the ability to measure reliably the expenditure during the development. Product development expenditure which does not meet these criteria is expensed when incurred.

Deferred development costs are stated at cost less any impairment losses and are amortised using the straight-line basis over the commercial lives of the underlying products not exceeding five years, commencing from the date when the products are put into commercial production.

Operating leases

Leases where substantially all the rewards and risks of ownership of assets remain with the lessor are accounted for as operating leases. Where the Group is the lessor, assets leased by the Group under operating leases are included in non-current assets, and rental receivables under the operating leases are credited to the income statement on the straight-line basis over the lease terms. Where the Group is the lessee, rentals payable under the operating leases are charged to the income statement on the straight-line basis over the lease terms.

Prepaid land premiums/land lease payments under operating leases are initially stated at cost and subsequently recognised on the straight-line basis over the lease terms.

Investments and other financial assets

Financial assets in the scope of HKAS 39 are classified as either financial assets at fair value through profit or loss, loans and receivables and available-for-sale financial assets, as appropriate. When financial assets are recognised initially, they are measured at fair value, plus, in the case of investments not at fair value through profit or loss, directly attributable transaction costs. The Group considers whether a contract contains an embedded derivative when the Group first becomes a party to it. The embedded derivatives are separated from the host contract which is not measured at fair value through profit or loss when the analysis shows that the economic characteristics and risks of embedded derivatives are not closely related to those of the host contract.

2.4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Investments and other financial assets (continued)

The Group determines the classification of its financial assets after initial recognition and, where allowed and appropriate, re-evaluates this designation at the balance sheet date.

All regular way purchases and sales of financial assets are recognised on the trade date, that is, the date that the Group commits to purchase or sell the asset. Regular way purchases or sales are purchases or sales of financial assets that require delivery of assets within the period generally established by regulation or convention in the marketplace.

Financial assets at fair value through profit or loss

Financial assets at fair value through profit or loss include financial assets held for trading. Financial assets are classified as held for trading if they are acquired for the purpose of sale in the near term. Gains or losses on investments held for trading are recognised in the income statement.

Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. Such assets are subsequently carried at amortised cost using the effective interest method. Amortised cost is calculated taking into account any discount or premium on acquisition and includes fees that are an integral part of the effective interest rate and transaction costs. Gains and losses are recognised in the income statement when the loans and receivables are derecognised or impaired, as well as through the amortisation process.

Available-for-sale financial assets

Available-for-sale financial assets are non-derivative financial assets in unlisted equity securities that are designated as available for sale or are not classified in any of the other two categories. After initial recognition, available-for-sale financial assets are measured at fair value, with gains or losses recognised as a separate component of equity until the investment is derecognised or until the investment is determined to be impaired, at which time the cumulative gain or loss previously reported in equity is included in the income statement.

When the fair value of unlisted equity securities cannot be reliably measured because (a) the variability in the range of reasonable fair value estimates is significant for that investment or (b) the probabilities of the various estimates within the range cannot be reasonably assessed and used in estimating fair value, such securities are stated at cost less any impairment losses.

Fair value

The fair value of investments that are actively traded in organised financial markets is determined by reference to quoted market bid prices at the close of business at the balance sheet date. For investments where there is no active market, fair value is determined using valuation techniques. Such techniques include using recent arm's length market transactions; reference to the current market value of another instrument which is substantially the same; a discounted cash flow analysis; and option pricing models.

NOTES TO FINANCIAL STATEMENTS

(Prepared under Hong Kong financial reporting standards)
31 December 2006

2.4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Impairment of financial assets

The Group assesses at each balance sheet date whether there is any objective evidence that a financial asset or a group of financial assets is impaired.

Assets carried at amortised cost

If there is objective evidence that an impairment loss on loans and receivables carried at amortised cost has been incurred, the amount of the loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows (excluding future credit losses that have not been incurred) discounted at the financial asset's original effective interest rate (i.e., the effective interest rate computed at initial recognition). The carrying amount of the asset is reduced either directly or through the use of an allowance account. The amount of the impairment loss is recognised in the income statement.

The Group first assesses whether objective evidence of impairment exists individually for financial assets that are individually significant, and individually or collectively for financial assets that are not individually significant. If it is determined that no objective evidence of impairment exists for an individually assessed financial asset, whether significant or not, the asset is included in a group of financial assets with similar credit risk characteristics and that group is collectively assessed for impairment. Assets that are individually assessed for impairment and for which an impairment loss is or continues to be recognised are not included in a collective assessment of impairment.

If, in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognised, the previously recognised impairment loss is reversed. Any subsequent reversal of an impairment loss is recognised in the income statement, to the extent that the carrying value of the asset does not exceed its amortised cost at the reversal date.

In relation to trade receivables, a provision for impairment is made when there is objective evidence (such as the probability of insolvency or significant financial difficulties of the debtor) that the Group will not be able to collect all the amounts due under the original terms of an invoice. The carrying amount of the receivables is reduced through the use of an allowance account. Impaired debts are derecognised when they are assessed as uncollectible.

Assets carried at cost

If there is objective evidence that an impairment loss has been incurred on an unquoted equity instrument that is not carried at fair value because its fair value cannot be reliably measured, the amount of the loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows discounted at the current market rate of return for a similar financial asset. Impairment losses on these assets are not reversed.

Available-for-sale financial assets

If an available-for-sale asset is impaired, an amount comprising the difference between its cost (net of any principal payment and amortisation) and its current fair value, less any impairment loss previously recognised in the income statement, is transferred from equity to the income statement. Impairment losses on equity instruments classified as available for sale are not reversed through the income statement.

NOTES TO FINANCIAL STATEMENTS

(Prepared under Hong Kong financial reporting standards)
31 December 2006

2.4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Derecognition of financial assets

A financial asset (or, where applicable, a part of a financial asset or part of a group of similar financial assets) is derecognised where:

- the rights to receive cash flows from the asset have expired;
- the Group retains the rights to receive cash flows from the asset, but has assumed an obligation to pay them in full without material delay to a third party under a "pass-through" arrangement; or
- the Group has transferred its rights to receive cash flows from the asset and either (a) has transferred substantially all the risks and rewards of the asset, or (b) has neither transferred nor retained substantially all the risks and rewards of the asset, but has transferred control of the asset.

Where the Group has transferred its rights to receive cash flows from an asset and has neither transferred nor retained substantially all the risks and rewards of the asset nor transferred control of the asset, the asset is recognised to the extent of the Group's continuing involvement in the asset. Continuing involvement that takes the form of a guarantee over the transferred asset is measured at the lower of the original carrying amount of the asset and the maximum amount of consideration that the Group could be required to repay.

Financial liabilities at amortised cost (including interest-bearing loans and borrowings)

Financial liabilities including trade and other payables, an amount due to the ultimate holding company and interest-bearing loans and borrowings are initially stated at fair value less directly attributable transaction costs and are subsequently measured at amortised cost, using the effective interest method unless the effect of discounting would be immaterial, in which case they are stated at cost.

Gains and losses are recognised in the income statement when the liabilities are derecognised as well as through the amortisation process.

Financial guarantee contracts

Financial guarantee contracts in the scope of HKAS 39 are accounted for as financial liabilities. A financial guarantee contract is recognised initially at its fair value plus transaction costs that are directly attributable to the acquisition or issue of the financial guarantee contract, except when such contract is recognised at fair value through profit or loss. Subsequent to initial recognition, the Group measures the financial guarantee contract at the higher of: (i) the amount determined in accordance with HKAS 37 *Provisions, Contingent Liabilities and Contingent Assets*; and (ii) the amount initially recognised less, when appropriate, cumulative amortisation recognised in accordance with HKAS 18 *Revenue*.

Derecognition of financial liabilities

A financial liability is derecognised when the obligation under the liability is discharged or cancelled or expires.

When an existing financial liability is replaced by another from the same lender on substantially different terms, or the terms of an existing liability are substantially modified, such an exchange or modification is treated as a derecognition of the original liability and a recognition of a new liability, and the difference between the respective carrying amounts is recognised in the income statement.

NOTES TO FINANCIAL STATEMENTS
(Prepared under Hong Kong financial reporting standards)
31 December 2006

2.4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Inventories

Inventories are stated at the lower of cost and net realisable value. Cost is determined on the weighted average basis and, in the case of work in progress and finished goods, comprises direct materials, direct labour, an appropriate proportion of overheads and/or subcontracting fee. Net realisable value is based on estimated selling prices less any estimated costs to be incurred to completion and disposal.

Construction contracts

Contract revenue comprises the agreed contract amount and appropriate amounts from variation orders, claims and incentive payments in respect of telecommunications systems contracts. Contract costs incurred comprise direct materials, the costs of subcontracting, direct labour and an appropriate proportion of variable and fixed construction overheads.

Revenue from fixed price telecommunications systems contracts is recognised using the percentage of completion method when the contract activities have progressed to a stage where economic benefit can be reasonably foreseen and is measured by reference to the proportion of costs incurred to date to the estimated total cost of the relevant contract.

Provision is made for foreseeable losses as soon as they are anticipated by management.

Where contract costs incurred to date plus recognised profits less recognised losses exceed progress billings, the surplus is treated as an amount due from customers for contract work.

Where progress billings exceed contract costs incurred to date plus recognised profits less recognised losses, the surplus is treated as an amount due to customers for contract work.

Government grants

Government grants are recognised at their fair value where there is reasonable assurance that the grant will be received and all attaching conditions will be complied with. When the grant relates to an expense item, it is recognised as income over the periods necessary to match the grant on a systematic basis to the costs that it is intended to compensate. Where the grant relates to an asset, the fair value is credited to other payable or other long-term payable accounts and is released to the income statement over the expected useful life of the relevant asset by equal annual instalments.

Provisions

A provision is recognised when a present obligation (legal or constructive) has arisen as a result of a past event and it is probable that a future outflow of resources will be required to settle the obligation, provided that a reliable estimate can be made of the amount of the obligation.

When the effect of discounting is material, the amount recognised for a provision is the present value at the balance sheet date of the future expenditures expected to be required to settle the obligation. The increase in the discounted present value amount arising from the passage of time is included in finance costs in the income statement.

Provisions for warranties granted by the Group on construction contracts are recognised based on cost of sales and past experience of the level of repairs and returns.

Provisions for warranties granted by the Group on handsets are recognised based on sales volume and past experience of the level of repairs and returns.

2.4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Income tax

Income tax comprises current and deferred tax. Income tax is recognised in the income statement, or in equity if it relates to items that are recognised in the same or a different period directly in equity.

Current tax assets and liabilities for the current and prior periods are measured at the amount expected to be recovered from or paid to the taxation authorities.

Deferred tax is provided, using the liability method, on all temporary differences at the balance sheet date between the tax bases of assets and liabilities and their carrying amounts for financial reporting purposes.

Deferred tax liabilities are recognised for all taxable temporary differences, except:

- where the deferred tax liability arises from goodwill or the initial recognition of an asset or liability in a transaction that is not a business combination and, at the time of the transaction, affects neither the accounting profit nor taxable profit or loss; and

- in respect of taxable temporary differences associated with investments in subsidiaries, associates and interests in joint ventures, where the timing of the reversal of the temporary differences can be controlled and it is probable that the temporary differences will not reverse in the foreseeable future.

Deferred tax assets are recognised for all deductible temporary differences, carryforward of unused tax credits and unused tax losses, to the extent that it is probable that taxable profit will be available against which the deductible temporary differences, and the carryforward of unused tax credits and unused tax losses can be utilised except:

- where the deferred tax asset relating to the deductible temporary differences arises from the initial recognition of an asset or liability in a transaction that is not a business combination and, at the time of the transaction, affects neither the accounting profit nor taxable profit or loss; and

- in respect of deductible temporary differences associated with investments in subsidiaries, associates and interests in joint ventures, deferred tax assets are only recognised to the extent that it is probable that the temporary differences will reverse in the foreseeable future and taxable profit will be available against which the temporary differences can be utilised.

The carrying amount of deferred tax assets is reviewed at each balance sheet date and reduced to the extent that it is no longer probable that sufficient taxable profit will be available to allow all or part of the deferred tax asset to be utilised. Conversely, previously unrecognised deferred tax assets are reassessed at each balance sheet date and are recognised to the extent that it is probable that sufficient taxable profit will be available to allow all or part of the deferred tax asset to be utilised.

Deferred tax assets and liabilities are measured at the tax rates that are expected to apply to the period when the asset is realised or the liability is settled, based on tax rates (and tax laws) that have been enacted or substantively enacted at the balance sheet date.

Deferred tax assets and deferred tax liabilities are offset, if a legally enforceable right exists to set off current tax assets against current tax liabilities and the deferred taxes relate to the same taxable entity and the same taxation authority.

NOTES TO FINANCIAL STATEMENTS
(Prepared under Hong Kong financial reporting standards)
31 December 2006

2.4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Employee benefits

Defined contribution pension schemes

The Company and certain of its subsidiaries established in the PRC have joined a number of defined contribution pension schemes organised by the relevant provincial and municipal social insurance management bodies of the PRC government for certain of its employees. The Company, these subsidiaries and the employees are required to make monthly contributions to these plans calculated as a percentage of the employees' salaries during the year. The contributions payable are charged as an expense to the income statement as incurred. The assets of the schemes are held separately from those of the Group in independently administered funds.

Defined benefits pension scheme

In addition, the Group provides certain employees, who joined the Group before 1 January 2002, with post-retirement monthly pension payments. The cost of providing these benefits under the Group's defined benefits pension scheme is actuarially determined and recognised over the employees' service period by using the projected unit credit method. The Group makes monthly pension payments to eligible retirees and no contribution has been made to fund future obligations since the commencement of the defined benefits scheme. Therefore, there are no assets in respect of this scheme held separately from those of the Group in independently administered funds and no actuarial valuation for the plan assets has been conducted.

Share-based payment transactions

The Company operates a share incentive scheme for the purpose of providing incentives and rewards to eligible participants who contribute to the success of the operations of the Group. Employees (including directors) of the Group receive remuneration in the form of share-based payment transactions, whereby employees render services as consideration for equity instruments (''equity-settled transactions'').

The cost of equity-settled transactions with employees is measured by reference to the fair value at the date at which they are granted. The fair value is determined by an external valuer using an appropriate pricing model, further details of which are given in note 38. In valuing equity-settled transactions, no account is taken of any performance conditions, other than conditions linked to the price of the shares of the Company (''market conditions''), if applicable.

The cost of equity-settled transactions is recognised, together with a corresponding increase in equity, over the period in which the performance and/or service conditions are fulfilled, ending on the date on which the relevant employees become fully entitled to the award (the ''vesting date''). The cumulative expense recognised for equity-settled transactions at each balance sheet date until the vesting date reflects the extent to which the vesting period has expired and the Group's best estimate of the number of equity instruments that will ultimately vest. The charge or credit to the income statement for a period represents the movement in cumulative expense recognised as at the beginning and end of that period.

No expense is recognised for awards that do not ultimately vest, except for awards where vesting is conditional upon a market condition, which are treated as vesting irrespective of whether or not the market condition is satisfied, provided that all other performance conditions are satisfied.

NOTES TO FINANCIAL STATEMENTS

(Prepared under Hong Kong financial reporting standards)
31 December 2006

2.4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Employee benefits (continued)

Share-based payment transactions (continued)

Where the terms of an equity-settled award are modified, as a minimum an expense is recognised as if the terms had not been modified. In addition, an expense is recognised for any modification which increases the total fair value of the share-based payment arrangement, or is otherwise beneficial to the employee as measured at the date of modification.

Where an equity-settled award is cancelled, it is treated as if it had vested on the date of cancellation, and any expense not yet recognised for the award is recognised immediately. However, if a new award is substituted for the cancelled award, and designated as a replacement award on the date that it is granted, the cancelled and new awards are treated as if they were a modification of the original award, as described in the previous paragraph.

Borrowing costs

Borrowing costs are recognised as expenses in the income statement in the period in which they are incurred.

Foreign currencies

These financial statements are presented in Renminbi, which is the Company's functional and presentation currency. Each entity in the Group determines its own functional currency and items included in the financial statements of each entity are measured using that functional currency. Foreign currency transactions are initially recorded using the functional currency rates ruling at the date of the transactions. Monetary assets and liabilities denominated in foreign currencies are retranslated at the functional currency rates of exchange ruling at the balance sheet date. All differences are taken to the income statement. Non-monetary items that are measured in terms of historical cost in a foreign currency are translated using the exchange rates at the dates of the initial transactions. Non-monetary items measured at fair value in a foreign currency are translated using the exchange rates at the date when the fair value was determined.

The functional currencies of certain overseas subsidiaries, a jointly-controlled entity and an associate are currencies other than the Renminbi. As at the balance sheet date, the assets and liabilities of these entities are translated into the presentation currency of the Company at the exchange rates ruling at the balance sheet date and, their income statements are translated into Renminbi at the weighted average exchange rates for the year. The resulting exchange differences are included in the exchange fluctuation reserve. On disposal of a foreign entity, the deferred cumulative amount recognised in equity relating to that particular foreign operation is recognised in the income statement.

For the purpose of the consolidated cash flow statement, the cash flows of overseas subsidiaries are translated into Renminbi at the exchange rates ruling at the dates of the cash flows. Frequently recurring cash flows of overseas subsidiaries which arise throughout the year are translated into Renminbi at the weighted average exchange rates for the year.

Cash and cash equivalents

For the purpose of the consolidated cash flow statement, cash and cash equivalents comprise cash on hand and demand deposits, and short-term highly liquid investments which are readily convertible into known amounts of cash and which are subject to an insignificant risk of changes in value, and have a short maturity of generally within three months when acquired.

For the purpose of the balance sheets, cash and cash equivalents comprise cash on hand and at banks, including term deposits, which are not restricted as to use.

NOTES TO FINANCIAL STATEMENTS
(Prepared under Hong Kong financial reporting standards)
31 December 2006

2.4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Revenue recognition

Revenue is recognised when it is probable that the economic benefits will flow to the Group and when the revenue can be measured reliably, on the following bases:

(a) from the sale of goods, when the significant risks and rewards of ownership have been transferred to the buyer, provided that the Group maintains neither managerial involvement to the degree usually associated with ownership, nor effective control over the goods sold;

(b) from the construction contracts, on the percentage of completion basis, as further explained in the accounting policy for ''Construction contracts'' above;

(c) from the rendering of services, when services are rendered;

(d) interest income, on an accrual basis using the effective interest method by applying the rate that discounts the estimated future cash receipts through the expected life of the financial instrument to the net carrying amount of the financial asset;

(e) dividend income, when the shareholders' right to receive payment has been established; and

(f) for contracts involving multiple deliverables, where the deliverables are governed by more than one authoritative accounting standard, the Group generally will evaluate each deliverable to determine whether it represents a separate unit of accounting based on the following criteria: (a) whether the delivered item has value to the customer on a standalone basis, (b) whether there is objective and reliable evidence of the fair value of the undelivered item(s), and (c) if the contract includes a general right of return relative to the delivered item, delivery or performance of the undelivered item(s) is considered probable and substantially in the control of the Group. If objective and reliable evidence of fair value exists for all units of accounting in the arrangement, revenue is allocated to each unit of accounting or element based on relative fair values. In situations where there is objective and reliable evidence of fair value for all undelivered elements, but not for delivered elements, the residual method is used to allocate the contract consideration. Under the residual method, the amount of revenue allocated to delivered elements equals the total arrangement consideration less the aggregate fair value of any undelivered elements. Each unit of accounting is then accounted for under the applicable revenue recognition guidance. So long as elements otherwise governed by separate authoritative accounting standards cannot be treated as separate units of accounting, the elements are combined into a single unit of accounting for revenue recognition purposes. In this case, revenue allocated to the unit of accounting is deferred until all combined elements have been delivered or, once there is only one remaining element to be delivered, based on the revenue recognition guidance applicable to the last delivered element within the unit of accounting.

Dividends

Final dividends proposed by the directors are classified as a separate allocation of retained profits within the equity section of the balance sheet, until they have been approved by the shareholders in a general meeting. When these dividends have been approved by the shareholders and declared, they are recognised as a liability.

NOTES TO FINANCIAL STATEMENTS

(Prepared under Hong Kong financial reporting standards)
31 December 2006

3. SIGNIFICANT ACCOUNTING JUDGEMENTS AND ESTIMATES

Judgements

In the process of applying the Group's accounting policies, management has made the following judgements, apart from those involving estimations, which have the most significant effect on the amounts recognised in the financial statements:

Revenue recognition

The Group's material revenue streams are the result of a wide range of activities, from custom design and installation over a period of time to a single delivery of equipment to a customer. The Group's networking solutions also cover a broad range of technologies and are offered on a global basis. As a result, our revenue recognition policies can differ depending on the level of customization within the solution and the contractual terms with the customer. Newer technologies within one of the Group's reporting segments may also have different revenue recognition policies, depending on, among other factors, the specific performance and acceptance criteria within the applicable contract. Therefore, management must use significant judgement in determining how to apply the current accounting standards and interpretations, not only based on the networking solution, but also within networking solutions based on reviewing the level of customization and contractual terms with the customer. As a result, our revenues may fluctuate from period to period based on the mix of solutions sold and the geographic region in which they are sold.

When a customer arrangement involves multiple deliverables where the deliverables are governed by more than one authoritative standard, the Group evaluates all deliverables to determine whether they represent separate units of accounting based on the following criteria:

- whether the delivered item has value to the customer on a stand alone basis;
- whether there is objective and reliable evidence of the fair value of the undelivered item(s); and
- if the contract includes a general right of return relative to the delivered item, delivery or performance of the undelivered item(s) is considered probable and is substantially in the Group's control.

The Group's determination of whether deliverables within a multiple element arrangement can be treated separately for revenue recognition purposes involves significant estimates and judgement, such as whether fair value can be established on undelivered obligations and/or whether delivered elements have standalone value to the customer. Changes to our assessment of the accounting units in an arrangement and/or our ability to establish fair values could significantly change the timing of revenue recognition.

If objective and reliable evidence of fair value exists for all units of accounting in the contract, revenue is allocated to each unit of accounting or element based on relative fair values. In situations where there is objective and reliable evidence of fair value for all undelivered elements, but not for delivered elements, the residual method is used to allocate the contract consideration. Under the residual method, the amount of revenue allocated to delivered elements equals the total arrangement consideration less the aggregate fair value of any undelivered elements. Each unit of accounting is then accounted for under the applicable revenue recognition guidance. If sufficient evidence of fair value cannot be established for an undelivered element, revenue related to delivered elements is deferred until the earlier of when sufficient fair value is established and when all remaining elements have been delivered. Once there is only one remaining element to be delivered within the unit of accounting, the deferred revenue is recognised based on the revenue recognition guidance applicable to the last delivered element. For instance, where post-contract support is the last delivered element within the unit of accounting, the deferred revenue is recognised ratably over the remaining post-contract support term once post-contract support is the only undelivered element.

NOTES TO FINANCIAL STATEMENTS

(Prepared under Hong Kong financial reporting standards)
31 December 2006

3. SIGNIFICANT ACCOUNTING JUDGEMENTS AND ESTIMATES (continued)

Judgements (continued)

Revenue recognition (continued)

The Group's assessment of which revenue recognition guidance is appropriate for accounting for a deliverable also can involve significant judgement. For instance, the determination of whether software is more than incidental to hardware can impact on whether the hardware is accounted for under software revenue recognition guidance or based on general revenue recognition guidance. This assessment could significantly impact the amount and timing of revenue recognition.

For elements related to customised network solutions and certain network build-outs, revenues are recognised under the HKAS 11 *Construction Contract*, generally using the percentage-of-completion method. In using the percentage-of-completion method, revenues are generally recorded based on a measure of the percentage of costs incurred to date on a contract relative to the estimated total expected contract costs. Profit estimates on long-term contracts are revised periodically based on changes in circumstances and any losses on contracts are recognised in the period that such losses become known. Generally, the terms of long-term contracts provide for progress billing based on completion of certain phases of work. Contract revenues recognised, based on costs incurred towards the completion of the project, that are unbilled are accumulated in the contracts in progress account included in accounts receivable, net. Billings in excess of revenues recognised to date on long-term contracts are recorded as advance billings in excess of revenues recognised to date on contracts within other accrued liabilities. Significant judgement is often required when estimating total contract costs and progress to completion on these arrangements, as well as whether a loss is expected to be incurred on the contract. Management uses historical experience, project plans and an assessment of the risks and uncertainties inherent in the arrangement to establish these estimates. Uncertainties include implementation delays or performance issues that may or may not be within the control of the Group. Changes in these estimates could result in a material impact on revenues and net earnings.

Revenue for hardware that does not require significant customisation, and where any software is considered incidental, is recognised under HKAS 18 *Revenue*, revenue is recognised provided that persuasive evidence of an arrangement exists, delivery has occurred or services have been rendered, the fee is fixed or determinable and collectibility is reasonably assured.

For hardware, delivery is considered to have occurred upon shipment provided that the risk of loss, and title in certain jurisdictions, have been transferred to the customer. For arrangements where the criteria for revenue recognition have not been met because legal title or the risk of loss on products was not transfer to the buyer until final payment had been received or where delivery had not occurred, revenue is deferred to a later period when title or the risk of loss passes either on delivery or on receipt of payment from the customer.

For further information on the Group's revenue recognition policies relating to our material revenue streams, please refer to note 2.4 to these consolidated financial statements.

3. SIGNIFICANT ACCOUNTING JUDGEMENTS AND ESTIMATES (continued)

Estimation uncertainty

The key assumptions concerning the future and other key sources of estimation uncertainty at the balance sheet date, 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.

Impairment of intangible assets and property, plant and equipment

The Group determines whether intangible assets and property, plant and equipment are impaired when there is an indication of impairment. This requires an estimation of the value in use of the cash-generating units to which the intangible assets and property, plant and equipment were allocated. Estimating the value in use requires the Group to make an estimate of the expected future cash flows from the cash-generating unit and also to choose a suitable discount rate in order to calculate the present value of those cash flows. The carrying amount of intangible assets at 31 December 2006 was RMB274,905,000 (2005: RMB335,835,000). The carrying amount of property, plant and equipment was approximately RMB3,053,019,000 (2005: RMB2,470,965,000). More details are set out in notes 15 and 17.

Management carries out impairment review on intangible assets and property, plant and equipment by comparing the lower of their carrying amount and recoverable amount of them respectively.

An impairment loss is recognised when the carrying amount of intangible assets and property, plant and equipment exceeds the recoverable amount. An impairment loss is charged to the income statement in the period in which it arises. Management assesses the recoverable amount by the higher of the fair value less costs to sell and the expected value in use which is determined by the expected useful life and the expected discounted net cash flows of intangible assets and property, plant and equipment.

Impairment of trade receivables

In determining whether there is objective evidence of an impairment loss, the Group takes into consideration the estimation of future cash flows. The amount of the impairment loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows (excluding future credit losses that have not been incurred) discounted at the financial asset's original effective interest rate (i.e., the effective interest rate computed at initial recognition). Where the actual future cash flows are less than expected, a material impairment loss may arise.

Equity settled share expense

The estimated cost of the share incentive scheme is recognised in income statements based on estimation of various assumptions.

One of the major factors that could impact the cost is the turnover rate of respective participants under the scheme. In situation that the actual turnover rate is less than the management estimation, such cost would be higher.

NOTES TO FINANCIAL STATEMENTS
(Prepared under Hong Kong financial reporting standards)
31 December 2006

3. SIGNIFICANT ACCOUNTING JUDGEMENTS AND ESTIMATES (continued)

Estimation uncertainty (continued)

Warranty claims

The Group generally offers warranties for its products for 12 months. Management estimates the related provision for future warranty claims based on historical warranty claim information, as well as recent trends that might suggest that past cost information may differ from future claims.

Factors that could impact the estimated claim information include the success of the Group's productivity and quality initiatives, as well as parts and labour costs.

Were claims costs to differ by 10% from management's estimates, the warranty provisions would be an estimated amount of approximately RMB25 million higher or lower in the year of 2006.

Depreciation and amortisation

The Group's net book value of property, plant and equipment as at 31 December 2006 was approximately RMB3,053,019,000 (2005: RMB2,470,965,000). The Group depreciates items of property, plant and equipment on the straight-line basis over their estimated useful lives, and after taking into account their estimated residual value, commencing from the date the items of property, plant and equipment are placed into productive use. The estimated useful lives and dates that the Group places the items of property, plant and equipment into productive use reflect the directors' estimate of the periods that the Group intends to derive future economic benefits from the use of the Group's property, plant and equipment.

Deferred tax assets

As at 31 December 2006, deferred tax assets of approximately RMB210,923,000 have been recognised in the Group's balance sheet. The realisability of the deferred tax assets mainly depend on whether sufficient future profits or taxable temporary differences will be realised in the future. Since the Group is expecting a growth in profits to be generated in the future based on management estimation, the directors of the Company consider that the deferred tax assets could be fully utilized in the future, and would be recognised in the income statement for the period in which such a reversal takes place.

4. SEGMENT INFORMATION

Segment information is presented by way of two segments: (i) on a primary segment reporting basis, by business segment; and (ii) on a secondary segment reporting basis, by geographical segment.

The Group's operating business are structured and managed separately, according to the nature of their operations and the products and services they provide. Each of the Group's business segments represents a strategic business unit that offers products and services which are subject to risks and returns that are different from those of the other business segments. Summary details of the business segments are as follows:

(a) The wireless communications segment engages in the provision of systems integration and the sale of equipment for mobile phone network systems, primarily in respect of CDMA, GSM and wireless local access (PHS) systems.

(b) The wireline switch and access segment engages in the manufacture and sale of wireline, circuit-switches and narrow-band access systems for fixed line phone systems.

NOTES TO FINANCIAL STATEMENTS

(Prepared under Hong Kong financial reporting standards)
31 December 2006

4. SEGMENT INFORMATION (continued)

(c) The optical and data communications segment engages in the provision of DSL systems, SDH, WDM systems and softswitch systems, broadband routing switches, wireless access data products and other data communications products.

(d) The handsets segment engages in the manufacture and sale of CDMA and GSM mobile phone handsets and wireless local access (PHS) handsets.

(e) The telecommunications software systems and services and other products segment represented the provision of telecommunications software systems such as operation support systems and the provision of fee-based services.

In determining the Group's geographical segments, revenues are attributed to the segments based on the location of the customers, and assets are attributed to the segments based on the location of the assets.

(a) Business segments

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

Group

	Wireless communications		Wireline switch and access		Optical and data communications		Handsets		Telecommunications software systems, services and other products		Consolidated	
	2006 RMB'000	2005 RMB'000	**2006 RMB'000**	2005 RMB'000	**2006 RMB'000**	2005 RMB'000	**2006 RMB'000**	2005 RMB'000	**2006 RMB'000**	2005 RMB'000	**2006 RMB'000**	2005 RMB'000
Segment revenue:												
Telecommunications system contracts	**9,186,920**	8,930,836	**2,279,424**	2,752,570	**3,874,634**	3,352,980	**—**	—	**1,912,160**	1,943,428	**17,253,138**	16,979,814
Sale of goods and services	**—**	—	**—**	—	**—**	—	**4,519,492**	4,333,082	**1,259,054**	263,024	**5,778,546**	4,596,106
Total	**9,186,920**	8,930,836	**2,279,424**	2,752,570	**3,874,634**	3,352,980	**4,519,492**	4,333,082	**3,171,214**	2,206,452	**23,031,684**	21,575,920
Segment results	**2,604,063**	2,590,240	**593,821**	1,085,112	**364,028**	160,110	**512,429**	118,165	**432,191**	334,131	**4,506,532**	4,287,758
Interest and unallocated gains											**792,124**	681,646
Unallocated expenses											**(4,121,795)**	(3,183,548)
Finance costs											**(153,694)**	(175,884)
Share of profits and losses of:												
Jointly-controlled entities											**(652)**	(1,198)
Associates											**8,175**	(2,969)
Profit before tax											**1,030,690**	1,605,805
Tax											**(127,078)**	(179,851)
Profit for the year											**903,612**	1,425,954

NOTES TO FINANCIAL STATEMENTS

(Prepared under Hong Kong financial reporting standards)
31 December 2006

4. SEGMENT INFORMATION (continued)

(a) Business segments (continued)

Group

Assets and liabilities	Wireless communications 2006 RMB'000	Wireless communications 2005 RMB'000	Wireline switch and access 2006 RMB'000	Wireline switch and access 2005 RMB'000	Optical and data communications 2006 RMB'000	Optical and data communications 2005 RMB'000	Handsets 2006 RMB'000	Handsets 2005 RMB'000	Telecommunications software systems, services and other products 2006 RMB'000	Telecommunications software systems, services and other products 2005 RMB'000	Consolidated 2006 RMB'000	Consolidated 2005 RMB'000
Segment assets	**7,928,525**	5,292,995	**1,979,726**	2,196,473	**3,352,383**	2,778,123	**2,368,637**	2,162,194	**1,124,605**	810,136	**16,753,876**	13,239,921
Investments in jointly-controlled entities											**5,936**	6,588
Investments in associates											**51,257**	35,583
Unallocated assets											**9,976,177**	9,181,950
Total assets											**26,787,246**	22,464,042
Segment liabilities	**491,760**	860,005	**56,382**	91,578	**560,098**	204,755	**254,266**	344,933	**269,644**	93,207	**1,632,150**	1,594,478
Unallocated liabilities											**13,829,259**	10,148,323
Total liabilities											**15,461,409**	11,742,801
Other segment information:												
Depreciation and amortisation	**218,625**	123,367	**61,374**	37,519	**140,369**	82,886	**137,870**	105,251	**53,653**	45,421	**611,891**	478,496
Capital expenditure	**422,669**	371,525	**118,655**	112,990	**271,375**	249,611	**266,542**	316,966	**103,729**	136,787	**1,182,970**	1,187,879

(b) Geographical segments

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

Group

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

NOTES TO FINANCIAL STATEMENTS

(Prepared under Hong Kong financial reporting standards)
31 December 2006

5. REVENUE, OTHER INCOME AND GAINS

Revenue, which is also the Group's turnover, represents the aggregate of an appropriate proportion of contract revenue from telecommunications systems contracts and the invoiced value of goods and services sold net of value-added tax (''VAT'') and after allowances for goods returns and trade discounts. All significant intra-group transactions have been eliminated on consolidation.

An analysis of the Group's revenue and other income and gains is as follows:

	Note	2006 RMB'000	2005 RMB'000
Revenue			
Telecommunications systems contracts		**17,253,138**	16,979,814
Sale of goods and services		**5,778,546**	4,596,106
		23,031,684	21,575,920
Other income			
Government grants		**22,544**	139,491
Contingent rent receivable in respect of an operating lease		**27,813**	—
Service fees		**39,633**	15,379
VAT subsidies, exemptions and refunds#		**612,163**	456,015
Bank and other interest income		**49,050**	54,870
		751,203	665,755
Gains			
Excess over the cost of business combinations		**—**	12,236
Fair value gain on an equity investment at fair value through profit or loss		**16,595**	—
Gain on disposal of an equity investment at fair value through profit or loss		**24,326**	—
Gain on deemed disposal of interests in a subsidiary	40	**—**	3,655
		40,921	15,891
		792,124	681,646

During the years ended 31 December 2005 and 2006, the Company received VAT subsidies on the amount of VAT paid for high-technology products as approved by the Shenzhen Economic and Trade Bureau (深圳市經濟貿易局), Shenzhen Science and Technology Bureau (深圳市科技局), Shenzhen Finance Bureau (深圳市財政局), Shenzhen State Tax Bureau (深圳市國家税務局), Shenzhen Local Tax Bureau (深圳市地方税務局) and Nanjing State Tax Bureau (南京市國家税務局). In addition, for the years ended 31 December 2005 and 2006, Shenzhen Zhongxing Software Company, Limited (''Zhongxing Software'') and Nanjing Zhonging Software Company, Limited, being a designated software enterprises, were entitled to VAT refunds on the effective VAT rate in excess of 3% after the payment of statutory net output VAT of 17%. Such VAT refunds were approved the Shenzhen State Tax Bureau (深圳市國家税務局) and Nanjing State Tax Bureau (南京市國家税務局) and had been received by Zhongxing Software and Nanjing Zhonging Software Company, Limited.

NOTES TO FINANCIAL STATEMENTS
(Prepared under Hong Kong financial reporting standards)
31 December 2006

6. PROFIT BEFORE TAX

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

	Notes	2006 RMB'000	2005 RMB'000
Cost of inventories sold		**14,295,410**	13,373,519
Depreciation	15	**510,333**	394,444
Less: Amount capitalised as deferred development costs		**—**	(7,585)
		510,333	386,859
Amortisation of intangible assets other than deferred development costs	17	**49,201**	50,355
Amortisation of deferred development costs**	17	**52,357**	32,380
		101,558	82,735
Impairment of goodwill*		**—**	56,267
Impairment of trade receivables*		**111,611**	15,642
Provision for warranties**	35	**114,724**	225,790
Write-down of inventories to net realisable value**		**52,781**	96,185
Minimum lease payments under operating leases on land and buildings		**206,054**	188,905
Auditors' remuneration		**6,080**	4,870
Staff costs (including directors' and supervisors' remuneration — note 8):			
Wages, salaries, bonuses, allowances and welfares		**3,103,539**	2,601,779
Equity settled share expense		**2,480**	—
Pension scheme contributions:			
Defined benefits pension scheme — note 33		**2,787**	2,224
Defined contribution pension scheme		**208,596**	187,081
		3,317,402	2,791,084
Foreign exchange differences, net*		**29,422**	48,390
Loss on disposal of items of property, plant and equipment*		**13,933**	6,163
Loss on disposal of intangible assets*	17	**952**	70
Recognition of financial guarantee contract*		**3,689**	—
Loss on disposal of interests in subsidiaries*		**—**	2,057

* The impairment of goodwill, impairment of trade receivables, foreign exchange differences, recognition of financial guarantee contract, loss on disposal of items of property, plant and equipment, loss on disposal of intangible assets and loss on disposal of interests in subsidiaries are included in "Other expenses" on the face of the consolidated income statement.

** The provision for warranties, amortisation of deferred development costs and write-down of inventories to net realisable value are included in "Cost of sales" on the face of the consolidated income statement.

NOTES TO FINANCIAL STATEMENTS

(Prepared under Hong Kong financial reporting standards)
31 December 2006

7. FINANCE COSTS

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

8. DIRECTORS' AND SUPERVISORS' REMUNERATION

Directors' and supervisors' remuneration for the year, disclosed pursuant to the Listing Rules and Section 161 of the Hong Kong Companies Ordinance, are as follows:

	Group	
	2006	2005
	RMB'000	RMB'000
Fees	**—**	—
Other emoluments of executive directors and supervisors:		
Salaries, bonuses, allowances and welfare	**2,795**	3,037
Performance related bonuses	**3,171**	2,524
Share incentive scheme	**15**	—
Retirement benefits scheme contribution	**51**	32
	6,032	5,593

During the year, certain directors were granted shares under a share incentive scheme in respect of their services to the Group, further details of which are set out in note 38 to the financial statements. The fair value of such shares which has been recognised in the income statement, was determined as at the date of grant and the amount included in the financial statements for the year is included in the above directors' remuneration disclosures.

(a) Independent non-executive directors

The salaries, bonuses, allowances and welfare paid to independent non-executive directors during the year were as follows:

	2006	2005
	RMB'000	RMB'000
Zhu Wuxiang	**60**	60
Chen Shaohua	**60**	60
Tan Zhenhui	**—**	25
Mi Zhengkun	**60**	60
Li Jin	**60**	60
Qiao Wenjun	**60**	60
	300	325

There were no other emoluments payable to the independent non-executive directors during the year (2005: Nil).

NOTES TO FINANCIAL STATEMENTS

(Prepared under Hong Kong financial reporting standards)
31 December 2006

8. DIRECTORS' AND SUPERVISORS' REMUNERATION (continued)

(b) Executive directors, non-executive directors and supervisors

	Fees RMB'000	Salaries, bonuses, allowances and welfare RMB'000	Performance related bonuses RMB'000	Share incentive scheme RMB'000	Retirement benefits scheme contributions RMB'000	Total remuneration RMB'000
2006						
Executive directors:						
Yin Yimin	—	422	1,141	—	9	1,572
Shi Lirong	—	354	420	—	9	783
He Shiyou	—	359	450	—	17	826
	—	1,135	2,011	—	35	3,181
Non-executive directors:						
Hou Weigui	—	332	405	—	—	737
Wang Zongyin	—	60	—	3	—	63
Xie Weiliang	—	60	—	3	—	63
Zhang Junchao	—	60	—	3	—	63
Li Juping	—	60	—	3	—	63
Dong Lianbo	—	60	—	3	—	63
	—	1,767	2,416	15	35	4,233
Supervisors:						
Zhang Taifeng	—	329	405	—	—	734
Wang Wangxi	—	249	248	—	9	506
He Xuemei	—	150	102	—	7	259
Qu Deqian	—	—	—	—	—	—
Wang Yan	—	—	—	—	—	—
	—	728	755	—	16	1,499

NOTES TO FINANCIAL STATEMENTS

(Prepared under Hong Kong financial reporting standards)
31 December 2006

8. DIRECTORS' AND SUPERVISORS' REMUNERATION (continued)

(b) Executive directors, non-executive directors and supervisors (continued)

	Fees RMB'000	Salaries, bonuses, allowances and welfare RMB'000	Performance related bonuses RMB'000	Retirement benefits scheme contributions RMB'000	Total remuneration RMB'000
2005					
Executive directors:					
Yin Yimin	—	423	700	8	1,131
Shi Lirong	—	353	420	8	781
He Shiyou	—	387	250	2	639
	—	1,163	1,370	18	2,551
Non-executive directors:					
Hou Weigui	—	332	363	—	695
Wang Zongyin	—	60	—	—	60
Xie Weiliang	—	60	—	—	60
Zhang Junchao	—	60	—	—	60
Li Juping	—	60	—	—	60
Dong Lianbo	—	60	—	—	60
Tang Shanyi	—	25	—	—	25
	—	1,820	1,733	18	3,571
Supervisors:					
Zhang Taifeng	—	332	363	—	695
Wang Wangxi	—	321	294	8	623
He Xuemei	—	159	134	6	299
Qu Deqian	—	—	—	—	—
Wang Yan	—	—	—	—	—
Li Jinhu	—	20	—	—	20
Cao Quansheng	—	20	—	—	20
Li Huanru	—	20	—	—	20
Cui Hongwei	—	20	—	—	20
	—	892	791	14	1,697

There was no arrangement under which directors and supervisors waived or agreed to waive any remuneration during the year.

NOTES TO FINANCIAL STATEMENTS

(Prepared under Hong Kong financial reporting standards)
31 December 2006

9. FIVE HIGHEST PAID EMPLOYEES

The five highest paid employees during the year included no (2005: one) director, details of whose remuneration are set out in note 8 above. Details of the remuneration of the five (2005: four) non-director and non-supervisor, highest paid employees for the year are as follows:

	2006 RMB'000	2005 RMB'000
Salaries, bonuses, allowances and welfare	**6,394**	4,145
Performance related bonuses	**1,041**	863
Retirement benefits scheme contributions	**1,030**	18
	8,465	5,026

The number of non-director and non-supervisor, highest paid employees whose remuneration fell within the following bands is as follows:

	Number of employees	
	2006	2005
Nil to RMB1,000,000	**—**	—
RMB1,000,001 to RMB1,500,000	**—**	4
RMB1,500,001 to RMB2,000,000	**5**	—
	5	4

During the year, no director or supervisor waived or agreed to waive any emolument, and no emoluments were paid by the Group to the directors, supervisors or any of the five highest paid employees as an inducement to join or upon joining the Group or as compensation for loss of office.

10. TAX

	2006 RMB'000	2005 RMB'000
Group:		
Current — Hong Kong	**6,951**	5,726
Current — Mainland China	**106,449**	34,700
Current — Overseas	**165,014**	94,331
Deferred tax charged/(credit) (note 36)	**(151,336)**	45,094
Total tax charge for the year	**127,078**	179,851

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

NOTES TO FINANCIAL STATEMENTS

(Prepared under Hong Kong financial reporting standards)
31 December 2006

10. TAX (continued)

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

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

As a designated software enterprise, Zhongxing Software, a major subsidiary of the Company has been approved as a new software enterprise and entitled to full exemption from corporate income tax for two years and a 50% relief in corporate income tax in the three years thereafter starting from the first profitable year from 1 January 2003 until 31 December 2007. The corporate income tax rate applicable to Zhongxing Software was 7.5% during the current year.

ZTE Mobile Tech Co., Ltd ("ZTE Mobile") is entitled to full exemption from corporate income tax for two years and a 50% relief in corporate income tax in the three years thereafter starting from the first profitable year from 1 January 2003 until 31 December 2007. ZTE Mobile is entitled to a corporate income tax rate of 7.5%.

A reconciliation of the tax expense applicable to profit before tax using the statutory rate for the countries in which the Company and its subsidiaries are domiciled to the tax expense at the effective tax rate, and a reconciliation of the applicable rate (i.e., the statutory tax rate) to the effective tax rate, are as follows:

	2006 RMB'000	%	2005 RMB'000	%
Profit before tax	**1,030,690**		1,605,805	
Tax at statutory tax rate	**340,128**	33.0	529,916	33.0
Lower tax rate for specific provinces or local authority	**(185,539)**	(18.0)	(289,045)	(18.0)
Expenses not deductible for tax	**97,993**	9.5	103,669	6.5
Income not subject to tax	**(36,595)**	(3.6)	(51,602)	(3.2)
Tax holiday	**(96,883)**	(9.4)	(89,482)	(5.5)
Profits and losses attributable to jointly-controlled entities and associates	**(1,129)**	(0.1)	625	—
Tax losses utilised from previous years	**(11,146)**	(1.1)	(5,702)	(0.4)
Other tax allowances	**(72,480)**	(7.0)	(41,558)	(2.6)
Tax losses of subsidiaries	**92,729**	9.0	23,030	1.4
Tax charge at the Group's effective rate	**127,078**	12.3	179,851	11.2

No share of tax attributable to jointly-controlled entities is included in "Share of profits and losses of jointly-controlled entities" on the face of the consolidated income statement (2005: Nil).

No share of tax attributable to associates is included in "Share of profits and losses of associates" on the face of the consolidated income statement (2005: Nil).

NOTES TO FINANCIAL STATEMENTS

(Prepared under Hong Kong financial reporting standards)
31 December 2006

11. PROFIT ATTRIBUTABLE TO EQUITY HOLDERS OF THE PARENT

The consolidated profit attributable to equity holders of the parent for the year ended 31 December 2006 includes a profit of approximately RMB831,130,000 (2005: RMB1,084,317,000) which has been dealt with in the financial statements of the Company (note 39(b)).

12. DIVIDEND

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

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

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

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

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

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

14. DISTRIBUTION OF PROFIT

In accordance with the Company Law of the PRC and the articles of associations, the Company and certain of its subsidiaries are required to allocate 10% of their profit after tax, as determined in accordance with PRC accounting standards and regulations applicable to these companies, to the statutory surplus reserve (the "SSR") until such reserves reach 50% of the registered capitals of these companies. Part of the SSR may be capitalised as these companies' share capitals, provided that the remaining balances after the capitalisation are not less than 25% of the registered capitals of these companies.

In previous years, the Company and certain of its subsidiaries are required to transfer 5% to 10% of their profit after tax, as determined in accordance with PRC accounting standards and regulations applicable to these companies, to statutory public welfare fund (the "PWF"). According to the "Company Law of the People's Republic of China (2005 revised)" that took effect as of 1 January 2006, and the modified articles of associations, the Company and its subsidiaries will not allocate the PWF starting from 2006. The balance of PWF as at 31 December 2005 was transferred to the SSR.

Certain of the Company's subsidiaries are Chinese-foreign equity joint ventures. In accordance with the "Law of the People's Republic of China on Chinese-Foreign Equity Joint Ventures" and their respective articles of associations, these subsidiaries are required to allocate certain of their profit after tax as determined in accordance with PRC accounting standards and related regulations to enterprise expansion fund, reserve fund and employee bonus and welfare fund. The allocation rates are determined by their respective board of directors.

NOTES TO FINANCIAL STATEMENTS
(Prepared under Hong Kong financial reporting standards)
31 December 2006

15. PROPERTY, PLANT AND EQUIPMENT

Group

	Buildings RMB'000	Leasehold improvements RMB'000	Machinery, computer and office equipment RMB'000	Motor vehicles RMB'000	Construction in progress RMB'000	Total RMB'000
31 December 2006						
At 31 December 2005 and at 1 January 2006:						
Cost	865,216	51,631	2,414,643	210,369	140,737	3,682,596
Accumulated depreciation and impairment	(115,695)	(28,046)	(1,003,661)	(64,229)	—	(1,211,631)
Net carrying amount	749,521	23,585	1,410,982	146,140	140,737	2,470,965
At 1 January 2006, net of accumulated depreciation and impairment	749,521	23,585	1,410,982	146,140	140,737	2,470,965
Additions	584	10,482	694,826	40,399	389,451	1,135,742
Disposals	—	—	(29,911)	(4,873)	—	(34,784)
Depreciation provided during the year	(32,891)	(19,327)	(434,526)	(23,589)	—	(510,333)
Transfers	17,587	9,591	33,374	—	(60,552)	—
Exchange realignments	(434)	—	(7,893)	(244)	—	(8,571)
At 31 December 2006, net of accumulated depreciation and impairment	734,367	24,331	1,666,852	157,833	469,636	3,053,019
At 31 December 2006:						
Cost	882,918	71,704	3,016,304	238,044	469,636	4,678,606
Accumulated depreciation and impairment	(148,551)	(47,373)	(1,349,452)	(80,211)	—	(1,625,587)
Net carrying amount	734,367	24,331	1,666,852	157,833	469,636	3,053,019

NOTES TO FINANCIAL STATEMENTS

(Prepared under Hong Kong financial reporting standards)
31 December 2006

15. PROPERTY, PLANT AND EQUIPMENT (continued)

Group

	Buildings RMB'000	Leasehold improvements RMB'000	Machinery, computer and office equipment RMB'000	Motor vehicles RMB'000	Construction in progress RMB'000	Total RMB'000
31 December 2005						
At 31 December 2004 and at 1 January 2005:						
Cost	650,152	60,020	1,845,110	158,541	115,574	2,829,397
Accumulated depreciation and impairment	(86,298)	(37,513)	(712,621)	(57,834)	—	(894,266)
Net carrying amount	563,854	22,507	1,132,489	100,707	115,574	1,935,131
At 1 January 2005, net of accumulated depreciation and impairment	563,854	22,507	1,132,489	100,707	115,574	1,935,131
Additions	4,642	12,948	614,462	66,183	271,950	970,185
Disposals	(9,279)	—	(17,672)	(5,170)	(15,434)	(47,555)
Acquisition of subsidiaries	—	—	12,345	475	—	12,820
Disposal of subsidiaries (note 40)	—	—	(5,589)	(539)	—	(6,128)
Depreciation provided during the year	(29,399)	(11,870)	(337,518)	(15,657)	—	(394,444)
Transfers	219,759	—	11,594	—	(231,353)	—
Exchange realignments	(56)	—	871	141	—	956
At 31 December 2005, net of accumulated depreciation and impairment	749,521	23,585	1,410,982	146,140	140,737	2,470,965
At 31 December 2005:						
Cost	865,216	51,631	2,414,643	210,369	140,737	3,682,596
Accumulated depreciation and impairment	(115,695)	(28,046)	(1,003,661)	(64,229)	—	(1,211,631)
Net carrying amount	749,521	23,585	1,410,982	146,140	140,737	2,470,965

NOTES TO FINANCIAL STATEMENTS

(Prepared under Hong Kong financial reporting standards)
31 December 2006

15. PROPERTY, PLANT AND EQUIPMENT (continued)

Company

	Buildings RMB'000	Leasehold improvements RMB'000	Machinery, computer and office equipment RMB'000	Motor vehicles RMB'000	Construction in progress RMB'000	Total RMB'000
31 December 2006						
At 31 December 2005 and at 1 January 2006:						
Cost	833,910	34,724	1,385,321	154,964	77,261	2,486,180
Accumulated depreciation and impairment	(102,885)	(23,112)	(596,068)	(45,568)	—	(767,633)
Net carrying amount	731,025	11,612	789,253	109,396	77,261	1,718,547
At 1 January 2006, net of accumulated depreciation and impairment	731,025	11,612	789,253	109,396	77,261	1,718,547
Additions	—	—	407,546	32,558	368,134	808,238
Disposals	—	—	(11,000)	(3,785)	—	(14,785)
Transfers from subsidiaries	—	—	22,141	1,090	—	23,231
Transfers to subsidiaries	—	—	(295,655)	(6,938)	—	(302,593)
Depreciation provided during the year	(31,836)	(5,473)	(213,725)	(16,092)	—	(267,126)
Transfers	—	9,591	33,374	—	(42,965)	—
Exchange realignments	(50)	—	(28)	73	—	(5)
At 31 December 2006, net of accumulated depreciation and impairment	699,139	15,730	731,906	116,302	402,430	1,965,507
At 31 December 2006:						
Cost	833,861	44,315	1,378,237	172,135	402,430	2,830,978
Accumulated depreciation and impairment	(134,722)	(28,585)	(646,331)	(55,833)	—	(865,471)
Net carrying amount	699,139	15,730	731,906	116,302	402,430	1,965,507

NOTES TO FINANCIAL STATEMENTS

(Prepared under Hong Kong financial reporting standards)
31 December 2006

15. PROPERTY, PLANT AND EQUIPMENT (continued)

Company

	Buildings RMB'000	Leasehold improvements RMB'000	Machinery, computer and office equipment RMB'000	Motor vehicles RMB'000	Construction in progress RMB'000	Total RMB'000
31 December 2005						
At 31 December 2004 and at 1 January 2005:						
Cost	624,882	47,519	1,063,557	118,952	98,101	1,953,011
Accumulated depreciation and impairment	(73,842)	(34,143)	(410,418)	(41,604)	—	(560,007)
Net carrying amount	551,040	13,376	653,139	77,348	98,101	1,393,004
At 1 January 2005, net of accumulated depreciation and impairment	551,040	13,376	653,139	77,348	98,101	1,393,004
Additions	—	8,543	474,924	52,349	208,919	744,735
Disposals	(10,731)	—	(6,515)	(4,217)	(10,000)	(31,463)
Transfers from subsidiaries	—	—	20,931	618	—	21,549
Transfers to subsidiaries	—	—	(161,085)	(3,941)	—	(165,026)
Depreciation provided during the year	(29,043)	(10,307)	(191,498)	(13,346)	—	(244,194)
Transfers	219,759	—	—	—	(219,759)	—
Reclassifications	—	—	(544)	544	—	—
Exchange realignments	—	—	(99)	41	—	(58)
At 31 December 2005, net of accumulated depreciation and impairment	731,025	11,612	789,253	109,396	77,261	1,718,547
At 31 December 2005:						
Cost	833,910	34,724	1,385,321	154,964	77,261	2,486,180
Accumulated depreciationand impairment	(102,885)	(23,112)	(596,068)	(45,568)	—	(767,633)
Net carrying amount	731,025	11,612	789,253	109,396	77,261	1,718,547

As at 31 December 2006, the Group was in the process of obtaining the real estate title certificate for a building located in Shenzhen, the PRC, with a net book value of approximately RMB238,060,000 (2005: RMB220,000,000), included in the Group's buildings.

NOTES TO FINANCIAL STATEMENTS

(Prepared under Hong Kong financial reporting standards)
31 December 2006

15. PROPERTY, PLANT AND EQUIPMENT (continued)

Company (continued)

Approximately RMB40,416,000 (2005: RMB14,000,000) of the Group's machinery, computer and office equipment represented telecommunications equipment that has been leased to a third party for the operation of a wireless network. According to the respective contract, the lease payment will be made to the Group's subsidiary by way of sharing a certain portion of the profit generated from such telecommunications network for a period of five years where the ownership of these telecommunications equipment will be retained by the subsidiary during the five-year period. During the five-year period, the Group will be solely responsible for the safeguard and the maintenance of the network. Considering that the risk in relation to the assets has not been substantially transferred to the third party, the directors are of the view that such arrangement should be accounted for as operating lease. The equipment was accounted for as construction in progress as at 31 December 2005.

At 31 December 2006, the real estate title certificate for certain of the Group's buildings with net book values of approximately RMB117.2 million (2005: Nil) were held by the court as security in relation to a litigation proceeding (note 42(b)).

16. PREPAID LAND PREMIUMS/LAND LEASE PAYMENTS

Group

	2006 **RMB'000**	2005 RMB'000
Carrying amount at 1 January	**56,480**	54,456
Additions during the year	**1,533**	3,341
Recognised during the year	**(1,418)**	(1,317)
Carrying amount at 31 December	**56,595**	56,480
Current portion	**(1,449)**	(1,418)
Non-current portion	**55,146**	55,062

Various pieces of leasehold land are held under medium term leases and are situated in Mainland China.

Company

	2006 **RMB'000**	2005 RMB'000
Carrying amount at 1 January	**50,706**	50,714
Additions during the year	**—**	1,241
Recognised during the year	**(1,300)**	(1,249)
Carrying amount at 31 December	**49,406**	50,706
Current portion	**(1,300)**	(1,300)
Non-current portion	**48,106**	49,406

NOTES TO FINANCIAL STATEMENTS

(Prepared under Hong Kong financial reporting standards)
31 December 2006

16. PREPAID LAND PREMIUMS/LAND LEASE PAYMENTS (continued)

Various pieces of leasehold land are held under medium term leases and are situated in Mainland China.

As at 31 December 2006, the Group was in the process of obtaining the land use right certificates of certain pieces of land located in Shenzhen, Wuxi, and Anhui, the PRC, with net book values of approximately RMB2,500,000, RMB3,400,000 and RMB2,600,000, respectively.

17. INTANGIBLE ASSETS

Group

	Technology know-how RMB'000	Computer software RMB'000	Operating concession RMB'000	Deferred development costs RMB'000	Total RMB'000
31 December 2006:					
Cost at 1 January 2006, net of accumulated amortisation and impairment	**1,356**	**96,108**	**56,264**	**182,107**	**335,835**
Additions	**—**	**42,715**	**1,172**	**—**	**43,887**
Retirements and disposals	**—**	**(480)**	**(472)**	**—**	**(952)**
Exchange realignments			**(2,307)**	**—**	**(2,307)**
Amortisation provided during the year	**(318)**	**(45,700)**	**(3,183)**	**(52,357)**	**(101,558)**
At 31 December 2006	**1,038**	**92,643**	**51,474**	**129,750**	**274,905**
At 31 December 2006:					
Cost	**1,356**	**268,722**	**68,007**	**239,619**	**577,704**
Accumulated amortisation and impairment	**(318)**	**(176,079)**	**(16,533)**	**(109,869)**	**(302,799)**
Net carrying amount	**1,038**	**92,643**	**51,474**	**129,750**	**274,905**
31 December 2005:					
Cost at 1 January 2005, net of accumulated amortisation and impairment	683	108,902	31,877	66,487	207,949
Additions	1,067	35,512	29,774	148,000	214,353
Retirements and disposals	—	(70)	—	—	(70)
Acquisition of subsidiaries	47	—	—	—	47
Disposals of subsidiaries (note 40)	—	(3,709)	—	—	(3,709)
Amortisation provided during the year	(441)	(44,527)	(5,387)	(32,380)	(82,735)
At 31 December 2005	1,356	96,108	56,264	182,107	335,835
At 31 December 2005:					
Cost	2,397	237,012	69,614	288,039	597,062
Accumulated amortisation and impairment	(1,041)	(140,904)	(13,350)	(105,932)	(261,227)
Net carrying amount	1,356	96,108	56,264	182,107	335,835

NOTES TO FINANCIAL STATEMENTS

(Prepared under Hong Kong financial reporting standards)
31 December 2006

17. INTANGIBLE ASSETS (continued)

Company

	Computer software RMB'000	Deferred development costs RMB'000	Total RMB'000
31 December 2006:			
Cost at 1 January 2006, net of accumulated amortisation and impairment	**86,320**	**182,107**	**268,427**
Additions	**33,843**	**—**	**33,843**
Retirements and disposals	**(334)**	**—**	**(334)**
Amortisation provided during the year	**(41,887)**	**(52,357)**	**(94,244)**
At 31 December 2006	**77,942**	**129,750**	**207,692**
At 31 December 2006:			
Cost	**250,127**	**239,620**	**489,747**
Accumulated amortisation and impairment	**(172,185)**	**(109,870)**	**(282,055)**
Net carrying amount	**77,942**	**129,750**	**207,692**
31 December 2005:			
Cost at 1 January 2005, net of accumulated amortisation and impairment	93,348	66,487	159,835
Additions	33,342	148,000	181,342
Retirements and disposals	(190)	—	(190)
Amortisation provided during the year	(40,180)	(32,380)	(72,560)
At 31 December 2005	86,320	182,107	268,427
At 31 December 2005:			
Cost	219,783	288,038	507,821
Accumulated amortisation and impairment	(133,463)	(105,931)	(239,394)
Net carrying amount	86,320	182,107	268,427

NOTES TO FINANCIAL STATEMENTS

(Prepared under Hong Kong financial reporting standards)
31 December 2006

18. INVESTMENTS IN SUBSIDIARIES

	Company	
	2006	2005
Unlisted shares, at cost	**555,379**	517,218
Less: Provision for impairment	**(113,065)**	(108,350)
	442,314	408,868

The Company's trade and bills receivable, other receivable, trade and bills payable and other payable balances with the subsidiaries are disclosed in notes 24, 26, 30 and 31, to the financial statements respectively. The amounts due from/to subsidiaries are unsecured, interest-free and are repayable on demand.

Particulars of the principal subsidiaries are as follows:

Name	Place and date of incorporation/ registration and operations	Nominal value of issued ordinary/ registered share capital	Percentage of equity attributable to the Company Direct	Indirect	Principal activities
ZTE Kangxun Telecom Company, Limited ("Kangxun")#(i) (深圳市中興康訊電子有限公司)	The PRC/ Mainland China 1 November 1996	RMB50,000,000	90	—	Manufacture and sale of electronic components
ZTE Soft Technology Co., Limited ("ZTE Soft")(ii) (南京中興軟創科技有限責任公司)	The PRC/ Mainland China 21 February 2003	US$7,231,029	76	—	Development, manufacture and marketing of computer software and digital equipment
Xian ZTE Jingcheng Communication Company, Limited ("Xian Jingcheng")#(i) (西安中興精誠通訊有限公司)	The PRC/ Mainland China 21 May 2004	RMB15,000,000	70	—	Development, manufacture and marketing of information technology products and provision of related technical services
Shenzhen Zhongxing Software Company, Limited ("Zhongxing Software")#(ii) (深圳市中興軟件有限責任公司)	The PRC/ Mainland China 9 July 2003	RMB50,000,000	73	25	Development of telecommunications systems software and provision of related consultancy services
Wuxi Zhongxing Optoelectronics Technologies Company, Limited ("Wuxi Zhongxing")#(i) (無錫市中興光電子技術有限公司)	The PRC/ Mainland China 31 January 2000	RMB10,000,000	65	—	Development of technology for optical electronic products and provision of related technical services
ZTE Integration Telecom Ltd.#(i) (深圳中興集訊通信有限公司)	The PRC/ Mainland China 27 June 2003	RMB55,000,000	75	5	Development, manufacture and sale of information technology products

NOTES TO FINANCIAL STATEMENTS

(Prepared under Hong Kong financial reporting standards)
31 December 2006

18. INVESTMENTS IN SUBSIDIARIES (continued)

Name	Place and date of incorporation/ registration and operations	Nominal value of issued ordinary/ registered share capital	Percentage of equity attributable to the Company Direct	Indirect	Principal activities
ZTE Mobile Tech Co., Limited ("ZTE Mobile")#(i) (深圳市中興移動技術有限公司)	The PRC/ Mainland China 12 September 2001	RMB33,333,000	95	—	Development, manufacture and sale of telecommunications related products
ZTE do Brasil Ltda##* (中興通訊(巴西)有限責任公司)	Brazil 7 August 2002	US$200,000 Ordinary	100	—	Development, manufacture and sale of telecommunications related products and provision of related technical services
Congo-Chine Telecom S.A.R.L. ("Congo-Chine")## (剛中電信有限責任公司)	The Democratic Republic of Congo 14 November 2000	US$17,450,0000 Ordinary	51	—	Construction and operation of telecommunications networks
Zhongxing Telecom Pakistan (Pvt.) Limited##* (中興通訊巴基斯坦(私人)有限公司)	Islamic Republic of Pakistan 21 September 1998	Rupees37,919,043 Ordinary	93	—	Manufacture and sale of telecommunications systems equipment
ZTE (H.K.) Limited (中興通訊(香港)有限公司)	Hong Kong 27 October 2000	HK$50,000,000 Ordinary	100	—	Marketing and sale of telecommunications systems equipment and provision of management services
Anhui Wantong Posts and Telecommunications Company, Limited ("Anhui Wantong")#(i) (安徽皖通郵電股份有限公司)	The PRC/ Mainland China 16 April 1997	RMB22,214,400	51	—	Development, manufacture and sale of computer software and integrated information systems
Shenzhen Changfei Investment Company, Limited ("Changfei")#(i) (深圳市長飛投資有限公司)	The PRC/ Mainland China 6 February 2004	RMB30,000,000	51	—	Investment holding
Shanghai Zhongxing Telecom Equipment Technology & Service Company, Limited#(i) (上海中興通訊技術有限責任公司)	The PRC/ Mainland China 10 May 2004	RMB10,000,000	51	—	Development, manufacture and sale of computer software and telecommunications systems equipment
Yangzhou Zhongxing Mobile Telecom Equipment Co., Limited#(i) (揚州中興移動通訊設備有限公司)	The PRC/ Mainland China 30 July 2002	RMB6,000,000	65	—	Development, manufacture and sale of computer software and integrated information systems

NOTES TO FINANCIAL STATEMENTS

(Prepared under Hong Kong financial reporting standards)
31 December 2006

18. INVESTMENTS IN SUBSIDIARIES (continued)

Name	Place and date of incorporation/ registration and operations	Nominal value of issued ordinary/ registered share capital	Percentage of equity attributable to the Company Direct	Indirect	Principal activities
ZTE Microelectronics Technology Co., Ltd[#(i)] (深圳市中興微電子技術有限公司)	The PRC/ Mainland China 28 November 2003	RMB15,000,000	—	81	Design, manufacture and sale of integrated circuit products
Shenzhen Kangquan Electromechanical Company, Limited ("Kangquan")[#] (深圳市康銓機電有限公司)	The PRC/ Mainland China 2 June 2003	RMB16,000,000	—	29.33[###]	Sale of telecommunications systems equipment and provision of related technical services
Shenzhen Lead Communications Company, Limited ("Lead")[#] (深圳市立德通訊器材有限公司)	The PRC/ Mainland China 17 June 2003	RMB10,000,000	—	31.88[###]	Sale of telecommunications systems equipment and provision of related technical services
Shenzhen Ruide Electronic Industrial Company, Limited[#] (深圳市睿德電子實業有限公司)	The PRC/ Mainland China 27 April 2004	RMB8,700,000	—	29.31[###]	Sale of telecommunications systems equipment and provision of related technical services
Guangzhou Nanfang Telecommunications System Software Company Limited ("Guangzhou Nanfang Telecom")[#(i)] (廣州南方電信系統軟件有限公司)	The PRC/ Mainland China 21 September 1999	RMB12,430,000	—	63.84	Development, manufacture and marketing of telecommunication systems software
ZiMax (Cayman) Holding Ltd. ("ZiMax")	Cayman Islands 13 August 2004	US$5,500,000 Ordinary	100	—	Investment holding
ZiMax Technologies, Inc. ("ZiMax Tech")	United States of America 2 June 2005	US$5,379,945 Ordinary	—	100	Research and development of telecommunications related products

(i) These subsidiaries are registered as limited companies under the PRC law.

(ii) These subsidiaries are registered as sino-foreign joint ventures under the PRC law.

\# The English names of these subsidiaries are directly translated from their Chinese names.

\## The Chinese names of these subsidiaries are directly translated from their registered names.

\### These subsidiaries are the subsidiaries of a non wholly-owned subsidiary of the Company, and accordingly, are accounted for as subsidiaries by virtue of the Company's control over them.

* Not audited by Ernst & Young Hong Kong or other Ernst & Young International member firms

The above table lists the subsidiaries of the Company which, in the opinion of the directors, principally affected the results for the year or formed a substantial portion of the net assets of the Group. To give details of other subsidiaries would, in the opinion of the directors, result in particulars of excessive length.

NOTES TO FINANCIAL STATEMENTS

(Prepared under Hong Kong financial reporting standards)
31 December 2006

19. INVESTMENTS IN JOINTLY-CONTROLLED ENTITIES

	Group		Company	
	2006	2005	**2006**	2005
	RMB'000	RMB'000	**RMB'000**	RMB'000
Unlisted shares, at cost	**—**	—	**2,500**	2,500
Share of net assets	**5,936**	6,588	**—**	—
	5,936	6,588	**2,500**	2,500

The Group's trade and bills receivable, trade and bills payable and other payable balances with a jointly-controlled entity are disclosed in notes 24, 30 and 31 to the financial statements respectively. The amounts due from/to the jointly-controlled entities are unsecured, interest-free and are repayable on demand.

Particulars of the principal jointly-controlled entities are as follows:

Name	Business structure	Place and date of incorporation/ registration and operations	Nominal Value of issued and paid-up capital/ registered capital	Percentage of Ownership interest	Percentage of Voting power	Percentage of Profit sharing	Principal activities
Beijing Zhongxing Telecom Ltd. ("Beijing Zhongxing")# (北京中興新通訊設備有限公司)	Corporate	The PRC/ Mainland China 17 March 1998	RMB5,000,000	50	50	50	Sale of telecommunications systems equipment, computer network and peripheral devices and provision of consultancy and equipment leasing services
Bestel Communications Limited ("Bestel")	Corporate	Republic of Cyprus 28 May 2001	CYP600,000 Ordinary	50	50	50	Provision of telecommunications solutions and related consultancy services

The English name of this jointly-controlled entity is directly translated from its Chinese name.

The investment in Beijing Zhongxing is directly held by the Company while that of Bestel is held by a wholly-owned subsidiary of the Company.

NOTES TO FINANCIAL STATEMENTS

(Prepared under Hong Kong financial reporting standards)
31 December 2006

19. INVESTMENTS IN JOINTLY-CONTROLLED ENTITIES (continued)

The following table illustrates the summarised financial information of the Group's jointly-controlled entities:

	2006	2005
	RMB'000	RMB'000
Share of the jointly-controlled entities' assets and liabilities		
Current assets	**7,272**	6,163
Non-current assets	**—**	2,530
Current liabilities	**(1,336)**	(2,105)
Net assets	**5,936**	6,588
Share of the jointly-controlled entities' results		
Turnover	**633**	4,315
Other revenue	**260**	1,427
Total revenue	**893**	5,742
Total expenses	**(1,538)**	(6,940)
Tax	**(7)**	—
Loss after tax	**(652)**	(1,198)

20. INVESTMENTS IN ASSOCIATES

	Group		**Company**	
	2006	2005	**2006**	2005
	RMB'000	RMB'000	**RMB'000**	RMB'000
Unlisted shares, at cost	**—**	—	**37,088**	37,088
Share of net assets	**51,257**	35,583	**—**	—
	51,257	35,583	**37,088**	37,088
Provision for impairment	**—**	—	**(9,774)**	(12,381)
	51,257	35,583	**27,314**	24,707

The Group's trade receivable, trade payable and other payable balances with associates are disclosed in notes 24, 30, 31 to the financial statements, respectively. The amounts due from/to associates are unsecured, interest-free and are repayable on demand.

NOTES TO FINANCIAL STATEMENTS

(Prepared under Hong Kong financial reporting standards)
31 December 2006

20. INVESTMENTS IN ASSOCIATES (continued)

Particulars of the principal associates are as follows:

Name	Business structure	Place and date of incorporation/ registration and operations	Nominal Value of issued and paid-up capital/ registered capital	Percentage of ownership interest attributable to the Group	Principal activities
Beijing Zhongxing Yuanjing Technology Co., Ltd. ("Beijing Yuanjing")#* (北京中興遠景科技有限公司)	Corporate	The PRC 18 October 2000	RMB10,000,000	30	Research and development of telecommunications related products
ZTE IC Design Co. Ltd ("ZTEIC Design")#* (深圳市中興集成電路設計有限責任公司)	Corporate	The PRC 20 March 2000	RMB64,000,000	40	Design, research, development and sale of integrated circuits and related electronical products
Shenzhen Weigao Semi-conductor Technology Co., Ltd.#* (深圳市微高半導體科技有限公司)	Corporate	The PRC 15 June 2004	RMB10,000,000	20.4	Design, research, development and sale of semi-conductor products
Wuxi Kaier Technology Co., Ltd.#* (無錫凱爾科技有限公司)	Corporate	The PRC 26 November 2004	RMB10,000,000	20.07	Development, manufacture and sale of camera lenses for mobile phone
Shenzhen Zhongxing Xinyu FPC Company Limited#* (深圳市中興新宇軟電路有限公司)	Corporate	The PRC 30 July 2003	RMB11,000,000	11.58**	Development, manufacture and sale of circuits; import and exportof related products and technologies
Shenzhen Smart Electronics Ltd. ("Smart")#* (深圳思碼特電子有限公司)	Corporate	The PRC 4 July 2005	HK$30,000,000	15.3**	Development, manufacture and sale of telecommunications related components

The English names of these associates are directly translated from their Chinese names.

* Not audited by Ernst & Young Hong Kong or other Ernst & Young International member firms.

** These associates are held through a non wholly-owned subsidiary of the Company which has significant influence over the boards of directors of these associates.

NOTES TO FINANCIAL STATEMENTS
(Prepared under Hong Kong financial reporting standards)
31 December 2006

20. INVESTMENTS IN ASSOCIATES (continued)

The above table lists the associates of the Group which, in the opinion of the directors, principally affected the results for the year or formed a substantial portion of the net assets of the Group. To give details of other associates would, in the opinion of the directors, result in particulars of excessive length.

The year end date for the financial statements of the above associates is coterminous with those of the Group.

The following table illustrates the summarised financial information of the Group's associates extracted from their management accounts:

	2006 RMB'000	2005 RMB'000
Assets	**395,992**	205,325
Liabilities	**244,427**	108,392
Revenues	**550,031**	169,154
Profit	**26,864**	7,543

21. AVAILABLE-FOR-SALE INVESTMENTS

	Group		Company	
	2006 RMB'000	2005 RMB'000	2006 RMB'000	2005 RMB'000
Unlisted equity investments, at fair value	**43,488**	43,288	**41,488**	41,288

The above investments consist of investments in equity securities which were designated as available-for-sale financial assets and have no fixed maturity date or coupon rate.

The fair values of unlisted available-for-sale equity investments have been estimated using a valuation technique based on assumptions that are not supported by observable market prices or rates. The directors believe that the estimated fair values resulting from the valuation technique, which are recorded in the consolidated balance sheet, and the related changes in fair values, which are recorded in the consolidated equity, are reasonable, and that they are the most appropriate values at the balance sheet date.

NOTES TO FINANCIAL STATEMENTS

(Prepared under Hong Kong financial reporting standards)
31 December 2006

22. INVENTORIES

	Group		Company	
	2006	2005	**2006**	2005
	RMB'000	RMB'000	**RMB'000**	RMB'000
Raw materials	**1,240,514**	1,248,645	**568,775**	782,628
Work in progress	**704,550**	532,923	**295,830**	287,420
Finished goods	**536,091**	458,759	**314,500**	208,044
	2,481,155	2,240,327	**1,179,105**	1,278,092

23. TELECOMMUNICATIONS SYSTEMS CONTRACTS

	Group		Company	
	2006	2005	**2006**	2005
	RMB'000	RMB'000	**RMB'000**	RMB'000
Amount due from customers for contract work	**5,833,480**	4,689,157	**5,809,647**	4,440,842
Amount due to customers for contract work	**(996,275)**	(733,455)	**(991,612)**	(688,876)
	4,837,205	3,955,702	**4,818,035**	3,751,966
Contract costs incurred plus recognised profits less recognised losses to date	**21,619,372**	19,420,235	**19,673,274**	16,346,089
Less: Progress billings	**(16,782,167)**	(15,464,533)	**(14,855,239)**	(12,594,123)
	4,837,205	3,955,702	**4,818,035**	3,751,966

NOTES TO FINANCIAL STATEMENTS

(Prepared under Hong Kong financial reporting standards)
31 December 2006

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

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

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

	Group		Company	
	2006	2005	**2006**	2005
	RMB'000	RMB'000	**RMB'000**	RMB'000
Within 6 months	**6,242,121**	3,968,731	**6,381,674**	4,697,530
7 to 12 months	**650,526**	701,656	**763,464**	840,424
1 to 2 years	**448,583**	313,288	**375,495**	428,519
2 to 3 years	**13,124**	10,551	**135,215**	11,872
Over 3 years	**6,383**	215	**42,659**	39,724
	7,360,737	4,994,441	**7,698,507**	6,018,069
Current portion of trade and bills receivables	**(6,988,034)**	(4,686,775)	**(7,370,341)**	(5,690,947)
Long-term portion	**372,703**	307,666	**328,166**	327,122

The balances due from subsidiaries, the ultimate holding company, jointly-controlled entities, associates and related companies included in the above are as follows:

	Group		Company	
	2006	2005	**2006**	2005
	RMB'000	RMB'000	**RMB'000**	RMB'000
Subsidiaries	**—**	—	**1,813,557**	1,661,034
The ultimate holding company	**2,074**	177	**142**	8
Jointly-controlled entities	**8,874**	2,070	**8,874**	2,070
Associates	**2,869**	2,150	**—**	—
Related companies	**678**	13,314	**49**	3,071
	14,495	17,711	**1,822,622**	1,666,183

The balances are unsecured, interest-free and are repayable on demand, and on credit terms similar to those offered to the major customers of the Group.

NOTES TO FINANCIAL STATEMENTS

(Prepared under Hong Kong financial reporting standards)
31 December 2006

25. FACTORED TRADE RECEIVABLES/FACTORED LONG-TERM TRADE RECEIVABLES

At 31 December 2006, the Company and a subsidiary of the Group factored trade receivables of RMB1,552,054,000 (2005: RMB724,181,000) to banks on a without-recourse basis for cash. As the Company and the subsidiary of the Group still retained the risks and rewards associated with the delay in payment by the customers, the financial asset derecognition conditions as stipulated in HKAS 39 have not been fulfilled. Accordingly, bank advances from the factoring of the Group's trade receivables have been accounted for as liabilities in the consolidated balance sheet.

26. PREPAYMENTS, DEPOSITS AND OTHER RECEIVABLES

	Group		Company	
	2006	2005	**2006**	2005
	RMB'000	RMB'000	**RMB'000**	RMB'000
Prepayments	**115,429**	154,597	**16,281**	70,729
Deposits and other receivables	**1,378,029**	1,029,214	**954,967**	1,025,357
Due from subsidiaries	**—**	—	**1,069,871**	1,122,894
Due from related companies	**3,865**	4,502	**—**	4,502
Dividend receivables	**—**	—	**817,631**	16,465
	1,497,323	1,188,313	**2,858,750**	2,239,947

The amounts due from subsidiaries and related companies are unsecured, interest-free and are repayable on demand.

27. LOAN RECEIVABLES

As at 31 December 2006, the Group had two loan receivables from customers.

A loan receivable of US$1,777,000 (equivalent to approximately RMB13,941,000) was granted during the year. The balance is unsecured, interest-free and is repayable in September 2007.

Another loan receivable of EUR787,500 (equivalent to approximately RMB8,085,000) (2005: RMB30,176,000) bore interest at the three-month EURIBOR + 1% to 3%, was repayable in four installments which had been fully repaid by February 2007.

A loan of SEK43,000,000 (equivalent to approximately RMB44,015,000) bore interest at the STIBOR + 3% to 8%, was granted in 2005 and secured by certain properties and shares of the customer and guaranteed by the customer's immediate holding company. The balance was repaid during the year.

The balance is measured at amortised cost in accordance with the valuation technique using the effective interest method. The directors believe that the carrying amount resulting from the valuation technique approximates to its fair value, which is reasonable and is the most appropriate value at the balance sheet date.

NOTES TO FINANCIAL STATEMENTS

(Prepared under Hong Kong financial reporting standards)
31 December 2006

28. EQUITY INVESTMENT AT FAIR VALUE THROUGH PROFIT OR LOSS

The equity investment for the Group and the Company at 31 December 2006 was listed in Hong Kong and was classified as held for trading.

29. CASH AND CASH EQUIVALENTS AND PLEDGED BANK DEPOSITS

	Group		Company	
	2006	2005	**2006**	2005
	RMB'000	RMB'000	**RMB'000**	RMB'000
Cash and bank balances	**3,168,658**	4,178,498	**2,018,061**	3,007,727
Time deposits	**1,142,402**	1,394,634	**939,859**	1,251,209
	4,311,060	5,573,132	**2,957,920**	4,258,936
Less: Pledged bank deposits	**(168,997)**	(175,899)	**(35,201)**	(46,126)
Cash and cash equivalents	**4,142,063**	5,397,233	**2,922,719**	4,212,810

At the balance sheet date, the cash and bank balances of the Group denominated in Renminbi amounted to approximately RMB2,072,490,000 (2005: RMB3,689,593,000). The Renminbi is not freely convertible into other currencies, however, under Mainland China's Foreign Exchange Control Regulations and Administration of Settlement, Sale and Payment of Foreign Exchange Regulations, the Group is permitted to exchange Renminbi for other currencies through banks authorised to conduct foreign exchange business.

At 31 December 2006, except for the pledged bank deposits of RMB31 million (2005: Nil) were frozen for a litigation proceeding (note 42(b)), all other pledged bank deposits were for banking facilities.

Cash at banks earns interest at floating rates based on daily bank deposit rates. Short-term time deposits are made for varying periods of between one day and three months depending on the immediate cash requirements of the Group, and earn interest at the respective short-term time deposit rates. The carrying amounts of the cash and cash equivalents and pledged deposits approximate to their fair values.

30. TRADE AND BILLS PAYABLES

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

	Group		Company	
	2006	2005	**2006**	2005
	RMB'000	RMB'000	**RMB'000**	RMB'000
Within 6 months	**6,816,521**	6,049,126	**8,858,602**	8,418,896
7 to 12 months	**81,489**	142,100	**704**	3,698
1 to 2 years	**47,855**	45,968	**8,256**	11,343
2 to 3 years	**14,612**	5,506	**1,272**	3,778
Over 3 years	**31,188**	27,092	**23,087**	19,738
	6,991,665	6,269,792	**8,891,921**	8,457,453

NOTES TO FINANCIAL STATEMENTS

(Prepared under Hong Kong financial reporting standards)
31 December 2006

30. TRADE AND BILLS PAYABLES (continued)

The balances due to subsidiaries, the ultimate holding company, related companies, associates and a jointly-controlled entity included in the above are as follows:

	Group		Company	
	2006	2005	**2006**	2005
	RMB'000	RMB'000	**RMB'000**	RMB'000
Subsidiaries	**—**	—	**8,778,447**	8,248,272
The ultimate holding company	**147,860**	104,563	**—**	—
Related companies	**71,367**	125,867	**3,724**	2,975
Associates	**22,108**	15,557	**—**	—
A jointly-controlled entity	**301**	182	**—**	—
	241,636	246,169	**8,782,171**	8,251,247

The balances are unsecured, interest-free and are repayable on demand.

The trade payables are non-interest-bearing and are normally settled on 90-day terms.

31. OTHER PAYABLES AND ACCRUALS

		Group		Company	
		2006	2005	**2006**	2005
	Note	**RMB'000**	RMB'000	**RMB'000**	RMB'000
Receipts in advance		**631,231**	860,106	**513,954**	492,673
Other payables		**890,569**	940,784	**476,793**	637,286
Accruals		**974,730**	847,861	**613,222**	562,147
Provision for warranties	35	**230,417**	248,998	**230,417**	248,998
Due to the ultimate holding company		**361**	313	**361**	313
Due to subsidiaries		**—**	—	**367,862**	647,775
Due to a jointly-controlled entity		**—**	1,024	**—**	1,024
Due to associates		**300**	765	**—**	765
Due to related companies		**4,964**	286	**272**	—
		2,732,572	2,900,137	**2,202,881**	2,590,981

The other payables are non-interest-bearing and have an average term of three months. The balances due to ultimate holding company, subsidiaries, a jointly-controlled entity, associates and related companies are unsecured, interest-free and are repayable on demand.

NOTES TO FINANCIAL STATEMENTS

(Prepared under Hong Kong financial reporting standards)
31 December 2006

32. INTEREST-BEARING BANK BORROWINGS

	2006			2005		
Group	**Effective interest rate (%)**	**Maturity**	**RMB000**	Effective interest rate (%)	Maturity	RMB000
Current						
Bank loans — unsecured	**4.43–6.14**	**2007**	**274,116**	5.58–6.14	2006	552,000
Bank loans — unsecured	**LIBOR+0.5**	**2007**	**546,610**	—	—	—
Bank loans — secured	**5.02**	**2007**	**125,000**	4.96	2006	47,695
			945,726			599,695
Non-current						
Bank loans — secured	**LIBOR+1.5**	**2015**	**269,737**	—	—	—
Bank loans — unsecured	**4–4.32**	**2008–2010**	**980,000**	4	2007	80,000
Bank loans — unsecured	**LIBOR+0.4**	**2008–2009**	**429,505**	—	—	—
			1,679,242			80,000
			2,624,968			679,695

	2006			2005		
Company	**Effective interest rate (%)**	**Maturity**	**RMB000**	Effective interest rate (%)	Maturity	RMB000
Current						
Bank loans — unsecured	**4.43–6.14**	**2007**	**195,217**	5.58-6.14	2006	500,000
Bank loans — unsecured	**LIBOR+0.5**	**2007**	**546,610**	—	—	—
			741,827			500,000
Non-current						
Bank loans — unsecured	**4.05–4.32**	**2008–2010**	**900,000**	—	—	—
Bank loans — unsecured	**LIBOR+0.4**	**2008–2009**	**429,478**	—	—	—
			1,329,478			—
			2,071,305			500,000

NOTES TO FINANCIAL STATEMENTS

(Prepared under Hong Kong financial reporting standards)
31 December 2006

32. INTEREST-BEARING BANK BORROWINGS (continued)

	Group		Company	
	2006	2005	**2006**	2005
	RMB'000	RMB'000	**RMB'000**	RMB'000
Analysed into:				
Bank loans repayable:				
Within one year or on demand	**945,726**	599,695	**741,827**	500,000
In the second year	**1,033,157**	80,000	**1,017,130**	—
In the third to fifth years, inclusive	**376,348**	—	**312,348**	—
Beyond five years	**269,737**	—	**—**	—
	2,624,968	679,695	**2,071,305**	500,000

Notes:

(a) Except for bank loans of approximately RMB1,521,042,000 (2005: RMB127,696,000) which are denominated in United Sates dollars, all borrowings are in Renminbi.

(b) Except for the unsecured bank loans with a carrying amount of RMB1,254,116,000 (2005: RMB632,000,000) and a secured bank loan with a carrying amount of RMB125,000,000 (2005: RMB47,695,000), all borrowings of the Group bear interest at floating interest rates.

The Group's and the Company's secured bank loans or banking facilities are secured by:

	Group		Company	
	2006	2005	**2006**	2005
	RMB'000	RMB'000	**RMB'000**	RMB'000
Pledged bank deposits	**137,997**	175,899	**4,201**	46,126
Trade receivables	**1,552,054**	771,876	**1,545,800**	688,605
	1,690,051	947,775	**1,550,001**	734,731

Certain of the Group's and Company's unsecured bank loans are guaranteed by:

	Group		Company	
	2006	2005	**2006**	2005
	RMB'000	RMB'000	**RMB'000**	RMB'000
Other banks or government	**120,900**	580,000	**—**	500,000

The carrying amounts of the Group's and the Company's borrowings approximate to their fair values.

NOTES TO FINANCIAL STATEMENTS
(Prepared under Hong Kong financial reporting standards)
31 December 2006

33. PROVISION FOR RETIREMENT BENEFITS

The Group and the Company provide certain of the eligible staff with post-retirement benefits pursuant to a retirement benefits plan. The plan is funded solely by the Group on an actual payment basis.

The latest actuarial valuation of the plan was conducted at 31 December 2006 in accordance with HKAS 19 *Employee Benefits* by qualified actuaries of Watson Wyatt Hong Kong Limited. The present value of defined benefits obligations and current service costs are determined actuarially based on the projected unit credit method, which involves a number of assumptions and estimates including the rate of inflation, discount rate, employees' turnover ratio as well as mortality rate. Actuarial gains/(losses) are recognised by amortising the amount by which cumulative unrecognised gains/(losses) exceed 10% of the greater of the assets of the plan and the defined benefits obligations over the average expected future working lifetime of the active members of the plan.

The benefits obligations recognised in the balance sheet are as follows:

Group and Company

	2006 **RMB'000**	2005 RMB'000
Present value of the obligations	**58,234**	54,577
Unrecognised actuarial losses	**(26,176)**	(24,118)
Net liability in the balance sheet	**32,058**	30,459

Movements in the net liability recognised in the balance sheet during the year are as follows:

	2006 **RMB'000**	2005 RMB'000
Net liability at beginning of year	**30,459**	28,923
Benefits expenses recognised in the consolidated income statement	**2,787**	2,224
Pension payments made	**(1,188)**	(688)
Net liability at end of year	**32,058**	30,459

The principal assumptions used in determining the pension benefits obligations are shown below:

	2006	2005
(a) Discount rate	**3.75%**	3.5%

(b) The expected rate of increase in salaries ranged from 1% to 7.5% per annum, which was based on the number of years of employment.

NOTES TO FINANCIAL STATEMENTS

(Prepared under Hong Kong financial reporting standards)
31 December 2006

33. PROVISION FOR RETIREMENT BENEFITS (continued)

The benefits expense recognised in the consolidated income statement for the year is as follows:

	2006 **RMB'000**	2005 RMB'000
Current service cost	**—**	—
Interest cost on benefits obligations	**1,890**	1,935
Net actuarial losses recognised in the year	**897**	289
Benefits expense included in staff costs — note 6	**2,787**	2,224

34. OTHER LONG-TERM PAYABLES

Other long-term payables represent government grants which are unsecured, interest-free and have no fixed terms of repayment.

35. PROVISION FOR WARRANTIES

	Group		**Company**	
	2006 **RMB'000**	2005 RMB'000	**2006** **RMB'000**	2005 RMB'000
At beginning of year	**248,998**	186,227	**248,998**	186,227
Additional provisions	**114,724**	225,790	**114,724**	225,790
Amounts utilised during the year	**(133,305)**	(163,019)	**(133,305)**	(163,019)
At 31 December 2006	**230,417**	248,998	**230,417**	248,998

In respect of telecommunications systems contracts, the Group and the Company provide warranties to their customers for twelve months after contract completion dates, during which free repair and maintenance services are provided. A provision for warranties is made at 2% to 2.5% of the cost of equipment sold during the year, and is estimated based on the equipment return rate and past experience of the level of repairs and maintenance. The estimation is reviewed on an ongoing basis and revised where appropriate.

In respect of handsets, the Group and the Company generally provide a one-year warranty to their customers under which faulty products will be repaired or replaced. The amount of provision for warranties is estimated based on sales volume and past experience of the level of repairs and return.

NOTES TO FINANCIAL STATEMENTS

(Prepared under Hong Kong financial reporting standards)
31 December 2006

36. DEFERRED TAX

The movements in deferred tax assets and liabilities during the year are as follows:

	Group		Company	
	2006	2005	**2006**	2005
	RMB'000	RMB'000	**RMB'000**	RMB'000
Deferred tax assets:				
At beginning of year	**59,587**	104,681	**55,113**	76,475
Deferred tax credit/(charged) to the income statement during the year (note 10)	**151,336**	(45,094)	**139,434**	(21,362)
At end of year	**210,923**	59,587	**194,547**	55,113
Deferred tax assets:				
Provision against inventories	**53,166**	39,069	**44,088**	39,069
Provision for warranties	**34,562**	37,350	**34,562**	37,350
Provision for retirement benefits	**4,809**	4,569	**4,809**	4,569
Tax losses	**51,141**	—	**51,141**	—
Overseas tax	**87,516**	—	**87,516**	—
Government grants	**399**	739	**399**	739
Unrealised profit arising on consolidation	**7,298**	4,474	**—**	—
Deferred tax liabilities:				
Intangible assets	**(27,968)**	(26,614)	**(27,968)**	(26,614)
Deferred tax assets, net	**210,923**	59,587	**194,547**	55,113

At 31 December 2005 and 2006, there was no significant unrecognised deferred tax liability for taxes that would be payable on the unremitted earnings of certain of the Group's subsidiaries, jointly-controlled entities and associates as the Group has no liability to additional tax should such amounts be remitted.

37. SHARE CAPITAL

	2006	2005
	RMB'000	RMB'000
Registered, issued, and fully paid		
State-owned A shares of RMB1.00 each	**392,080**	392,080
Legal person A shares of RMB1.00 each	**29,724**	29,724
Individual A shares of RMB1.00 each	**377,567**	377,567
H shares of RMB1.00 each	**160,151**	160,151
	959,522	959,522

Zhongxingxin, the ultimate holding company of the Group, has further undertaken not to sell its original non-tradable shares amounting to more than five percent and ten percent of the total share capital of the Company during the period from the 13th month to 24th month and the period from the 25th month to 36th month subsequent to their listing on the Shenzhen Stock Exchange on 29 December 2005, respectively.

37. SHARE CAPITAL (continued)

Zhongxingxin has further provided a specific undertaking that where it sells its shares during the period from the 13th month to the 24th month after such shares have been granted the right of listing and circulation on the Shenzhen Stock Exchange, the price at which the shares are sold shall not be lower than the mathematical average of the closing prices of its A Shares for the 60 trading days prior to the first announcement of the Share Reform Plan by the Board, that is, RMB26.75 per share. The proceeds from any sale in breach of such undertaking shall be reverted to the Company's account for the benefit of all shareholders of the Company.

38. SHARE INCENTIVE SCHEME

During the year, the Company launched a share incentive scheme for providing incentive and reward to 3,435 employees of the Company and its subsidiaries (the ''Participants''), including 21 directors and senior management pursuant to which the Company has agreed to grant a total number of 43,182,000 A shares (the ''Awarded Shares'') for the benefit of the Participants. The Participants have to pay the subscription amounts for the Awarded Shares on the basis of the purchase of 5.2 Awarded Shares at the subscription price for every 10 Awarded Shares granted, out of which the subscription amounts for 3.8 Awarded Shares are funded by the Participants at their own cost and the subscription amounts for the 1.4 Awarded Shares are funded by the conversion of the deferred bonus that the Participants would otherwise have received prior to their agreement not to participate in the distribution of 2006 deferred bonus. The subscription price is RMB30.05 per share, being the closing price of the Company's A shares as quoted on the Shenzhen Stock Exchange on the trading day immediately preceding the date on which the board meeting for reviewing the share incentive scheme was convened for the first time.

According to the share incentive scheme, the Company has set aside a total number of 4,798,000 shares (the ''Potential Awarded Shares'') for granting to employees (the ''Potential Participants'') who make significant contributions to the Company and important personnel required by the Company who are identified after the share incentive scheme has been reviewed and passed at the general meeting. The Supervisor Committee will verify the qualifications of the aforesaid employees. The admission of Directors, Supervisors and Senior Management as the Potential Participants shall be submitted to the general meetings of the Company for its approval. The subscription price for the Potential Awarded Shares will be calculated on the same basis of the Awarded Shares as described above.

The Awarded Shares and the Potential Awarded Shares will be vested to the Participants subject to the terms and conditions attached to the share incentive scheme for a period no shorter than two years from the date of approval, during which the participants shall be restricted from disposing of any of the Awarded Shares. The shares awarded by the Company under the share incentive scheme are considered to be share-based payments under HKFRS 2.

The fair value of the shares awarded during the year was estimated at approximately RMB2,480,000.

The fair value of shares awarded during the year was estimated as at the date of grant, valued by an independent professional valuer, Towers Perrin, taking into account the expected future dividend yield prior to the vesting of the Awarded Shares of which the participants will not be entitled, and other terms and conditions upon which the shares were awarded.

NOTES TO FINANCIAL STATEMENTS

(Prepared under Hong Kong financial reporting standards)
31 December 2006

39. RESERVES

(a) Group

The amounts of the Group's reserves and the movements therein for the current and prior years are presented in the consolidated statement of changes in equity on pages 177 and 178 of the financial statements.

The capital reserves of the Group include the non-distributable reserves of the Company and its subsidiaries created in accordance with accounting and financial regulations in the PRC.

In accordance with the PRC Company Law and the Company's articles of association, the Company and its subsidiaries registered in the PRC are required to appropriate certain percentage of the statutory net profit after tax to the statutory reserve fund. Subject to certain restrictions set out in the relevant PRC regulations and in the subsidiaries' articles of association, the statutory reserve fund may be used either to offset losses, or for capitalisation issues by way of paid-up capital. The reserves cannot be used for purposes other than those for which they are created and are not distributable as cash dividends.

The share incentive scheme reserve was created for the share incentive scheme launched by the Company to provide incentive and reward to certain employees of the Company and its subsidiaries.

(b) Company

	Notes	Issued share capital RMB'000	Capital reserve RMB'000	Share incentive scheme reserves RMB'000	Statutory reserves RMB'000	Exchange fluctuation reserve RMB'000	Retained profits RMB'000	Proposed final dividend RMB'000	Total RMB'000
At 1 January 2005		959,522	5,462,515	—	650,718	3,561	229,830	239,880	7,546,026
Final 2004 dividend declared		—	—	—	—	—	—	(239,880)	(239,880)
Transfer from/(to) retained profits		—	—	—	118,885	—	(118,885)	—	—
Profit for the year		—	—	—	—	—	1,084,317	—	1,084,317
Proposed final 2005 dividend	12	—	—	—	—	—	(239,880)	239,880	—
Exchange realignments and other income recognised directly in equity		—	5,306	—	—	(3,509)	—	—	1,797
At 31 December 2005 and 1 January 2006		959,522	5,467,821	—	769,603	52	955,382	239,880	8,392,260
Final 2005 dividend declared		—	—	—	—	—	—	(239,880)	(239,880)
Transfer from/(to) retained profits		—	—	—	—	—	—	—	—
Loss for the year		—	—	—	—	—	831,130	—	831,130
Proposed final 2006 dividend	12	—	—	—	—	—	(143,928)	143,928	—
Exchange realignments and other income recognised directly in equity		—	—	—	—	(1,545)	—	—	(1,545)
Equity settled share expense	38	—	—	2,480	—	—	—	—	2,480
At 31 December 2006		959,522	5,467,821	2,480	769,603	(1,493)	1,642,584	143,928	8,984,445

NOTES TO FINANCIAL STATEMENTS

(Prepared under Hong Kong financial reporting standards)
31 December 2006

40. DISPOSAL OF INTERESTS IN SUBSIDIARIES

	2006 RMB'000	2005 RMB'000
Net assets disposed of:		
Property, plant and equipment	—	6,128
Intangible assets	—	3,709
Available-for-sale investment	—	1,582
Inventories	—	11,013
Cash and bank balances	10,518	31,552
Trade receivables	—	26,399
Prepayments and other receivables	254	5,880
Trade payables	—	(14,833)
Short-term loan	—	(9,990)
Accruals and other payables	(78)	(35,517)
Minority interests	(100)	(11,555)
	10,594	14,368
Loss on disposal of interests in subsidiaries	—	(1,198)
Gain on deemed disposal of interest in a subsidiary	—	3,655
	10,594	16,825

	2006 RMB'000	2005 RMB'000
Satisfied by:		
Cash	10,229	328
Reclassification from interests in subsidiaries to interests in associates	365	10,900
Reclassification from interests in subsidiaries to interests in jointly-controlled entities	—	5,597
	10,594	16,825

An analysis of the net inflow of cash and cash equivalents in respect of the disposal of interests in subsidiaries is as follows:

	2006 RMB'000	2005 RMB'000
Cash consideration	10,229	328
Cash and bank balances disposed of	(10,518)	(31,552)
Net outflow of cash and cash equivalents in respect of the disposal of interests in subsidiaries	(289)	(31,224)

NOTES TO FINANCIAL STATEMENTS

(Prepared under Hong Kong financial reporting standards)
31 December 2006

41. NOTE TO THE CONSOLIDATED CASH FLOW STATEMENT

Major non-cash transaction

During the year, the Company acquired a 3% interest in ZTE Software from another shareholder with effect from July 2006 at a consideration of approximately RMB29 million. The consideration was included in the other payables at 31 December 2006.

42. CONTINGENT LIABILITIES

(a) At the balance sheet date, contingent liabilities not provided for in the financial statements were as follows:

Group and Company

	2006 RMB'000	2005 RMB'000
Factored trade receivables	**107,181**	438,490
Guarantees given to banks in respect of performance bonds	**5,200,588**	2,823,760
	5,307,769	3,262,250

(b) On 3 November 2005, a Jiangsu Provincial Higher People's Court (the "Court") action was commenced by a customer against a subsidiary of the Group and the Company in respect of a claim for return of advance payment, accrued interest and compensating losses of approximately RMB71 million in aggregate. As at the date of approval of these financial statements, no decision had been made in the court proceedings.

Meanwhile, RMB31 million of the Group's cash had been temporary frozen and the real estate title certificate for certain of the Group's buildings with net book value of approximately RMB117.2 million were held by the court as security for such litigation. In the opinion of the directors, based on legal advice from the Company's lawyer engaged for this action, the subsidiary of the Group and the Company have valid defences against such claims and any resulting liabilities would not have any material adverse impact on the Group's financial position. Therefore, no provision in respect of such claims was made in the financial statements.

(c) On 16 December 2005, an arbitration was commenced by a foreign supplier against the Company in respect of claims for breach of contract and infringement of intellectual property rights in the amount of approximately US$36,450,000 (equivalent to approximately RMB294.2 million) in aggregate.

As at the approval date of these financial statements, no arbitral award or other decision by the tribunal had been made on the claims. In the opinion of the directors, based on legal advice from the Company's lawyer engaged for the action, the Company had valid defences against the claims brought in the arbitration, the directors currently believed that the outcome of the arbitration would not have a material adverse impact on the Group's financial position. Therefore, no provision in respect of such claims had been made in the financial statements.

(d) On 18 August 2005, the Company received a notice of arbitration from a foreign consultant in respect of a claim for consultancy fee, agency fee and compensation for undue delay in honouring payment with a total amount approximately US$1,714,000 (equivalent to approximately RMB13,384,000). During the year of 2006, the plaintiff raised the claim to approximately US$2,143,000 (equivalent to approximately RMB16,734,000).

NOTES TO FINANCIAL STATEMENTS

(Prepared under Hong Kong financial reporting standards)
31 December 2006

42. CONTINGENT LIABILITIES (continued)

(d) (continued)

As at the approval date of these financial statements, no decision has been made in the arbitration. In the opinion of the directors, based on legal advice from the Company's lawyer engaged for this action, the Company has valid defences, against such claims and any resulting liabilities would not have any material adverse impact on the Group's financial position. Therefore, no provision in respect of such claims has been made in the financial statements.

(e) In 2005, ZTE Pakistan Private Limited, the subsidiary of the Group in Pakistan had commenced a defence action against the Collectorate of Customs, Sales Tax and Central Excise (Adjudication/Appeals), Rawalpindi in respect of a claim by the latter for additional customs duties of approximately Rs.177 million (equivalent to approximately RMB23.9 million), which was subsequently raised to approximately Rs.240 million (equivalent to approximately RMB31.2 million) and a penalty of approximately Rs.2.4 billion (equivalent to approximately RMB324 million) for an alleged misdeclaration of imported goods in the Customs, Central Excise and Sales Tax Appellate Tribunal, Islamabad, Pakistan.

The Central Board of Revenue referred all disputes between the parties to the Alternate Dispute Resolution Committee (the ''Committee'') for resolution and on 5 September 2005, the Committee has recommended in favour of the subsidiary of the Group.

As at the approval date of these financial statements, no decision has been made in the Tribunal. The directors estimated that the maximum financial impact to the Group relating to additional customs duties would be in the order of approximately Rs.36 million (equivalent to approximately RMB4.8 million) and has made an accrual of RMB4 million accordingly in the Group's financial statements for the year ended 31 December 2006. In the opinion of the directors, based on legal advice from the Company's lawyer engaged for this action, the subsidiary of the Group has valid defences, against the aforesaid claims and any resulting liabilities would not have any material adverse impact on the Group's financial position. Therefore, no further provision in respect of customs duties penalty was considered necessary to be made in the financial statements.

(f) In August 2006, a foreign customer commenced an arbitration for a claim against the Company, for Rs.762,982,000 (equivalent to approximately RMB97,980,000), in respect of the Company's failure to honour a contract. As at the approval date of these financial statements, the arbitration body has not made any decision regarding the case; while in return, the Company has launched a counter claim against the foreign customer for failure in honouring the contract. As at the approval date of these financial statements, no decision has been made in the arbitration and neither did the Company pay any compensation regarding the arbitration. In the opinion of the directors, based on legal advice from the Company's lawyer engaged for this action, the Company had valid defence against such claims and any resulting liabilities would not have material adverse impact on the Group's financial position. Accordingly, no provision in respect of such claims was made in the financial statements.

(g) The Group has provided a financial guarantee for an independent customer with a maximum amount of RMB50 million included corresponding interest, which will expire in September 2018.

In accordance with HKAS 39 and HKFRS 4, such financial guarantee contract is accounted for as a financial liability and recognised initially at its fair value of RMB3,689,000.

NOTES TO FINANCIAL STATEMENTS
(Prepared under Hong Kong financial reporting standards)
31 December 2006

43. PLEDGE OF ASSETS

Details of the Group's bank loans, which are secured by the assets of the Group, are included in note 32 to the financial statements.

44. OPERATING LEASE ARRANGEMENTS

(a) As lessor

The Group is entitled to share a portion of the profit generated from the telecommunication network as disclosed in note 15 to the financial statements. During the year, approximately RMB 29 million (2005: Nil) of operating lease rental income had been recognised under this arrangement.

(b) As lessee

The Group leases certain of its offices under operating lease arrangements, with leases negotiated for terms ranging from 1 to 12 years.

At 31 December 2006, the Group had total future minimum lease payments under non-cancellable operating leases falling due as follows:

	2006	2005
	RMB'000	RMB'000
Within one year	**118,347**	97,047
In the second to fifth years, inclusive	**81,470**	79,109
After five years	**1,554**	7,269
	201,371	183,425

45. COMMITMENTS

In addition to the operating lease commitments detailed in note 44 above, the Group had the following commitments at the balance sheet date:

Capital commitments

	2006	2005
	RMB'000	RMB'000
Land and buildings:		
Contracted, but not provided for	**795,991**	231,561
Investment in associates:		
Contracted, but not provided for	**80,331**	21,065

NOTES TO FINANCIAL STATEMENTS

(Prepared under Hong Kong financial reporting standards)
31 December 2006

46. DIFFERENCES IN FINANCIAL STATEMENTS PREPARED UNDER PRC GAAP AND HKFRSs

Ernst & Young is responsible for the audit of the Group's and the Company's financial statements prepared under HKFRSs.

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

	Notes	**2006 RMB'000**	2005 RMB'000
Profit			
Profit from ordinary activities attributable to shareholders under PRC GAAP		**807,353**	1,194,343
Add back/(deduct):			
Accounting standards differences			
Recognition of government grants	(i)	**2,123**	(8,881)
Provision for retirement benefits	(ii)	**(1,599)**	(1,536)
Deferred development costs	(iii)	**(52,357)**	115,621
Recognition of an excess over the cost of business combinations	(iv)	**—**	9,460
Deferred tax	(v)	**(1,454)**	(21,306)
Fair value gains on an equity investment at fair value through profit or loss	(vi)	**16,595**	—
Recognition of a financial guarantee contract	(vii)	**(3,689)**	—
Profit attributable to equity holders of the parent under HKFRSs		**766,972**	1,287,701
Shareholders' equity			
Shareholders' equity under PRC GAAP		**10,678,911**	10,125,095
Add back/(deduct):			
Accounting standards differences			
Recognition of government grants	(i)	**(2,805)**	(4,926)
Provision for retirement benefits	(ii)	**(32,058)**	(30,459)
Deferred development costs	(iii)	**129,751**	182,108
Deferred tax	(v)	**(22,760)**	(21,306)
Fair value gains on an equity investment at fair value through profit or loss	(vi)	**16,595**	—
Recognition of a financial guarantee contract	(vii)	**(3,689)**	—
Equity attributable to equity holders of the parent under HKFRSs		**10,763,945**	10,250,512

NOTES TO FINANCIAL STATEMENTS

(Prepared under Hong Kong financial reporting standards)
31 December 2006

46. DIFFERENCES IN FINANCIAL STATEMENTS PREPARED UNDER PRC GAAP AND HKFRSs (continued)

(i) Government grants

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

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

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

(ii) Provision for retirement benefits

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

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

(iii) Deferred development costs

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

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

(iv) Excess over the cost of business combinations

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

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

(v) Deferred tax

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

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

Under PRC GAAP, equity investments held for trading are measured at cost.

Under HKFRSs, equity investments held for trading are classified as financial assets at fair value through profit or loss. Any gains or losses result from change in fair value are recognised in the income statement.

NOTES TO FINANCIAL STATEMENTS

(Prepared under Hong Kong financial reporting standards)
31 December 2006

46. DIFFERENCES IN FINANCIAL STATEMENTS PREPARED UNDER PRC GAAP AND HKFRSs (continued)

(vii) Financial guarantee contract

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

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

47. RELATED PARTY TRANSACTIONS

(I) Transactions with related parties

In addition to the transactions and balances detailed elsewhere in these financial statements, the Group had the following material related party transactions during the year:

	Notes	**2006 RMB'000**	2005 RMB'000
The ultimate holding company:			
Purchase of raw materials	(a)	**359,439**	311,970
Sale of finished goods	(b)	**3,682**	545
Shareholders of the ultimate holding company:			
Purchase of raw materials	(a)	**145,991**	208,207
Sale of finished goods	(e)	**7,830**	19,621
Jointly-controlled entities:			
Purchase of raw materials	(a)	**—**	89
Sale of finished goods	(b)	**31,947**	7,513
Acquisition of a 19% equity interest in ZTE ITS Limited	(c)	**—**	1,024
Associates:			
Purchase of raw materials	(a)	**105,858**	48,787
Sale of finished goods	(b)	**18,101**	2,815
Sale of finished goods	(e)	**—**	9,025
Purchase of raw materials	(e)	**—**	5,874
Entity controlled by key management personnel of the Group:			
Purchase of raw materials	(a)	**217**	8,166
Shareholder of a subsidiary:			
Corporate guarantee	(d)	**80,000**	80,000
Fellow subsidiaries:			
Purchase of raw materials	(a)	**107,379**	125,950
Sale of finished goods	(b)	**1,218**	13

In the opinion of the directors, the above transactions were conducted in the ordinary course of business.

NOTES TO FINANCIAL STATEMENTS

(Prepared under Hong Kong financial reporting standards)
31 December 2006

47. RELATED PARTY TRANSACTIONS (continued)

(I) Transactions with related parties (continued)

Notes:

(a) The purchases of raw materials were made in accordance with published prices and conditions similar to those offered by the suppliers to their major customers.

(b) The sales of finished goods were made in accordance with published prices and conditions offered to major customers of the Group.

(c) In 2005, Beijing Zhongxing Telecom Ltd, the Group's 50% owned jointly-controlled entity, disposed of its 70% equity interest in ZTE ITS Limited, of which 19% of the disposed interests was acquired by the Company for a cash consideration of RMB1,024,000. Subsequent to the disposal of the 70% equity interests in ZTE ITS Limited by Beijing Zhongxing Telecom Ltd, ZTE ITS Limited, which was formerly a 35% owned jointly-controlled entity of the Group, became a 19% owned available-for-sale investment of the Group.

(d) The guarantee in respect of bank borrowings was provided by related parties at nil consideration.

(e) The purchase and sale prices of the goods were determined at rates mutually agreed between the Group and the related parties.

(II) Outstanding balances with related parties:

(i) Details of the Group's trade balances with the ultimate holding company, jointly-controlled entities, associates and other related parties as at balance sheet date are disclosed in notes 24 and 30 to the financial statements.

(ii) Details of the Group's balances of receivables and payables which are not trading in nature with the ultimate holding company, jointly-controlled entities, associates and other related parties as at balance sheet date are disclosed in notes 26 and 31 to the financial statements.

(III) Compensation of key management personnel of the Group

	2006	2005
	RMB'000	RMB'000
Short-term employee benefits	**4,992**	4,875
Post-employment benefits	**74**	53
Total compensation paid to key management personnel	**5,066**	4,928

Included in the transactions with the Group's ultimate holding company and the fellow subsidiaries, certain transactions amounting to approximately RMB451 million constitute continuing connected transactions as defined in Chapter 14A of the Listing Rules.

NOTES TO FINANCIAL STATEMENTS

(Prepared under Hong Kong financial reporting standards)
31 December 2006

48. FINANCIAL RISK MANAGEMENT OBJECTIVES AND POLICIES

The main risks arising from the Group's financial instruments are interest rate risk, foreign currency risk, credit risk and liquidity risk. Generally, the Group introduces conservative strategies on its risk management. As the Group's exposure to these risks is kept to a minimum, the Group has not used any derivatives and other instruments for hedging purposes. The Group does not hold or issue derivative financial instruments for trading purposes. The board of directors reviews and agrees policies for managing each of these risks and they are summarised as follows:

Interest rate risk

At 31 December 2006, the bank loans of the Group and the Company including fixed rate debts and floating debts based on LIBOR. The Group and the Company have no significant concentration of interest rate risk.

Foreign currency risk

The Group has transactional currency exposures. Such exposures arise from sales or purchases by operating units in currencies other than the units' functional currency, where the revenue is predominately in US$ and RMB and certain portion of the bank loans is denominated in US$. The Group tends to accept foreign currency exchange risk avoidance or allocation terms when arriving at purchase and sales contracts. The Group takes rolling forecast on foreign currency revenue and expenses, matches the currency and amount incurred, so as to alleviate the impact to business due to exchange rate fluctuation.

Credit risk

With respect to credit risk arising from the other financial assets of the Group, which comprise cash and cash equivalents, and trade receivables, the Group's exposure to credit risk arises from default of the counterparty, with a maximum exposure equal to the carrying amount of these instruments.

In order to minimise the credit risk, the management of the Group has delegated a team responsible for determination of credit limits, credit approvals and other monitoring procedures to ensure that follow-up action is taken to recover overdue debts. In addition, the Group reviews regularly the recoverable amount of each individual trade receivables to ensure that adequate impairment losses are made for irrecoverable amounts. In this regard, the directors of the Company consider that the Group's credit risk is minimal.

Liquidity risk

The Group's objective is to maintain a balance between continuity of funding and flexibility through the use of bank loans and other interest-bearing loans. In addition, banking facilities have been put in place for contingency purposes.

49. POST BALANCE SHEET EVENT

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

50. APPROVAL OF THE FINANCIAL STATEMENTS

The financial statements were approved and authorised for issue by the board of directors on 18 April 2007.

DOCUMENTS AVAILABLE FOR INSPECTION

1. Text of the 2006 annual report signed by the Chairman of the Board of Directors;

2. Original copies of the Group's audited financial reports and consolidated financial statements for the year ended 31 December 2006 prepared in accordance with the PRC GAAP and HKFRSs duly signed by the Company's legal representative, Chief Financial Officer and Head of Finance Division;

3. Original copy of the auditors' report with stamped by the certified public accountants and duly signed and sealed by the registered accountants;

4. Original copies of all of the Company's released documents and announcements published in China Securities Journal, Securities Times and Shanghai Securities News during the reporting period;

5. Articles of Association.

By order of the Board

Hou Weigui
Chairman

19 April 2007