

ZTE中兴

ZTE CORPORATION

中興通訊股份有限公司

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

(Stock Code: 763)

2006 FIRST QUARTERLY REPORT

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

1. IMPORTANT

- 1.1 The Board of Directors, Supervisory Committee and the Directors, Supervisors and senior management of ZTE Corporation (the “Company”) confirm that this 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 its contents.
- 1.2 This quarterly report has been considered and approved by the seventeenth meeting of the third 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 has authorised in writing Mr. Li Juping, Director, to vote on his behalf. Mr. Xie Weiliang, Vice Chairman, was unable to attend the meeting due to work reasons, and authorised in writing Mr. Dong Lianbo, Director, to vote on his behalf. Mr. Shi Lirong, Director, was unable to attend the meeting due to work reasons, and authorised in writing Mr. Yin Yimin, Director, to vote on his behalf.
- 1.3 The financial statements contained in this quarterly report are unaudited. The financial information contained in this report has been prepared in accordance with generally accepted accounting principles in the People’s Republic of China (“PRC GAAP”). The Company has also disclosed in this quarterly report a reconciliation of net profits and shareholders’ equity of the Company and its subsidiaries (together referred to as the “Group”) from PRC GAAP to Hong Kong accounting standards (“HKASs”).
- 1.4 Mr. Hou Weigui, Chairman of the Company, Mr. Wei Zaisheng, Chief Financial Officer of the Company and Mr. Shi Chunmao, Head of Finance Division of the Company, hereby declare that they warrant the truthfulness and completeness of the financial report contained in this quarterly report.

2. CORPORATE PROFILE

2.1 Corporate information

Stock Name (A share/H share) G Zhongxing/ZTE
Stock code (A share/H share) 000063/763

	Secretary to the Board of Directors	Authorised representatives	Joint company secretaries	Securities affairs representative
Name	Feng Jianxiong	Yin Yimin Feng Jianxiong	Feng Jianxiong Suen Pui Yee, Samantha	Li Liuhong
Address	ZTE Plaza, Keji Road South, Hi-Tech Industrial Park, Nanshan District, Shenzhen, Guangdong Province, People's Republic of China			
Telephone	+86 755 26770282			
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E-mail	fengjianxiong@zte.com.cn			
Place of business in Hong Kong	8/F Gloucester Tower, the Landmark, 11 Pedder Street, Central, Hong Kong			

2.2 Financial Information

2.2.1 Major Accounting Data and Financial Indicators of the Group

Item	As at 31 March 2006	As at 31 December 2005	Change as at the end of the reporting period compared with the end of last year (%)
Total assets (RMB in thousands)	21,310,164	21,779,131	(2.15)
Shareholders' equity (excluding minority interests) (RMB in thousands)	10,156,038	10,125,095	0.31
Net assets per share (RMB)	10.58	10.55	0.28
Adjusted net assets per share (RMB)	10.57	10.55	0.19

Item	For the three months ended 31 March 2006	For the three months ended 31 March 2005	Change for the reporting period compared with the same period last year
Net cashflow from operating activities (RMB in thousand)	(2,271,243)	(2,336,083)	2.78%
Earnings per share (RMB)*	0.035	0.240	(85.42%)
Return on net assets (%)	0.33	2.45	Decreased by 2.12 percentage points
Return on net assets after extraordinary gains or losses (%)	0.35	2.43	Decreased by 2.08 percentage points

Note: There was no change in share capital of the Company for the period commencing from 1 January 2005 to 31 March 2006, and the share capital of the Company comprised 959,521,650 shares.

Extraordinary gain or loss items for the three months ended 31 March 2006

	Amount (RMB in thousands)
Subsidy income (non-recurrent)	2,089
Non-operating income	2,292
Less: Non-operating expenses	7,425
Less: Effect of income tax	<u>(457)</u>
Total	<u><u>(2,587)</u></u>

2.2.2 Income Statements (unaudited)

Please refer to the part 4.2.

2.2.3 Differences in financial statements prepared in accordance with PRC GAAP and HKASs

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

(RMB in thousands)

Item	Net Profit for the three months ended 31 March 2006 (Unaudited)	Shareholders' equity as at 31 March 2006 (Unaudited)
Under PRC GAAP	33,418	10,156,038
Add back/(deduct):		
Deferred development costs (i)	(14,245)	162,937
Provision for retirement benefits (ii)	(384)	(30,843)
Deferred tax (iii)	1,609	(19,697)
Under Hong Kong accounting standards	20,398	10,268,435

(i) *Deferred development costs*

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

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

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

(iii) *Deferred tax*

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

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

Total number of shareholders as at the end of the reporting period	Number of shareholders: the Company had 31,546 shareholders, of which 31,032 were A shareholders, 514 were H shareholders.
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Shareholdings of top ten holders of shares in circulation that are not subject to lock-up

Name of shareholder	Number of shares in circulation that are not subject to lock-up held at the end of the reporting period (shares)	Type
HKSCC Nominees Limited	159,565,639	H shares
Deutsche Bank Aktiengesellschaft	22,969,266	A shares
Tian Yuan Equity Fund	8,534,410	A shares
Yulong Securities Investment Fund	6,193,734	A shares
E Fund SSE100 ETF	5,549,336	A shares
China Life Insurance Company Limited — profit sharing — individual profit sharing-005L-FH002 shen	5,390,020	A shares
China Southern Sustaining Growth Equity Fund	4,790,113	A shares
Citigroup Global Markets Limited	4,788,579	A shares
Kai Yuan Securities Equity Fund	4,756,078	A shares
Yuyang Securities Investment Fund	4,636,335	A shares

3. MANAGEMENT DISCUSSION AND ANALYSIS

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

During the reporting period, there was a substantial decline in investments in PHS and CDMA networks as telecommunications carriers in the PRC adjusted their total capital expenditure and investment structure in line with their development strategies. Meanwhile, large-scale testing of TD-SCDMA as a 3G mobile communications standard commenced in Baoding, Xiamen and Qingdao, underpinning growth of investment in rural telecommunications networks in line with the building of new rural communities.

Against such a backdrop, the Group succeeded in maintaining stable growth in its revenue from principal operations with efforts in identifying potential profit centres, on the back of a diversified product range. The Group's revenue from principal operations during the reporting period amounted to RMB4,589,518,000, which increased 6.96% compared to the same period last year, although profit from principal operations fell 12.71% to RMB1,494,857,000 from 1,712,602,000 for the same period last year as a result of the increased weighting of terminal products and a decline in gross profit margin for system equipment.

As a result of the decline in PHS and CDMA investment, revenue from wireless communications systems as a percentage of total revenue decreased to 29.96% as compared to 44.74% for the same period last year. Revenue from wireline switch & access systems and optical & data communications systems as a percentage of total revenue remained stable year-on-year, while the contribution of telecommunications software systems, services and other products leaped to 16.00% from 3.92% for the same period last year. The growth in revenue from handsets as a percentage of total revenue to 27.42% for the reporting period from 20.61% for the same period last year was mainly driven by exports.

For the next quarter, the Group will focus on the marketing of softswitch, IPTV, value-added services businesses and handsets, capitalising on opportunities presented by focused procurement by carriers to develop a balanced customer base comprising domestic carriers of various profiles.

The Group will tap further into the markets of developed countries and multinational carriers after consecutive years of investment in the international market, in terms of both financial and human resources. Meanwhile, it will step up its commercialisation of existing projects and enhance its international business as a driving force of the Company's operations. Moreover, the Group is also prepared to meet intense competition of the 3G era by raising the level of industrialisation of its products as its TD-SCDMA undergoes large-scale testing.

Operational risks and risk control measures:

While the Group has formulated specific and feasible operating policies based on current operating conditions, it is still subject to the following major risks in its operations:

1. Changing market demands in China — Sales and profitability of the Group's existing product lines may decline and fluctuate as a result of the decline in investments by PRC carriers in CDMA, PHS and PSTN, which are major products of the Group, while value-added services, IPTV and other new products are still in a preliminary stage of development, and are unlikely to replace the traditional products in the short-term as a comparable source of revenue and profit contribution.
2. Uncertainties in international business — The commercial viability of various projects are subject to a variety of factors prevailing in the international market such as political and economic developments, legal issues, taxation and the financial environment, the uncertainties of which will affect the revenue and profitability of the Group.
3. Uncertainties in China's 3G market — The issue of 3G licences is subject to a variety of factors which are difficult to accurately predict. The extent of the future development of the 3G market is dependent on external as well as internal factors, such as the level of market competition, consumer preferences, carriers' strategies, value-added services and the progress in terminal development. Therefore, uncertainties exist in the marketing of the Group's 3G products in China.

In order to mitigate these risks, the Group will continue to expand into new markets and increase investments in the research and development of new products to avoid over-dependence on any single product or market and assure sustainable and stable development.

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

Applicable Not applicable

Principal operations by business segment

Industry	Revenue from principal operations (RMB in thousands)	Cost of principal operations (RMB in thousands)	Gross profit margin
Telecommunications equipment	4,589,518	3,078,243	32.93%
Of which: connected transactions	3,383	2,324	31.30%

Principal operations by product segment

Product	Revenue from principal operations (RMB in thousands)	Cost of principal operations (RMB in thousands)	Gross profit margin
Wireless communication systems	1,374,950	804,529	41.49%
Wireline switch and access	503,725	284,097	43.60%
Optical and data communications systems	717,894	533,289	25.71%
Handsets	1,258,438	951,097	24.42%
Telecommunications software systems, services and other products	734,511	505,231	31.22%
Total	4,589,518	3,078,243	32.93%

3.1.2 Seasonal or cyclical characteristics of the Group's operations

Applicable Not applicable

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

Applicable Not applicable

Item	As a percentage of total profit for the three months ended 31 March 2006	As a percentage of total profit for the 12 months ended 31 December 2005	Increase/decrease(%)
Profit from principal operations	2,394.1%	501.1%	1,893.0 ¹
Profit from other operations	7.6%	1.1%	6.5
Expenses for the period	2,298.0%	429.4%	1,868.6 ¹
Investment gains	(5.5%)	(4.0%)	(1.5)
Subsidy income	10.0%	30.5%	(20.5) ²
Non-operating items, net	(8.2%)	0.7%	(8.9)

Note 1: The significant change in the profit and expenses for the period as a percentage of total profit for the current period as compared to the same period last year was attributable to the substantial year-on-year decline of total profit as a result of lower gross profit margin for the current period.

Note 2: The substantial decrease in subsidy income as compared to the same period last year was mainly attributable to the decrease in tax refund in respect of software received during the current period.

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

Applicable Not applicable

There were changes in the income mix of the Group for the reporting period as compared to the same period last year and the full year of 2005. The weighting of certain product segments changed as a percentage of revenue from principal operations, the details of which are set out as follows:

Product	As a percentage of principal operations	
	Compared with the year 2005	Compared with first quarter of 2005
Wireless communications systems	Down by 11 percentage points	Down by approximately 15 percentage points
Handsets	Up by 7 percentage points	Up by approximately 7 percentage points
Telecommunications software systems, services and other products	Up by approximately 6 percentage points	Up by approximately 12 percentage points
Wireline switch and access	Down by approximately 2 percentage points	Basically unchanged
Optical and data communications systems	Basically unchanged	Down by 4 percentage points

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

Applicable Not applicable

During the reporting period, revenue from wireless communications systems, which had a higher gross profit margin, decreased as a percentage of revenue from principal operations, while revenue from handsets and from telecommunications software systems, services and other products, which had a lower gross profit margin, both increased as a percentage of revenue from principal operations (see Section 3.1.4 of this report), combining to result in a decline of the Group's gross profit margin for its principal operations to 32.93% for the reporting period.

3.2 Analysis of significant events and their effects and proposed solutions

Applicable Not applicable

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

Applicable Not applicable

3.2.2 Ongoing connected transactions during the reporting period

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

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

Classification of transaction	Member of the Group (party to connected transaction)	Member of the Group (counterparty to connected transaction)	Subject matter	Pricing basis	Transaction amount for January to March 2006 (excluding VAT) (RMB in 10,000)	As a percentage of transactions in the same classification	Settlement	Whether different from estimated conditions
Purchases of raw materials	ZTE Kangxun Telecom Company, Limited	Shenzhen Zhongxingxin Telecommunications Equipment Company, Limited and its subsidiaries, Shenzhen Zhongxing Xindi Telecommunications Equipment Company, Limited and Shenzhen Zhongxing Xinyu FPC Company, Limited	Various telecommunications products such as cabinets, cases, distribution frames, soft circuit boards and other raw materials	Consistent with market prices (as per contract)	10,842.61	3.20%	banker's acceptance bill	No
	ZTE Kangxun Telecom Company Limited	Xi'an Microelectronics Technology Research Institute	Circuit protectors and other electronic products	Consistent with market prices (as per contract)	195.74	0.06%	banker's acceptance bill	No
	ZTE Kangxun Telecom Company Limited	Shenzhen Zhongxing WXT Equipment Company, Ltd and its investee entity, Shenzhen Gaodonghua Communication Technique Co., Ltd	IC, connector assemblies, optical devices, modules and other ancillary equipment	Consistent with market prices (as per contract)	5,235.93	1.55%	banker's acceptance bill	No
	ZTE Kangxun Telecom Company, Limited	Chung Hing (Hong Kong) Development Limited	Printers and other electronic products	Consistent with market prices (as per contract)	25.18	0.01%	banker's acceptance bill	No
	Shenzhen Lead Communications Company, Limited	Shenzhen Zhongxing Xinyu FPC Company, Limited	Soft circuit boards and other products	Consistent with market prices (as per contract)	118.04	0.03%	banker's acceptance bill	No
	ZTE Kangxun Telecom Company, Limited	Shenzhen Zhongxing Information Technology Company, Limited	Dispatch exchange systems, integrated police alarm command dispatch systems, pre-hospitalisation first-aid command dispatch systems	Consistent with market prices (as per contract)	257.26	0.08%	banker's acceptance bill	No

Classification of transaction	Member of the Group (party to connected transaction)	Member of the Group (counterparty to connected transaction)	Subject matter	Pricing basis	Transaction amount for January to March 2006 (excluding VAT) (RMB in 10,000)	As a percentage of transactions in the same classification	Settlement	Whether different from estimated conditions
Products sales	The Company	Xi'an Microelectronics Technology Research Institute	Handsets and other products	Consistent with market prices (as per contract)	0.03	0.00%	banker's acceptance bill	No
	ZTE Kangxun Telecom Company, Limited	Shenzhen Zhongxing WXT Equipment Company, Ltd	IC and other products	Consistent with market prices (as per contract)	301.58	0.07%	banker's acceptance bill	No
	The Company and ZTE Kangxun Telecom Company, Limited	Shenzhen Zhongxing Information Technology Company, Limited	Optical transmission systems, power supply equipment, data products and conferencing TV	Consistent with market prices (as per contract)	36.69	0.01%	banker's acceptance bill	No

3.2.3 Significant litigation during the reporting period

Applicable Not applicable

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

There was no substantial progress during the reporting period in respect of the other litigation and arbitration proceedings disclosed in the 2005 annual report of the Company published on 7 April 2006. The Company will make timely announcements in the event of any substantial progress of such matters.

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

Applicable Not applicable

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

Applicable Not applicable

3.3.2 Changes in scope of consolidation and reasons therefor

Applicable Not applicable

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

Company Name	Change	Reason
ZTE Software (Xi'an) Co., Ltd.	Included	New incorporation
ZTE India R&D Center Private Limited	Included	New incorporation

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

Applicable Not applicable

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

Applicable Not applicable

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

Applicable Not applicable

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

Applicable Not applicable

Name of shareholder	Special undertaking	Performance of contract	Performance of undertaking
Shenzhen Zhongxingxin Telecommunications Equipment Company, Limited (“Zhongxingxin”), the largest shareholder of the Company	Where Zhongxingxin sells its shares during the period from the 13th month to the 24th month after the non-circulating shares of the Company have been granted the right of listing and circulation on the Shenzhen Stock Exchange, the price at which the shares are sold shall not be less than RMB30.76 per share, which is 115% of the mathematical average of the closing prices of its A shares for the 60 trading days prior to the initial announcement made by the directors of the Company regarding the Share Reform Plan, that is, RMB26.75 per share (such price to be calculated on an ex-rights basis and net of any dividends, bonus issues and 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.	Performance in progress	Strict compliance with undertaking

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

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

4. APPENDICES

4.1 BALANCE SHEET (unaudited)

(Amounts in RMB'000)

Assets	As at 31 March 2006		As at 31 December 2005	
	Group	Company	Group	Company
Current assets:				
Cash in banks and on hands	3,253,884	2,358,257	5,573,132	4,258,936
Bills receivable	1,501,773	1,312,494	1,244,853	1,209,151
Dividends receivable	—	16,465	—	16,465
Trade receivables	3,981,576	4,920,954	3,441,922	4,481,796
Factored trade receivables	36,165	4,974	36,416	5,007
Other receivables	291,937	1,390,092	279,975	1,230,352
Accounts prepaid	82,741	69,327	151,174	67,305
Inventories	2,966,273	1,608,521	2,519,547	1,557,312
Amounts due from customers for contract work	5,332,024	5,140,020	4,689,157	4,440,842
Prepaid expenses	2,680	—	—	—
Total current assets	17,449,053	16,821,104	17,936,176	17,267,166
Long-term equity investments	86,993	2,647,268	85,459	2,833,305
Fixed assets:				
Fixed assets — cost	3,664,243	2,509,250	3,623,940	2,491,000
Less: Accumulated depreciation	1,229,159	753,981	1,148,789	712,768
Net fixed assets	2,435,084	1,755,269	2,475,151	1,778,232
Less: Impairment provision	94,980	87,002	94,980	87,002
Fixed assets, net	2,340,104	1,668,267	2,380,171	1,691,230
Construction in progress	164,175	108,734	126,741	77,261
Total fixed assets	2,504,279	1,777,001	2,506,912	1,768,491
Intangible and other assets:				
Intangible assets	149,125	77,400	160,264	87,081
Long-term prepaid expenses	5,613	—	—	—
Long-term trade receivables	324,966	324,966	307,666	327,122
Factored long-term trade receivables	694,340	690,201	687,765	683,598
Long-term deferred assets	13,996	—	13,996	—
Total intangible and other assets	1,188,040	1,092,567	1,169,691	1,097,801
Deferred taxes				
Deferred taxes assets	81,799	76,419	80,893	76,419
Total assets	21,310,164	22,414,359	21,779,131	23,043,182

Legal representative:
Hou Weigui

Chief Financial Officer:
Wei Zaisheng

Head of Finance Division:
Shi Chunmao

	(Amounts in RMB'000)			
Liabilities and owner's equity	As at 31 March 2006		As at 31 December 2005	
	Group	Company	Group	Company
Current liabilities				
Short-term loans	165,100	100,000	99,695	—
Bank advance on factored trade receivables	36,165	4,974	36,416	5,007
Bills payable	2,424,165	2,219,238	1,977,584	1,918,831
Accounts payable	3,681,681	5,539,508	4,292,208	6,538,622
Amount due to customers for contract work	595,770	595,770	733,455	688,876
Advanced from customers	840,873	530,703	861,024	493,438
Accrued payroll	631,602	374,630	622,804	367,583
Welfare payable	415,591	333,889	394,216	326,370
Dividends payable	156,959	928	163,008	928
Taxes payable	(807,932)	(751,070)	(670,282)	(844,875)
Other levies	7,472	3,000	7,134	2,996
Other payables	456,213	963,048	626,066	1,084,091
Accrued expenses	360,549	295,319	346,668	286,561
Anticipated liabilities	24,391	13,000	20,035	16,000
Long-term loans maturity within one year	500,000	500,000	500,000	500,000
Total current liabilities	9,488,599	10,722,937	10,010,031	11,384,428
Long-term liabilities:				
Long-term loans	80,000	—	80,000	—
Long-term bank advance on factored trade receivables	694,340	690,201	687,765	683,598
Specific payables	411,351	349,020	405,511	359,220
Total long-term liabilities	1,185,691	1,039,221	1,173,276	1,042,818
Total liabilities	10,674,290	11,762,158	11,183,307	12,427,246
Minority interests				
Minority interests	479,836	—	470,729	—
Shareholders' equity:				
Share capital	959,522	959,522	959,522	959,522
Capital reserve	5,506,424	5,532,896	5,506,424	5,532,896
Surplus reserve	1,264,058	769,603	1,264,060	769,603
Comprising: welfare reserve	344,908	242,464	344,908	242,464
Undistributed profit	2,204,608	3,152,634	2,171,190	3,116,070
Foreign exchange difference	(18,454)	(2,334)	(15,981)	(2,035)
Declared cash dividends	239,880	239,880	239,880	239,880
Total owner's equity	10,156,038	10,652,201	10,125,095	10,615,936

**TOTAL LIABILITIES AND
OWNER'S EQUITY**

21,310,164 22,414,359 21,779,131 23,043,182

Legal representative:
Hou Weigui

Chief Financial Officer:
Wei Zaisheng

Head of Finance Division:
Shi Chunmao

4.2 INCOME STATEMENTS (unaudited)

Item	(Amounts in RMB'000)			
	For the three months ended 31 March 2006		For the three months ended 31 March 2005	
	Group	Company	Group	Company
1. Revenue from principal operating activities	4,589,518	4,377,253	4,290,746	4,166,171
Less: Cost of principal operating activities	3,078,243	3,330,439	2,565,713	3,337,719
Taxes and levies on principal operating activities	<u>16,418</u>	<u>12,559</u>	<u>12,431</u>	<u>4,262</u>
2. Profit from principal operating activities	<u>1,494,857</u>	<u>1,034,255</u>	<u>1,712,602</u>	<u>824,190</u>
Add: Profit from other operating activities	4,762	343	372	(52)
Less: Selling and distribution costs	709,951	560,434	643,194	613,758
Administrative expenses	711,779	218,003	814,310	510,521
Finance costs	<u>13,141</u>	<u>24,099</u>	<u>34,627</u>	<u>40,580</u>
3. Operating profit	<u>64,748</u>	<u>232,062</u>	<u>220,843</u>	<u>(340,721)</u>
Add: Investment income	(3,408)	(186,635)	(11)	127,054
Subsidy income	6,233	—	57,737	—
Non-operating income	2,292	103	7,793	2,807
Less: Non-operating expenses	<u>7,425</u>	<u>3,550</u>	<u>5,509</u>	<u>3,989</u>
4. Total profit	<u>62,440</u>	<u>41,980</u>	<u>280,853</u>	<u>(214,849)</u>
Less: Income tax	14,665	5,416	20,355	—
Minority interest	<u>14,357</u>	<u>—</u>	<u>30,067</u>	<u>—</u>
5. Net profit	<u>33,418</u>	<u>36,564</u>	<u>230,431</u>	<u>(214,849)</u>

Supplemental information:

Item	For the three months ended 31 March 2006	For the three months ended 31 March 2005
1. Gains on sales or disposal of segments or investee companies	—	—
2. Losses as a result of natural disasters	—	—
3. Increase/decrease in total profit arising from changes of accounting policies	—	—
4. Increase/decrease in total profit arising from changes of accounting estimates	—	—
5. Losses on debt restructuring	—	—
6. Others	—	—
Legal representative: Hou Weigui	Chief Financial Officer: Wei Zaisheng	Head of Finance Division: Shi Chunmao

4.3 CASH FLOW STATEMENT (unaudited)

Item	(Amounts in RMB'000)	
	For the three months ended 31 March 2006	
	Group	Company
1. Cash flows from operating activities		
Cash received from sale of goods or rendering of services	3,814,520	3,678,242
Cash received from taxes returned	56,481	45,045
Cash received relating to other operating activities	<u>26,264</u>	<u>15,052</u>
Sub-total of cash inflow	<u>3,897,265</u>	<u>3,738,339</u>
Cash paid for goods and services	4,339,288	4,472,143
Cash paid to and on behalf of employees	723,951	308,209
Payments of taxes and levies	172,123	45,236
Cash paid relating to other operating activities	<u>933,146</u>	<u>825,699</u>
Sub-total of cash outflow	<u>6,168,508</u>	<u>5,651,287</u>
Net cash flow from operating activities	<u>(2,271,243)</u>	<u>(1,912,948)</u>
2. Cash flows from investing activities		
Cash received from disinvestment	—	—
Cash received from gains of investment	—	—
Net cash received from disposal of fixed, intangible and other long-term assets	691	605
Cash received relating to other investing activities	<u>—</u>	<u>—</u>

	Sub-total of cash inflow	<u>691</u>	<u>605</u>
	Cash paid to acquire fixed, intangible and other long-term assets	81,038	62,592
	Cash paid from investment	2,247	—
	Cash paid relating to other investing activities	<u>—</u>	<u>—</u>
	Sub-total of cash outflow	<u>83,285</u>	<u>62,592</u>
	Net cash flow from investing activities	<u>(82,594)</u>	<u>(61,987)</u>
3.	Cash flows from financing activities		
	Cash received from shareholders' investment	—	—
	Cash received from borrowings	121,100	100,000
	Cash received relating to other financing activities	<u>—</u>	<u>—</u>
	Sub-total of cash inflow	<u>121,100</u>	<u>100,000</u>
	Cash repayments of amounts borrowed	55,696	—
	Cash payments for distribution of dividends or profits and repayment of interests	34,644	25,714
	Cash paid relating to other financing activities	<u>—</u>	<u>—</u>
	Sub-total of cash outflow	<u>90,340</u>	<u>25,714</u>
	Net cash flow from financing activities	<u>30,760</u>	<u>74,286</u>
4.	Effect of foreign exchange rate changes on cash	<u>3,829</u>	<u>(30)</u>
5.	Net increase in cash and cash equivalents	<u>(2,319,248)</u>	<u>(1,900,679)</u>
Legal representative:	Chief Financial Officer:	Head of Finance Division:	
Hou Weigui	Wei Zaisheng	Shi Chunmao	
Item		(Amounts in RMB'000)	
		For the three months ended 31 March 2006	
		Group	Company
1.	Investing and financing activities not involving cash		
	Capital converted from liabilities	—	—
	Convertible bond maturity within 1 year	—	—
	Financial leased fixed assets	—	—
2.	Reconciliation of net profit to cash flows from operating activities		
	Net profit	33,418	36,564
	Add: Minority interest	14,357	—
	Provision for assets impairment	(131,026)	(157,810)

Depreciation of fixed assets	104,578	65,760
Amortization of intangible assets	14,590	10,672
Amortization of long-term prepaid expenses	710	—
Decrease in prepaid expenses (less: increase)	(2,680)	—
Increase in accrued expenses	18,238	5,758
Losses on disposal of fixed, intangible and other long-term assets	4,458	3,550
Finance expense	20,597	27,004
Losses on investment	3,408	186,635
Decrease of inventories (less: increase)	(195,221)	(48,046)
Decrease in operating receivable items (less: increase)	(1,488,609)	(1,268,199)
Increase in operating payable items (less: decrease)	(669,517)	(774,836)
Deferred tax asset	1,456	—
Net cash flows from operating activities	(2,271,243)	(1,912,948)
3. Net increase in cash and cash equivalents		
Cash at end of period	3,253,884	2,358,257
Less: Cash at beginning of period	5,573,132	4,258,936
Add: Cash equivalents at end of period	—	—
Less: Cash equivalents at beginning of period	—	—
Net increase in cash and cash equivalents	(2,319,248)	(1,900,679)

Legal representative:
Hou Weigui

Chief Financial Officer:
Wei Zaisheng

Head of Finance Division:
Shi Chunmao

5. DOCUMENTS AVAILABLE FOR INSPECTION

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

By order of the Board
Hou Weigui
Chairman

Shenzhen, PRC
26 April 2006

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

*Please also refer to the published version of this announcement in **The Standard**.*