

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 sixteenth meeting of the third session of the Board of Directors of the Company. Mr. He Shiyong, Director, was unable to attend the meeting due to work reasons and authorised in writing, Mr. Yin Yimin, Director, to vote on his behalf. Mr. Mi Zhengkun, Independent Director, was unable to attend the meeting due to work reasons and authorised in writing, Mr. Zhu Wuxiang, Independent Director, to vote on his behalf.

The respective financial statements of the Group for the year ended 31 December 2005 were prepared in accordance with generally accepted accounting principles ("PRC GAAP") in the PRC and with Hong Kong Accounting Standards ("HKASs") 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 HKASs, of which the English version shall prevail.

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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.
"Chung Hing Hong Kong"	Chung Hing (Hong Kong) Development Limited.
"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.
"HKASs"	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.
"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).
"DWDM"	Dense wavelength division multiplexing, a technology that enables a single optical fiber to carry multiple data channels (or wavelengths). Commercial DWDM systems now exceed 100 channels.
"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.
"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 which is 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.

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 telecommunications 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 listed telecommunications equipment manufacturer in China's A share market in terms of market capitalisation, revenue from principal operations and net profits. In December 2004, the Company conducted a 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 listed company to be listed in Hong Kong.

The Group is engaged in 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 and the Group has established 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

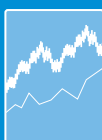
1.	Legal name (in Chinese) Chinese abbreviation Legal name (in English) English abbreviation	中興通訊股份有限公司 中興通訊 ZTE Corporation ZTE
2.	Legal representative	Hou Weigui
3.	Secretary to the Board of Directors Joint company secretaries Securities affairs representative Registered and office address Postal code Telephone Facsimile E-mail Website Place of business in Hong Kong	Feng Jianxiong Feng Jianxiong Suen Pui Yee, Samantha Li Liuhong ZTE Plaza Keji Road South Hi-Tech Industrial Park Nanshan District Shenzhen, People's Republic of China 518057 + 86 755 26770282 + 86 755 26770286 fengjianxiong@zte.com.cn http://www.zte.com.cn 8/F Gloucester Tower The Landmark 11 Pedder Street 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: G Zhongxing H shares Hong Kong Stock Exchange Stock code: 763 Stock name: ZTE
6.	Newspapers designated for information disclosure by the Company <i>Domestic</i> <i>Hong Kong</i>	China Securities Journal Securities Times Shanghai Securities News The Standard (English) Hong Kong Economic Times (Chinese)

7.	<p>Authorised websites on which this annual report is made available</p> <p>Place where this annual report is available for inspection</p>	<p>http://www.cninfo.com.cn http://www.hkex.com.hk</p> <p>ZTE Plaza Keji Road South Hi-Tech Industrial Park Nanshan District Shenzhen, Guangdong Province People's Republic of China</p>
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.	<p>Legal advisers</p> <p><i>As to Chinese law</i></p> <p><i>As to Hong Kong and US law</i></p>	<p>Jun He Law Offices 20th Floor, China Resources Building Beijing, People's Republic of China</p> <p>Freshfields Bruckhaus Deringer 11th Floor, Two Exchange Square Central, Hong Kong</p>
10.	<p>Auditors</p> <p><i>PRC</i></p> <p><i>Hong Kong</i></p>	<p>Ernst & Young Hua Ming 21/F, China Resources Building 5001 Shennan Dong Road Shenzhen, Guangdong Province People's Republic of China</p> <p>Ernst & Young 18/F, Two International Finance Centre 8 Finance Street Central, Hong Kong</p>
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 numbers	State tax: 44030127939873X Local tax: 44030327939873X

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NEWS



How
are
you



CHAIRMAN'S STATEMENT

Dear Shareholders:

I am pleased to present the annual report of the Group for the financial year ended 31 December 2005. 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 2005

Despite being confronted with greater challenges as compared to the preceding period, the Group delivered stable operating results in 2005 as a result of strategies taken by management and concerted efforts from our staff under the leadership of the Board. More importantly, our endeavours over the years, especially in 2005, have noticeably enhanced our competitiveness in the domestic and global marketplace, boosting our research and development capabilities and the market competitiveness of our core products, including 3G, NGN and handsets, laying solid foundations for our development in the longer term.

In 2005, the Group further consolidated its leading industry position in the domestic market. Through profound understanding of the telecommunications industry and telecommunications service providers, the Group adopted a strategy of customisation and achieved sound sales performance in products such as NGN, fixed line intelligence, IPTV and GoTa and maintained its leading competitive position, mitigating the adverse impact resulting from the sharp decline in CDMA and PHS investments.

In 2005, the global telecommunications market sustained steady growth. The establishment of an effective sales and marketing regime has improved the Group's penetration and fostered its brand recognition in markets strategically conducive to its future development, winning recognition from a growing number of leading international carriers. With long-term growth potential, our international business expanded quickly, accounting for a larger share of our overall business volume, lending strong support to the current results of the Company.

BUSINESS OUTLOOK

The Group is fully aware of the importance of improving the efficiency of its operations. During the year under review, the global sales and marketing platform was refined to enhance the efficiency of our decision-making process for sales and marketing as well as our risk management capabilities. An optimised research and development system improved the speed and efficiency in the development of new products, contributing to critical breakthroughs in some of our major projects, in particular, our 3G-related projects. In addition, more efficient and effective administration of support systems including financial management and human resources resulted in better coordination among business segments.

The steady growth of the global telecommunications industry presents opportunities for the development of the Group. In view of intense competition in the telecommunications industry globally, the Group will draw on its solid track record and focus our operations in three areas: to seek transformation from a major supplier of telecommunications products in China to a leading international supplier of telecommunications products; from the provision of communications hardware to the provision of software and services and, finally, from a technological and operations-driven business model to a market-based one. The objectives set for 2006 are as follows:

- In addition to consolidating its presence in emerging markets, the Group will seek to explore developed countries and the market for multinational carriers. The Group will adopt a localisation strategy for its human resources, research and development as well as production, and leverage on its increasingly stronger sales and marketing network and brand name, to actively expand its presence in developed countries and the market for multinational carriers to ensure sustained growth of its international business.



- The domestic market remains the Group's core market. We will capitalise fully on strategic opportunities presented by 3G to further balance our business development among geographic regions domestically. In addition, the Group will continue to provide customised services and end-to-end integrated solutions to assist its customers in developing new business and revenue sources, expand the range of products and increase its market share. We will also foster consumption activities and promote our products and services to end-users through strategic partnerships with our customers.
- The Group will aim to strengthen and expedite research and development in order to deliver products of top international standards. The accumulation of technological expertise and development of a well-trained team over the years has laid a good foundation for developing such products, whereas the increasing demands from our customers provides an external motivational force to drive such development. In 2006, resources will be deployed to encourage innovation in research and development in order to achieve this goal.
- As with other successful enterprises, the Group sees the recruitment and training of talents as an underlying driving force for growth. In the year ahead, we will actively solicit high-calibre people on a global basis and develop a pool of management personnel to ensure that human capital is adequate to match its corporate development. Meanwhile, the Group will conduct a thorough review of its experience in relation to building its corporate culture, and seek to enhance solidarity and efficiency within the company by persistent fulfilment of the principles of speed, innovation and learning.

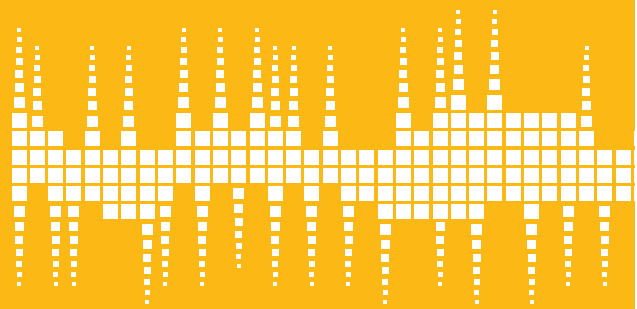
Capitalising on our 3G development in the domestic market together with our international business expansion, the Company and the Board of Directors will endeavour in the year ahead to refine our corporate governance structure and enhance transparency to provide sound returns for our shareholders as well as the society at large.

Hou Weigui
Chairman

Shenzhen, China
7 April 2006



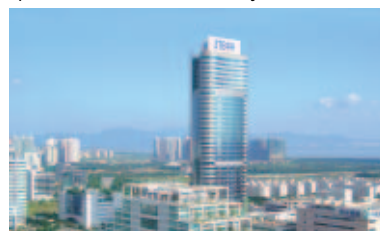
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World.





MAJOR EVENTS

January 2005	Recognised as one of the "Ten Most Influential Brand Names in China's IT Industry" at the 2005 Conference for Competitive Global Chinese Brand Names.
February 2005	H Shares of the Company was included as a constituent stock of the Hang Seng China Enterprise Index and MSCI Standard Index.
May 2005	Introduced the most complete series of TD-SCDMA solutions in the industry launched at the 2005 International TD-SCDMA Summit held in Beijing.
May 2005	Obtained an exclusive right of construction of NGN long-distance commercial trial network for China Telecom.
June 2005	Mr. Hou Weigui, our chairman, received the first session "Leader of A-Share Enterprise with the Best Investor Relations Award" from Securities Market Weekly.
June 2005	Became the first telecommunications manufacturer in China to be ranked among global Information Technology 100 by <i>Business Week</i> .
July 2005	President Mr. Yin Yimin was named one of the top 25 "Stars of Asia" by <i>Business Week</i> .
September 2005	Received "Shenzhen Mayor Award of Quality 2005".
November 2005	Completion of the R&D Building of ZTE's headquarters in Shenzhen.
December 2005	Signed an agreement with Hutchison 3G of Hutchison Whampoa Group to supply the first batch of 3G WCDMA-F866 handsets in Europe.
December 2005	GoTa, the only digital trunking technology, was recognised as a "Key Technological Invention of the Information Industry" by the Ministry of Information Industry of China.
December 2005	Share Reform Plan of A Share Market was implemented successfully.



1. MAJOR FINANCIAL DATA OF THE GROUP FOR 2005 PREPARED IN ACCORDANCE WITH PRC GAAP

Unit: RMB in millions

Item	Amount
Total profit	1,501.9
Net profit	1,194.3
Net profit after extraordinary gains or losses	1,212.9
Profit from principal operations	7,525.5
Profit from other operations	15.8
Operating profit	1,092.3
Investment income	(59.4)
Subsidy income	458.0
Net non-operating income and expenses	10.9
Net cash flow arising from operating activities	177.3
Net increase in cash and cash equivalents	(2,025.1)

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

Unit: RMB in millions

Item	Amount
Subsidy income	22.7
Non-operating income	27.6
Less: non-operating expenses	16.7
Less: Provision for impairment of equity investment	55.5
Less: effect of income tax	(3.3)
Total	(18.6)

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

Item	2005	2004	2003	
			Before adjustment	After adjustment
Revenue from principal operations (RMB million)	21,575.9	22,698.2	16,036.0	16,036.0
Net profit (RMB million)	1,194.3	1,008.9	752.5	704.1
Total assets (RMB million)	21,779.1	20,830.0	15,767.0	15,833.4
Shareholder's equity (RMB million) (excluding minority interests)	10,125.1	9,174.4	5,043.9	4,810.4
Earnings per share (RMB)	1.24*	1.05	1.13	1.06
Net assets per share (RMB)	10.55*	9.56	7.56	7.21
Return on net assets (%)	11.80	11.00	14.92	14.64
Adjusted net assets per share (RMB)	10.55	9.53	7.29	6.94
Net cashflow per share arising from operating activities (RMB)	0.18	1.71	1.71	1.71

* Based on 959,521,650 shares, being the total share capital of the Company as at 31 December 2005. There was no change in the total share capital of the Company during 2005.

FINANCIAL HIGHLIGHTS

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

Profit for the reporting period	Return on net assets*		Earnings per share (RMB)*	
	Fully diluted	Weighted average	Fully diluted	Weighted average
Profit from principal operations	74.33%	78.13%	7.84	7.84
Operating profit	10.79%	11.34%	1.14	1.14
Net profit	11.80%	12.40%	1.24	1.24
Net profit after extraordinary gains or losses	11.98%	12.59%	1.26	1.26

* 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.

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

Unit: RMB in millions

Item 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	—	—	959.5
Capital reserve	5,491.7	14.7	—	5,506.4
Surplus reserve	985.3	278.8	—	1,264.1
In which: statutory welfare fund	252.0	92.9	—	344.9
Retained profit	1,495.4	1,194.3	518.5	2,171.2
Difference in foreign currency translation	2.6	—	18.6	(16.0)
Cash dividends declared	239.9	239.9	239.9	239.9
Total shareholders' equity	9,174.4	1,727.7	777.0	10,125.1

Reasons for the changes:

1. For details of reasons for changes in share capital during the reporting period, please refer to Notes 28, 29 and 30 to the financial statements prepared in accordance with PRC GAAP.
2. The translation differences in foreign currency of the Company were attributed to the consolidation of financial statements in foreign currency.

5. MAJOR FINANCIAL DATA OF THE GROUP PREPARED IN ACCORDANCE WITH HKASs

Unit: RMB in millions

	For the year ended 31 December				
	2005	2004	2003	2002	2001
Results					
Turnover	21,575.9	21,220.1	17,036.1	10,795.9	9,440.9
Cost of sales	(14,101.7)	(13,813.5)	(11,226.1)	(6,924.2)	(6,142.2)
Gross profit	7,474.2	7,406.6	5,810.0	3,871.7	3,298.7
Other revenue and gains	681.6	534.1	252.0	312.1	119.2
Research and development costs	(1,959.5)	(2,265.2)	(1,535.7)	(1,127.9)	(1,048.3)
Selling and distribution costs	(3,186.4)	(2,799.6)	(1,981.5)	(1,277.0)	(1,150.3)
Administrative expenses	(1,095.4)	(981.4)	(869.0)	(542.4)	(528.3)
Other operating expenses	(128.6)	(162.4)	(213.9)	(212.6)	10.1
Profit from operating activities	1,785.9	1,732.1	1,461.9	1,023.9	701.1
Finance costs	(175.9)	(140.4)	(171.2)	(122.3)	(160.6)
Share of profits and losses of jointly-controlled entities and associates	(4.2)	3.1	(3.6)	4.2	2.0
Profit before tax	1,605.8	1,594.8	1,287.1	905.8	542.5
Tax	(179.8)	(115.0)	(198.6)	(159.7)	(106.8)
Profit before minority interests	1,426.0	1,479.8	1,088.6	746.1	435.7
Minority interests	(138.3)	(207.3)	(60.3)	(42.5)	(21.7)
Net profit from ordinary activities attributable to shareholders	1,287.7	1,272.5	1,028.3	703.6	414.0

Unit: RMB in millions

	As at 31 December				
	2005	2004	2003	2002	2001
Assets and liabilities					
Total assets	22,464.0	21,007.8	16,476.4	12,022.8	9,042.6
Total liabilities	11,742.8	11,312.2	11,649.9	8,124.8	5,847.3
Minority interests	470.7	478.4	226.6	215.4	134.3
Shareholders' equity	10,250.5	9,217.2	4,599.9	3,682.6	3,061.0

6. MAJOR FINANCIAL INDICATORS OF THE GROUP PREPARED IN ACCORDANCE WITH HKASs

	2005	2004	2003	2002	2001
Basic earnings per share (RMB/share)	1.34	1.57	1.28	0.88	0.53
Net assets per share (RMB/share)	11.17	11.96	6.03	4.87	4.09
Return on net assets	12.01%	13.12%	21.31%	18.05%	12.96%

Note: In accordance with HKASs, the above figures are calculated based on weighted average method. The weighted average share capital is 959,521,650 shares in 2005.

FINANCIAL HIGHLIGHTS

7. RECONCILIATION OF DIFFERENCES OF NET PROFIT FOR 2005 AND SHAREHOLDERS' EQUITY OF THE GROUP AS AT 31 DECEMBER 2005 PREPARED IN ACCORDANCE WITH PRC GAAP AND HKASs

Unit: RMB in millions

	PRC GAAP	HKASs
Net profit for 2005	1,194.3	1,287.7
Shareholders' equity for 2005	10,125.1	10,250.5
Explanation of differences	For details please refer to Note 44 to financial statements prepared under HKASs.	

8. IMPORTANT NOTE

In order to more accurately reflect the operational performance and assets of the Group, the following new items have been added in the balance sheet for the 2005:

(Long-term) factored accounts receivable: This item relates to (long-term) creditors receivable pledged to bank in exchange of the granting of bank facilities whose risks and rewards have not been fully transferred, accounted for based on the principle of "substance over form" in accordance with the Provisional Regulations on Accounting Treatment of Creditor Financing between Enterprises and Banks/Financial Institutions issued by the Ministry of Finance. This item was included under "accounts receivable" in 2004.

Bank facilities secured by (long-term) factored accounts receivable: This item relates to bank facilities obtained by pledging (long-term) creditors receivable to banks accounted for based on the principle of "substance over form" in accordance with the Provisional Regulations on Accounting Treatment of Creditor Financing between Enterprises and Banks/Financial Institutions issued by the Ministry of Finance. This item was included under "short-term borrowings" in 2004.

Work contract amounts receivable (payable): This item relates to accumulated costs incurred and gross profit (loss) recognised in respect of construction contracts and settled progress bills. Costs are accounted for based on actual costs, comprising direct materials, direct labour, construction machinery, other direct costs and a relevant portion of construction overheads. If accumulated costs incurred and gross profit (loss) recognised in respect of the construction contract of an individual project exceed settled progress bills, the difference is recognised as work contract amount receivable. If settled progress bills exceed costs incurred and gross profit (loss) recognised to date in respect of the construction contract of an individual project, the difference is recognised as work contract amount payable. The item was included under "inventories" in 2004.

Long-term accounts receivable: This item relates to creditors receivable provided by the Group to its customers with a credit term (instalment period) of over one year.

Long-term deferred assets: This item relates to the value of equipment or product used by the Group under a specific business model (joint operation with international telecommunications carriers). Equipment or products are stated at historical cost, including relevant expenses incurred in bringing such equipment or products to their existing useful state (such as tax, insurance, freight and installation), and are amortised, starting from the month in which the equipment is put to use, on a straight-line basis over the term of joint operation or the useful lives of the equipment, whichever is shorter.

For details and balances of the respective items please refer to the financial statements of the Group prepared under PRC GAAP and the notes thereto.

CHANGES IN SHARE CAPITAL AND SHAREHOLDERS

1. CHANGES IN SHARE CAPITAL AS AT 31 DECEMBER 2005

Unit: shares

	Before change		Increase/decrease as a result of the change				After change	
	Number of shares	Percentage (%)	Issue of new shares	Share Reform	Conversion from capital reserve	Others (Transfer of shareholdings)	Sub-total	Number of shares
I. Shares subject to lock-up	498,341,861	51.94		(75,257,187)			(75,257,187)	423,084,674
1. State-owned shares								
2. State-owned legal person shares	462,272,370	48.18		(70,192,466) ¹			(70,192,466)	392,079,904
3. Other domestic shares comprising:								
Domestic legal person shares	35,043,840	3.65		(2,046,590) ¹		(21,565,440) ²	(23,612,030)	11,431,810
Domestic natural person shares (including shares held by senior management of the Company)	1,025,651	0.11		256,413 ¹			256,413	1,282,064
4. Foreign shares comprising:								
Foreign legal person shares	0	0		(3,274,544) ¹		21,565,440 ²	18,290,896	18,290,896
Foreign natural person shares								
II. Shares not subject to lock-up	461,179,789	48.06		75,257,187			75,257,187	535,436,976
1. RMB ordinary shares	301,028,749	31.37		75,257,187 ¹			75,257,187	376,285,936
2. Domestic-listed foreign shares								
3. Overseas-listed foreign shares (H shares)	160,151,040	16.69						160,151,040
4. Others								
III. Total numbers of shares	959,521,650	100						959,521,650

Note 1: Holders of non-circulating shares of the Company offered 2.5 shares for every 10 shares to the holders of A Shares of the Company whose names were registered on the register of the Company maintained at China Securities Depository & Clearing Corporation Limited, Shenzhen Branch on the date of registration for changes in shares following the implementation of the Share Reform Plan (28 December 2005). Please refer to the Revised Share Reform Plan published by the Company on the designated website for information disclosure on 23 November 2005 for details.

Note 2: On 10 November 2005, 21,565,440 shares of the Company held by Fortune Trust & Investment Company, Ltd were transferred to Jade Dragon (Mauritius) Limited and share transfer procedures were completed. Please refer to the announcement dated 11 November 2005 published by the Company in China Securities Journal, Securities Times, Shanghai Securities News, South China Morning Post and Hong Kong Economic Times for details.

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 2005

Issue Year	Class of shares	Date of issue	Issue price	Quantity (no. of shares)	Date of listing	No. of shares approved for listing	Date of ceasing trading
2004	H share	29/11/2004	HKD22.00	160,151,040	9/12/2004	160,151,040	—

CHANGES IN SHARE CAPITAL AND SHAREHOLDERS

3. SHAREHOLDERS AS AT 31 DECEMBER 2005

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

Total numbers of shareholders

Number of shareholders: the Company had 23,924 shareholders in total (of which 23,241 were holders of A shares and 683 were holders of H shares).

Top ten shareholders					
Name of shareholder	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	358,958,824	None
2. HKSCC Nominees Limited	Foreign shareholders	16.62	159,428,039	—	Unknown
3. Deutsche Bank Aktiengesellschaft	Foreign shareholders	2.63	25,237,082	—	Unknown
4. Jade Dragon (Mauritius) Limited	Foreign shareholders	1.91	18,290,896	18,290,896	None
5. Hunan Nantian (Group) Co., Ltd	Others	1.19	11,431,810	11,431,810	None
6. China Southern Sustaining Growth Equity Fund	Others	0.94	9,000,000	—	Unknown
7. Tian Yuan Equity Fund	Others	0.82	7,875,000	—	Unknown
8. SYWG BNP Paribas Security Investment Fund	Others	0.75	7,233,846	—	Unknown
9. Yulong Securities Investment Fund	Others	0.68	6,493,734	—	Unknown
10. Kai Yuan Equity Fund	Others	0.63	6,001,544	—	Unknown

CHANGES IN SHARE CAPITAL AND SHAREHOLDERS

Top ten holders of the shares not subject to lock-up		
Name of shareholder	Number of shares held that not subject to selling restrictions	Class of share
1. HKSCC Nominees Limited	159,428,039	H shares
2. Deutsche Bank Aktiengesellschaft	25,237,082	A shares
3. China Southern Sustaining Growth Equity Fund	9,000,000	A shares
4. Tian Yuan Equity Fund	7,875,000	A shares
5. SYWG BNP Paribas Security Investment Fund	7,233,846	A shares
6. Yulong Securities Investment Fund	6,493,734	A shares
7. Kai Yuan Equity Fund	6,001,544	A shares
8. Yuyang Securities Investment Fund	5,807,811	A shares
9. Merchant Stock Investment Fund	5,427,830	A shares
10. Jing Fu Securities Investment Fund	5,011,430	A shares
Descriptions of any connected party relationships or concert party relationships among the above shareholders	<p>1. Among the Company's top ten holders of shares not subject to lock-up, China Southern Sustaining Growth Equity Fund, Tian Yuan Equity Fund and Kai Yuan Equity Fund are managed by the same fund manager, China Southern Fund Management Co., Ltd.; Yulong Securities Investment Fund and Yuyang Securities Investment Fund are managed by the same fund manager, Boshi Fund Management Co., Ltd.</p> <p>2. There were no connected party relationships between Zhongxingxin, the largest shareholder of the Company and other top ten shareholders and top ten holders of shares not subject to lock-up, or concert party relationships, as defined under the "PRC Measures for the Management of Information Disclosure for Changes in Shareholding of Shareholders of Listed Companies".</p> <p>3. Save for the above, the Company is not aware of any connected party relationships or concert party relationships (as defined under the "PRC Measures for the Management of Information Disclosure for Changes in Shareholding of Shareholders of Listed Companies") among the top ten shareholders and the top ten holders of shares that are not subject to lock-up.</p>	

CHANGES IN SHARE CAPITAL AND SHAREHOLDERS

	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

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:	RMB10,000,000

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

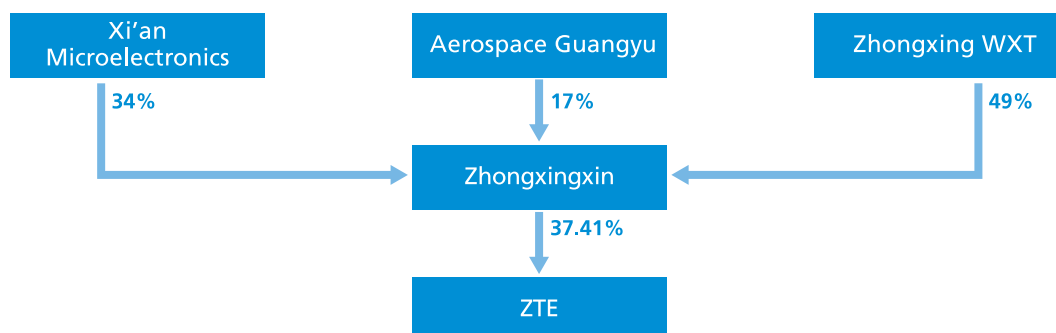
The controlling shareholder of the Company, Zhongxingxin was jointly formed by Xi'an Microelectronics, Shenzhen Aerospace Guangyu Industrial Group Company ("Aerospace Guangyu") and Zhongxing WXT, each holding a 34%, 17% and 49% stake in Zhongxingxin respectively. Zhongxingxin currently has 9 directors,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

Xi'an Microelectronics, a subsidiary of China Aerospace Times Electronics Corporation, is a large state-owned research institute, which was established in 1965 with its establishment expenses amounting to RMB198,530,000. The legal representative of the institute is Mr. Zhang Junchao. It is the only specialised 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.

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

The following diagram shows the shareholding relationships between the above units and the Company as at 31 December 2005:



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

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

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

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

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

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

CHANGES IN SHARE CAPITAL AND SHAREHOLDERS

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

As at 31 December 2005, the following shareholders held an interest of 5% or more in the Company's issued share capital as shown in the register maintained by the Company pursuant to 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
Zhongxing WXT	358,958,824 A shares (L)	37.41	44.91
Xi'an Microelectronics	358,958,824 A shares (L)	37.41	44.91
China Aerospace Times Electronics Corporation	358,958,824 A shares (L)	37.41	44.91
China Aerospace Science and Technology Corporation	358,958,824 A shares (L)	37.41	44.91
JPMorgan Chase & Co.	20,626,380 H shares (L)	2.15	12.88
	18,675,780 H shares (P)	1.95	11.66
Goldman Sachs (Asia) LLC	11,622,000 H shares (L)	1.21	7.82
Goldman Sachs (Cayman) Holding Company	11,622,000 H shares (L)	1.21	7.82
Temasek Holdings (Private) Limited	11,326,800 H shares (L)	1.18	7.07
Fidelity International Limited	11,278,200 H shares (L)	1.18	7.04
T. Rowe Price Associates, Inc. and its affiliates	11,237,200 H shares (L)	1.17	7.00
Aranda Investments (Mauritius) Pte Ltd	11,141,800 H shares (L)	1.16	6.96
Platinum Asset Management Limited	9,648,000 H shares (L)	1.01	6.02
The Capital Group Companies, Inc.	9,618,100 H shares (L)	1.00	6.01
Massachusetts Financial Services Company ("MFS")	8,428,100 H shares (L)	0.88	5.26
Sun Life Financial, Inc.	8,428,100 H shares (L)	0.88	5.26

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

Save as disclosed above, as at 31 December 2005, 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 5 April 2006 the Company has sufficient public shareholding, in compliance with the minimum requirement of Hong Kong Stock Exchange Listing Rules.

1. BIOGRAPHICAL DETAILS OF DIRECTORS, SUPERVISORS AND SENIOR MANAGEMENT

Directors

Mr. Hou Weigui, 64, is the Chairman of the Board of Directors and a non-executive Director of the Company and was initially appointed in November 1997. Mr. Hou is a senior engineer and one of the founders of Shenzhen Zhongxing Semiconductor Co., Ltd., and Zhongxingxin. He was the 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 36 years of management experience. His term of office is from February 2004 to February 2007.

Mr. Wang Zongyin, 61, is a Vice Chairman of the Board of Directors and a non-executive Director of the Company and was appointed in February 2004. He 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 2003 to the present. 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 operations. His term of office is from February 2004 to February 2007.

Mr. Xie Weiliang, 50, is a Vice Chairman of the Board of Directors and a non-executive Director of the Company and was appointed in February 2004. 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. and Shenzhen Aerospace Guangyu Industrial (Group) Co. since 2003. He possesses substantial experience in management and business operations. His term of office is from February 2004 to February 2007.

Mr. Zhang Junchao, 52, is a non-executive Director of the Company, and was appointed in February 2004. 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. His term of office is from February 2004 to February 2007.

Mr. Li Juping, 50, is a non-executive Director of the Company, and was initially appointed in April 1999. 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 2001 to 2003, and as the chief engineer of China Aerospace Times Electronics Corporation from 2003 to the present. His term of office is from February 2004 to February 2007.

Mr. Dong Lianbo, 49, is a non-executive Director of the Company, and was appointed in February 2004. 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. His term of office is from February 2004 to February 2007.

DIRECTORS, SUPERVISORS, SENIOR MANAGEMENT AND EMPLOYEES



Mr. Yin Yimin, 42, is an executive Director of the Company and was initially appointed in November 1997. He was appointed in 2004 as President and 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 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 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 many years of experience in the operation of telecommunications business and over 15 years of management experience. His term of office is from February 2004 to February 2007.

Mr. Shi Lirong, 42, is an executive Director of the Company and was initially appointed in February 2001. Mr. Shi has been a Senior Vice President of the Company since 1999 and is responsible for the sales system 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. He has many years of experience in the telecommunications industry and over 15 years of management experience. His term of office is from February 2004 to February 2007.

Mr. He Shiyong, 39, is an executive Director of the Company and was initially appointed in February 2001. Mr. He has been the Senior Vice President of the Company since 1999 and is responsible for the handsets 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. He has many years of experience in the telecommunications industry as well as over 13 years of management experience. His term of office is from February 2004 to February 2007.

Mr. Zhu Wuxiang, 40, is an Independent Non-executive Director of the Company, and was initially appointed in July 2003. 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. His term of office is from February 2004 to February 2007.

Mr. Chen Shaohua, 44, is an Independent Non-executive Director of the Company, and was initially appointed in July 2003. 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. His term of office is from February 2004 to February 2007.

Mr. Qiao Wenjun, 35, is an Independent Non-executive Director of the Company, and was initially appointed in July 2003. 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 is a partner of Zhong Lun Law Firm, the head of its Shanghai office and a lawyer. His term of office is from February 2004 to February 2007.

Mr. Mi Zhengkun, 60, is an Independent Non-executive Director of the Company, and was appointed in February 2004. 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. His term of office is from February 2004 to February 2007.

Mr. Li Jin, 38, is an Independent Non-executive Director of the Company, and was appointed in June 2004. Mr. Li is currently the vice president of Technology Exchange Ltd, a post he has been holding since November 2003. 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 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. His term of office is from June 2004 to February 2007.

Joint Company Secretaries

Mr. Feng Jianxiong, 32, the joint company secretary of the Company. Mr. Feng was initially appointed as the Secretary to the Board of Directors in 2000, and is currently working as the Head of the Securities and Investor Relations Division of the Company. Mr. Feng graduated from Tianjin University of Finance and Economics with a bachelor's degree in international finance. Mr. Feng joined Zhongxingxin in July 1996. He has been the Head of the Investment Department of the Company and the Head of the Securities and Finance Department since 2000. His term of office is from February 2004 to February 2007.

Ms. Suen Pui Yee, Samantha, 50, was appointed as the joint company 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 specialises in professional corporate secretarial services with more than 20 years' experience in corporate governance, administration and management. Ms. Suen is a fellow member of The Hong Kong Institute of Company Secretaries, The Institute of Chartered Secretaries and Administrators of the United Kingdom and a fellow of the Taxation Institute of Hong Kong. Her term of office is from November 2004 to February 2007.

Supervisors

Mr. Zhang Taifeng, 64, was appointed as the Chairman of the Supervisory Committee of the Company in February 2004. Mr. Zhang graduated from Jilin University with a bachelor's degree in semiconductor technology. 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 has been the Chairman of the Board of Directors from November 1997 to February 2004. His term of office is from February 2004 to February 2007.

Mr. Wang Wangxi, 39, is a Supervisor of the Company, and is currently the director of the Human Resources Division of the Company. 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 became the chief executive officer of Zhongxing Telecom Pakistan (Pvt) Ltd. in early 2000, and deputy general manager of the Company's First Sales Division. His term of office is from February 2004 to February 2007.

Ms. He Xuemei, 35, 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 the Network Operations Division of the Company and ZTE Kangxun after joining the Company in January 1998. Her term of office is from February 2004 to February 2007.

DIRECTORS, SUPERVISORS, SENIOR MANAGEMENT AND EMPLOYEES



Mr. Qu Deqian, 44, is a Supervisor of the Company. Since 2003, he served as the Deputy General Manager of Zhongxing WXT. 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. His term of office is from June 2005 to February 2007.

Ms. Wang Yan, 41, is a Supervisor of the Company. She is currently the Deputy General Manager and Chief Accountant of Zhongxingxin. Ms. Wang graduated from the Department of Management and Industrial Accounting of Northeast Industrial Institute in July 1998 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. Her term of office is from June 2005 to February 2007.

Senior Management

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

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

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

Mr. Wei Zaisheng, 43, 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 October 1988 and served as the chief financial officer and an assistant to the general manager of Zhongxingxin from 1993 to 1997. During the period of 1997 to 1999, he was the Vice President of the Company. Mr. Wei has many years of experience in the telecommunications industry including more than 17 years of management experience. His term of office is from February 2004 to February 2007.

Mr. Xie Daxiong, 42, is a Senior Vice President of the Company and is responsible for the system products business 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's degree. Mr. Xie joined Zhongxingxin in 1994 and had been the head of the Nanjing Research Institute of Zhongxingxin. From 1998 to February 2004, Mr. Xie was the products manager, and subsequently the general manager of the Company's CDMA Division. Mr. Xie has many years of experience in the telecommunications industry and more than 9 years of management experience. His term of office is from February 2004 to February 2007.

Ms. Zhou Susu, 51, 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. 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 of 1997 to 1999, she was a Vice President of the Company. Ms. Zhou has many years of experience in the telecommunications industry and more than 15 years of management experience. Her term of office is from February 2004 to February 2007.

Mr. Tian Wenguo, 37, is a Senior Vice President of the Company and is responsible for the marketing and operational systems of the Company. Mr. Tian graduated from Harbin Institute of Technology in 1991, specialising in electromagnetic surveys and devices. Mr. Tian joined Zhongxingxin in 1996, and from 1997 to 2002, he has been the manager of the Company's Chongqing Sales Office and the general manager of the Southwest Region, and from 2002 to 2005, he has been the Vice President and general manager of Second Sales Division of the Company. Mr. Tian has many years of experience in the telecommunications industry and more than 8 years of management experience. His term of office is from February 2004 to February 2007.

Ms. Fang Rong, 41, has been a Vice President and concurrently the general manager of the Fourth Sales Division of the Company since 1998. Ms. Fang is a senior engineer, graduated from the Nanjing University of Posts and Telecommunications in 1987, specialising in telecommunications engineering. From 1987 to 1995, Ms. Fang carried out research and development work in the Posts and Telecommunications Office of the Wuhan Academy of Postal and Telecommunications Sciences. From 1995 to 1997, she worked in marketing in Zhongxingxin. Ms. Fang has many years of experience in the telecommunications industry and more than 10 years of management experience. Her term of office is from February 2004 to February 2007.

Ms. Chen Jie, 47, has been a Vice President of the Company and concurrently the general manager of the Networking Operations Division since 2002. Ms. Chen graduated from the Nanjing University 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 title 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 US. Ms. Chen has more than 10 years' experience of operation and management in the telecommunications industry. Her term of office is from February 2004 to February 2007.

Mr. Ding Mingfeng, 36, has been a Vice President of the Company since 1998 and concurrently the General Manager of the Mobile Operations Division. Mr. Ding graduated from Harbin Institute of Technology in 1994, specializing in computer science and has obtained a master's degree. 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. He has many years of experience in the telecommunications industry and more than 9 years of management experience. His term of office is from February 2004 to February 2007.

Mr. Zhang Chuanhai, 40, is a Vice President of the Company since 2002 and currently the general manager of the Third Sales Division. 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 and more than 8 years of management experience. His term of office is from February 2004 to February 2007.

Mr. Ye Weimin, 39, is a Vice President of the Company and currently the general manager of Fifth Sales Division since 2001. Mr. Ye graduated from Shanghai Jiao Tong University in 1988, 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 division and the Customer Services Division and deputy general manager of Third Sales Division, and general manager of Mobile Operations Division. Mr. Ye has many years of experience in the telecommunications industry and more than 10 years of management experience. His term of office is from February 2004 to February 2007.

DIRECTORS, SUPERVISORS, SENIOR MANAGEMENT AND EMPLOYEES



Mr. Qiu Weizhao, 42, has been a Vice President of the Company since 1998, and is the responsible officer of the supply chain of the Company. He is also the general manager of ZTE Kangxun, a subsidiary of the Company. Mr. Qiu is a senior engineer, graduated from Xidian University in 1988, specialising in telecommunications and electronic systems, and has obtained a master's degree. Mr. Qiu joined Changde Wired Communication (Group) Company in 1998 and served as the deputy general manager. He joined the Company in 1998. His term of office is from February 2004 to February 2007.

Mr. Ni Qin, 46, has been a Vice President of the Company since 1998, currently in charge of IT construction. 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 Zhongxingxin's Shanghai Research Institute from 1994 to 1997. His term of office is from February 2004 to February 2007.

Mr. Zhao Xianming, 39, is a Vice President of the Company and concurrently the general manager of the CDMA Business Division. Mr. Zhao graduated from the Harbin Institute of Technology in 1997, specialising in telecommunications and electronic systems and has obtained a doctorate degree. From 1991 to 1998, Mr. Zhao served as an associate professor 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 has been the head of the Research & Development Group, project manager and general product manager. His term of office is from February 2004 to February 2007.

Mr. Xu Huijun, 32, is a Vice President of the Company and the general manager of the General Products Division. Mr. Xu graduated from the Tsinghua University in 1998, specialising in electronic engineering and has obtained a master's degree. He joined the Company in 1998 and has served as a project manager of the General Products Division and the head of Beijing Research Centre. His term of office is from February 2004 to February 2007.

Mr. Feng Jianxiong is the secretary to the board of directors of the Company. Please refer to his biography under the paragraph headed "Joint Company Secretaries" in this section.

2. CHANGES IN THE SHAREHOLDINGS AND REMUNERATION OF DIRECTORS, SUPERVISORS AND SENIOR MANAGEMENT IN 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)	Annual remuneration (RMB10,000)	Whether remuneration is received from shareholder entities or other connected entities
Directors									
Hou Weigui	Male	64	Chairman of the Board of Directors	2/2004-2/2007	175,680	+43,920	219,600	69.52	No
Wang Zongyin	Male	61	Vice Chairman of the Board of Directors	2/2004-2/2007	0	0	0	6.00	Yes
Xie Weiliang	Male	50	Vice Chairman Of the Board of Directors	2/2004-2/2007	0	0	0	6.00	Yes
Zhang Junchao	Male	52	Director	2/2004-2/2007	0	0	0	6.00	Yes
Li Juping	Male	50	Director	2/2004-2/2007	0	0	0	6.00	Yes
Dong Lianbo	Male	49	Director	2/2004-2/2007	0	0	0	6.00	Yes
Yin Yimin	Male	42	Director, President	2/2004-2/2007	97,344	+24,336	121,680	113.1	No
Shi Lirong	Male	42	Director, Senior Vice President	2/2004-2/2007	76,608	+19,152	95,760	78.12	No
He Shiyong	Male	39	Director, Senior Vice President	2/2004-2/2007	72,806	+18,201	91,007	63.89	No
Zhu Wuxiang	Male	40	Independent Director	2/2004-2/2007	0	0	0	6.00	No
Chen Shaohua	Male	44	Independent Director	2/2004-2/2007	0	0	0	6.00	No
Qiao Wenjun	Male	35	Independent Director	2/2004-2/2007	0	0	0	6.00	No
Mi Zhengkun	Male	60	Independent Director	2/2004-2/2007	0	0	0	6.00	No
Li Jin	Male	38	Independent Director	6/2004-2/2007	0	0	0	6.00	No
Supervisors									
Zhang Taifeng	Male	64	Chairman of the Supervisory Committee	2/2004-2/2007	97,344	+24,336	121,680	69.52	No
Wang Wangxi	Male	39	Supervisor	2/2004-2/2007	0	0	0	62.35	No
He Xuemei	Female	35	Supervisor	2/2004-2/2007	0	0	0	29.86	No
Qu Deqian	Male	44	Supervisor	5/2005-2/2007	8,016	+2,004	10,020	0	Yes
Wang Yan	Female	41	Supervisor	5/2005-2/2007	0	0	0	0	Yes
Senior Management									
Wei Zaisheng	Male	43	Senior Vice President, Chief Financial Officer	2/2004-2/2007	76,608	+19,152	95,760	77.04	No
Xie Daxiong	Male	42	Senior Vice President	2/2004-2/2007	35,871	+8,968	44,839	75.21	No
Zhou Susu	Female	51	Senior Vice President	2/2004-2/2007	76,608	+19,152	95,760	68.31	No
Tian Wenguo	Male	37	Senior Vice President	2/2004-2/2007	19,440	+4,860	24,300	87.06	No
Fang Rong	Female	41	Vice President	2/2004-2/2007	33,108	+8,277	41,385	74.03	No
Chen Jie	Female	47	Vice President	2/2004-2/2007	75,600	+18,900	94,500	133.45	No
Ding Mingfeng	Male	36	Vice President	2/2004-2/2007	49,405	+12,351	61,756	66.17	No
Zhang Chuanghai	Male	40	Vice President	2/2004-2/2007	7,920	+1,980	9,900	81.25	No
Ye Weimin	Male	39	Vice President	2/2004-2/2007	27,043	+6,761	33,804	81.96	No
Qiu Weizhao	Male	42	Vice President	2/2004-2/2007	0	0	0	73.69	No
Ni Qin	Male	46	Vice President	2/2004-2/2007	63,072	+15,768	78,840	71.49	No
Zhao Xianming	Male	39	Vice President	2/2004-2/2007	0	0	0	74.34	No
Xu Huijun	Male	32	Vice President	2/2004-2/2007	0	0	0	71.04	No
Feng Jianxiong	Male	32	Secretary to the Board of Directors	2/2004-2/2007	0	0	0	47.50	No

Note 1: Reason for changes: The increase of the shares held by the above Directors, Supervisors and senior management is as a result of the Shares Reform. Please refer to Note 1 to the section headed "Changes in Share Capital and Shareholders" on page 19 for details.

Note 2: Mr. Tan Shanyi and Mr. Tan Zhenhui, Directors who resigned during the year, each received a Director's allowance of RMB25,000 (the standard amount of allowance for Directors is RMB5,000 per month) during 2005. Supervisors Ms. Li Huanru, Ms. Cui Hongwei, Mr. Cao Quansheng and Mr. Li Jinhu each received a supervisor's allowance of RMB20,000 in 2005 (the standard amount of allowance for Supervisors is RMB4,000 per month).

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
Zhang Junchao	Lishan Microelectronics Corporation	General Manager	since 10/2003
Dong Lianbo	Zhongxingxin	Director	4/2004–4/2007
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 5 subsidiaries including ZTE Software Zhongxing WXT	Chairman/Director Chairman
Wang Zongyin	China Aerospace Times Electronics Corporation Long March Launch Vehicle Technology, Co., Ltd	General Manager Chairman
Xie Weiliang	Shenzhen Aerospace Guangyu Industrial (Group) Company CASIC Shenzhen (Group) Company Limited	General Manager 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
Chen Shaohua	Xiamen University	Professor
Qiao Wenjun	Zhong Lun Law Firm	Partner
Mi Zhengkun	Nanjing University of Posts and Telecommunications	Professor
Li Jin	Technology Exchange Ltd	Vice President
Zhang Taifeng	Holds positions in 3 subsidiaries including ZTE Kangxun	Chairman/Director
Yin Yimin	Holds positions in 7 subsidiaries including ZTE Kangxun Zhongxing WXT	Chairman/Director Vice Chairman
Shi Lirong	Holds positions in 12 subsidiaries including ZTE Kangxun Zhongxing WXT	Chairman/Director Director
He Shiyong	Shenzhen Changfei Investment Company, Limited Zhongxing WXT	Chairman Supervisor
Wei Zaisheng	Holds positions in 9 subsidiaries including ZTE Kangxun Zhongxing WXT	Director Director
Xie Daxiong	Holds positions in 7 subsidiaries including Shenzhen Zhongxing Mobile Telecom Equipment Co., Ltd	Chairman/Director
Zhou Susu	Holds positions in 4 subsidiaries including ZTE (H.K.) Limited Zhongxing WXT	Chairman/Director Director

Name	Name of entity in which position is held	Position
Fang Rong	Holds positions in 6 subsidiaries including Wuxi Zhongxing Optoelectronics Technologies Company, Limited	Chairman/Director
Chen Jie	Holds positions in 10 subsidiaries including Nanjing Zhongxing Software Development Technology Co., Ltd.	Chairman/Director
Ding Mingfeng	Holds positions in 9 subsidiaries including ZTE (H.K.) Limited	Director/Chairman
Tian Wenguo	Holds positions in 3 subsidiaries including Beijing Zhongxing Intelligent Transportation Systems Ltd.	Chairman/Director
Zhang Chuanhai	Anhui Wantong Posts and Telecommunications Company, Limited	Director
Ye Weimin	Zhongxing WXT Shanghai Zhongxing Telecom Equipment Technology & Service Company, Limited	Supervisor Chairman
Qiu Weizhao	Holds positions in 2 subsidiaries including ZTE (H.K.) Limited	Director/General Manager
Zhao Xianming	Holds positions in 2 subsidiaries including Zimax (Cayman) Holding Co.	Director
Xu Huijun	Holds positions in 3 subsidiaries including Wuxi Zhongxing Optoelectronics Technologies Company, Limited	Director/Chairman
Qu Deqian	Hold positions in 2 subsidiaries including Shenzhen Kangquan Electromechanical Company, Limited Zhongxing WXT	Director/Supervisor Deputy General Manager
Wang Yan Feng Jianxiong	Hold positions in 3 subsidiaries including Zhongxing Xinyu Holds positions in 2 subsidiaries including Shenzhen Zhongxing Telecom Equipment Technology & Service Company, Limited	Director/Supervisor Supervisor

5. CHANGES IN DIRECTORS, SUPERVISORS AND SENIOR MANAGEMENT DURING THE REPORTING PERIOD

1. Changes in Directors

In order to apply to the Hong Kong Stock Exchange for waivers from voting and disclosure requirements under relevant provisions of the Hong Kong Stock Exchange Listing Rules in respect of certain connected transactions, Mr. Tan Shanyi, a connected person in the aforesaid connected transactions, agreed in November 2004 to resign as a Director of the Company to ensure smooth completion of the H Share offering and listing of the Company.

In compliance with the regulation on prohibition of senior officials of universities and colleges from serving as independent directors of corporate entities in the community issued by the Ministry of Education of the People's Republic of China, Mr. Tan Zhenhui, Independent Director of the Company, resigned in March 2005, at which time he was principal of Beijing Jiaotong University.

At the 2004 annual general meeting of the Company held on 31 May 2005, the resolution regarding the resignation of Directors was considered and approved, whereby the resignations of Mr. Tan Shanyi (a Director of the Company) as Director of the Company and Mr. Tan Zhenhui (an Independent Director of the Company) as Independent Director of the Company were duly approved.

2. Changes in Supervisors

In order to apply to the Hong Kong Stock Exchange Listing Rules for the waivers from voting and disclosure requirements under relevant rules of the Hong Kong Stock Exchange in respect of certain connected transactions, Ms. Li Huanru, Ms. Cui Hongwei, Mr. Cao Quansheng and Mr. Li Jinhu, as connected persons in the aforesaid connected transactions, agreed in November 2004 to resign as Supervisors of the Company to ensure smooth completion of the H Share offering and listing of the Company.

At the 2004 annual general meeting of the Company held on 31 May 2005, the resolution regarding the appointment and removal of Supervisors was considered and approved, whereby the resignations of Ms. Li Huanru, Ms. Cui Hongwei, Mr. Cao Quansheng and Mr. Li Jinhu as Supervisors of the Company and the election by way of cumulative voting of Mr. Qu Deqian and Ms. Wang Yan as shareholder representative Supervisors of the third session of the Supervisory Committee were duly approved.

3. Changes in senior management

There were no changes in senior management during the year.

6. DECISION-MAKING PROCESS AND CRITERIA FOR DECIDING REMUNERATION FOR 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.

7. THE GROUP'S EMPLOYEES AND JOB DIVISION

As at the end of the year, the Group has 30,811 employees, with an average age of 30. There are 16 retired employees.

Classification by specialisation as follows:

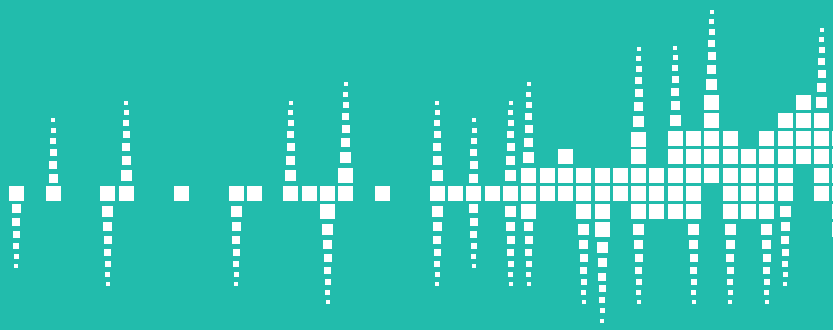
Specialisation	No. of employees	Percentage of total no. of employees
R&D	9,616	31.21%
Marketing and Sales	4,229	13.73%
Customer Service	6,960	22.59%
Manufacturing	6,232	20.22%
Administration	3,774	12.25%
Total	30,811	100.00%

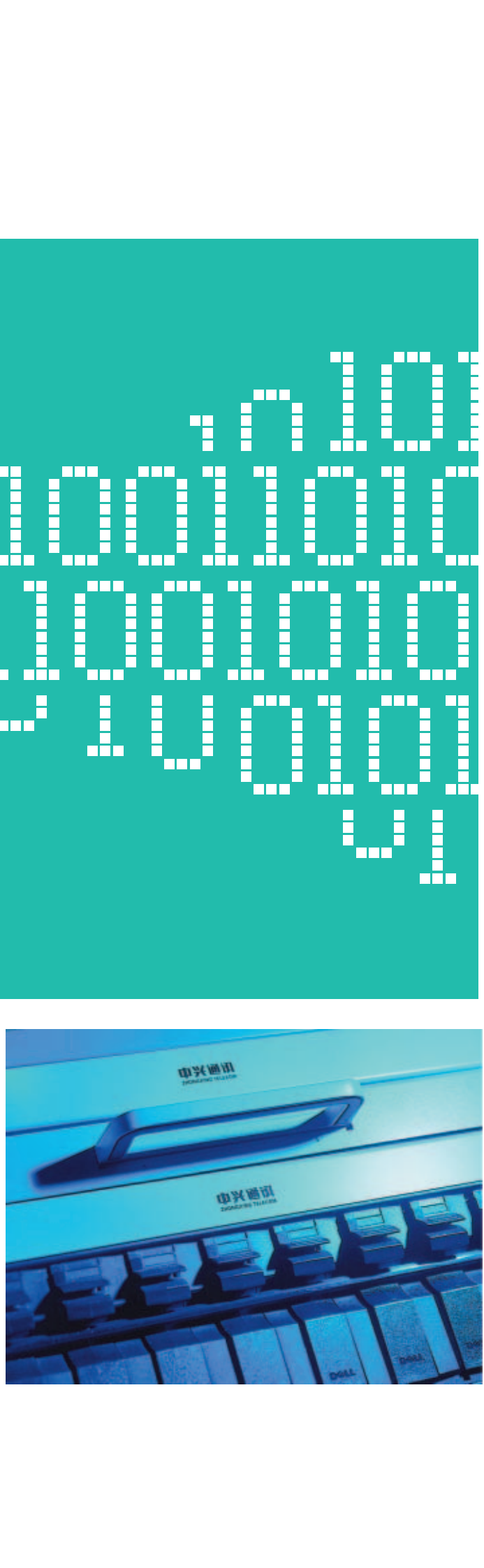
Note: In the 2004 annual report, employees were classified on the basis of the departments to which they belong. In this annual report, employees were classified on the basis of their relevant roles within the Group.

Classification by academic qualifications:

Academic qualifications	No. of employees	Percentage of total no. of employees
Doctorate degree	435	1.41%
Master's degree	7,807	25.34%
Bachelor's degree	12,888	41.83%
Others	9,681	31.42%
Total	30,811	100.00%

From NOW
to the FUTURE





CORPORATE GOVERNANCE STRUCTURE



1. CORPORATE GOVERNANCE REPORT PREPARED ACCORDING TO 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 rules 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 in 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, who possess professional knowledge and work experience in legal, accounting and other areas, 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.

Stakeholders: the Company respects the legal rights and interests of banks and other stakeholders such as creditors, employees, consumers, suppliers, and the community, and actively work 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 rules, regulations 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 and the appointment of auditors), 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 at Board of Directors meetings are as follows:

Name of Independent Director	No. of Board Meetings requiring attendance	Attendance in person	Attendance by proxy	Absent
Zhu Wuxiang	4	4	0	0
Chen Shaohua	4	3	1	0
Qiao Wenjun	4	3	1	0
Mi Zhengkun	4	4	0	0
Li Jin	4	3	1	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 and accounting department. It has established an independent accounting and auditing system and a financial management system, and maintains an independent bank account.

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

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 ACCORDING TO THE REQUIREMENTS OF THE HONG KONG STOCK EXCHANGE LISTING RULES

The Group is dedicated to raising the corporate governance standards and improving the accountability and transparency of the Group, with a view to creating the greatest value for its shareholders in the long term.

1. Corporate Governance Practices

Save as the deviations stated below, the Group had complied with all the code provisions of the Code on Corporate Governance Practices set out as Appendix 14 to the Hong Kong Stock Exchange Listing Rules:

A.1.3

Code Provision: Notice of at least 14 days should be given of a regular board meeting to give all directors an opportunity to attend. For all other board meetings, reasonable notice should be given.

Deviation: The Articles of Association provides for notice to be given 10 days prior to a regular Board meeting.

Explanation: To ensure full compliance of our corporate governance practices with the provisions set out in the Code on Corporate Governance Practices, the Company has commenced giving notice of meeting 14 days before the commencement of a regular Board of Directors meeting in actual operation and proposed amendments have been made to relevant terms of the Articles of Association to be submitted to the 2005 Annual General Meeting for review.

A.5.4

Code Provision: The board should establish written guidelines on no less exacting terms than the Model Code for relevant employees in respect of their dealings in the securities of the issuer.

Deviation: Prior to 10 April 2005, the Board had not established any written guidelines for relevant employees in respect of their dealings in the securities of the Company.

Explanation: The resolution adopting 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 was considered and passed in the twelfth meeting of the third session of the Board of Directors of the Company on 10 April 2005 as written guidelines for the Directors and relevant employees of the Company in respect of their dealings in the securities of the Company.

B.1.3

Code Provision: The terms of reference of the remuneration committee should include, as a minimum, the following specific duties:

- (b) to have the delegated responsibility to determine the specific remuneration packages of all executive directors and senior management, including benefits in kind, pension rights and compensation payments, including any compensation payable for loss or termination of their office or appointment, and make recommendations to the board of the remuneration of non-executive directors. The remuneration committee should consider factors such as salaries paid by comparable companies, time commitment and responsibilities of the directors, employment conditions elsewhere in the group and desirability of performance-based remuneration;
- (c) to review and approve performance-based remuneration by reference to corporate goals and objectives resolved by the board from time to time;
- (d) to review and approve the compensation payable to executive directors and senior management in connection with any loss or termination of their office or appointment to ensure that such compensation is determined in accordance with relevant contractual terms and that such compensation is otherwise fair and not excessive for the issuer;
- (e) to review and approve compensation arrangements relating to dismissal or removal of directors for misconduct to ensure that such arrangements are determined in accordance with relevant contractual terms and that any compensation payment is otherwise reasonable and appropriate.

Deviation: In light of the scope of responsibilities of the remuneration and evaluation committee provided for in the above code provision, the Remuneration and Evaluation Committee of the Company had not completely performed its duties in actual operation. While the performance management rules of the Company's senior management (including the President) have been reviewed and approved by the Remuneration and Evaluation Committee, the specific remuneration packages for other members of the senior management of the Company (other than the President) were not subject to review and approval by the Remuneration and Evaluation Committee before 10 April 2005.

Explanation: The amended Terms of Reference of the Remuneration and Evaluation Committee, revised in accordance with the Code of Corporate Governance Practices to comply with code provision B.1.3, were considered and approved by the Board of Directors at its meeting on 10 April 2005. Since 10 April 2005, the Company has strictly complied with the new requirements of the Code on Corporate Governance Practices.

C.3.3

Code Provision: The terms of reference of the audit committee should include at least the following duties:-

- (b) to review and monitor the external auditor's independence and objectivity and the effectiveness of the audit process in accordance with applicable standard. The audit committee should discuss with the auditor the nature and scope of the audit and reporting obligations before the audit commences;
- (c) to develop and implement policy on the engagement of an external auditor to supply non-audit services. For this purpose, external auditor shall include any entity that is under common control, ownership or management with the audit firm or any entity that a reasonable and informed third party having knowledge of all relevant information would reasonably conclude as part of the audit firm nationally or internationally. The audit committee should report to the board, identifying any matters in respect of which it considers that action or improvement is needed and making recommendations as to the steps to be taken;
- (f) to review the issuer's financial controls, internal control and risk management systems;

- (g) to discuss with the management the system of internal control and ensure that management has discharged its duty to have an effective internal control system.

Deviation: In respect of the scope of responsibilities of the Audit Committee stipulated in the above code provisions, the Audit Committee of the Company had not fully performed its duties in actual operation.

Explanation: The amended Terms of Reference for the Audit Committee, revised in accordance with the Code of Corporate Governance Practices to comply with code provision C.3.3, were considered and approved by the Board of Directors at its meeting on 10 April 2005. Since 10 April 2005, the Company has strictly complied with the new requirements of the Code on Corporate Governance Practices.

2. The Board of Directors

(1) *Functions of the Board of Directors*

The Board of Directors is responsible for convening general meetings of shareholders, 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.

(2) *Board composition*

The Board of the Company comprises 14 Directors, including 3 Executive Directors, 6 Non-executive Directors and 5 Independent Non-executive Directors, in compliance with the requirement of Rule 3.10(1) of the Hong Kong Stock Exchange Listing Rules. There is one Chairman and 2 Vice Chairmen of the Board of Directors. The profile and terms of office of the Directors are set out in the section headed "Biographical Details of Directors, Supervisors and Senior Management" on pages 25 to 30 of this annual report.

(3) *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 shareholders of the Company. Details of the appointment and removal of the Directors during 2005 are set out in the section headed "Changes in Directors, Supervisors and Senior Management During the Reporting Period" on pages 33 to 34 of this annual report.

(4) *Qualifications and Independence of Independent Non-executive Directors*

There are 5 Independent Non-executive Directors in the Company who have substantial experience and possess academic and professional qualifications in the telecommunications, financial, legal and banking areas, in compliance with Rule 3.10(2) of the Hong Kong Stock Exchange Listing Rules, and assist in ensuring that the interests of shareholders as a whole are safeguarded by the Board of Directors. During the reporting period, the Independent Non-executive Directors' functions of perfecting the corporate governance structure of the Company and protecting the interests of minority shareholders were particularly evident.

The Company confirms that it has received written confirmations from all the Independent Non-executive Directors regarding their independence in accordance with Rule 3.13 of the Hong Kong Stock Exchange Listing Rules. The Company considers that all the Independent Non-executive Directors are independent based on the guidelines set out in Rule 3.13 of the Hong Kong Stock Exchange Listing Rules.

(5) Measures taken to ensure the Directors perform their duties

The Company has adopted the following measures in order to ensure that the Directors perform their duties:

1. The Company would supply the Director with all the relevant and necessary information when the Director takes up his post. 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 Hong Kong Stock Exchange Listing Rules, and 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 third-party guarantees, use of capital by connected persons and connected transactions, the Company would engage relevant independent professional bodies, such as auditors, sponsors 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 first Extraordinary General Meeting in 2005. Please refer to the announcement published in China Securities Journal, Securities Times, Shanghai Securities News, South China Morning Post and Hong Kong Economic Times on 13 October 2005.

(6) Board Meetings

1. The Articles of Association requires that the Directors should convene regular meetings at least twice a year. The Company will amend the Articles of Association to specify that the Board of Directors shall convene at least four meetings each year and will submit such amendment to the 2005 Annual General Meeting for review. The Chairman, as the convener of the Board of Directors Meeting, is responsible for determining the agenda. In 2005, the Board of Directors convened four meetings, details of which are set out in the section headed "Operation of the Board of Directors" on pages 63 to 64 of this annual report. Attendance of Directors at Board of Directors meetings in 2005 were as follows:

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

2. As required by the Articles of Association, all Directors should be given 10 days' notice prior to the commencement of a regular Board of Directors meeting, while 5 days' notice should be applied to extraordinary Board of Directors meetings. Since April 2005, the Company has been in strict compliance with the requirement set out in code provision A.1.3 of Appendix 14 to the Listing Rules, by giving notice of 14 days prior to a regular Board 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 extraordinary 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.

(7) *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 143 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.

(8) *Chairman and Chief Executive Officer*

The Chairman of the Company is Mr. Hou Weigui, Non-executive Director, and the President of the Company is Mr. Yin Yimin, Executive Director.

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 147 and 164 of the Articles of Association, respectively.

The Chairman is accountable to the shareholders by 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 and the day-to-day management and operation of the Company based on goals 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.

(9) *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, all of which were set up in 2003. The terms of reference defining the responsibilities and authority for each of the specialist committees have been formulated, details of which are as follows:

A. *The Remuneration and Evaluation Committee*

(i) 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.

The Terms of Reference of the Remuneration and Evaluation Committee is available on the website designated for the disclosure of the Company's information.

(ii) Members of the Remuneration and Evaluation Committee

The Remuneration and Evaluation Committee comprises seven Directors, including four Independent Directors, two Non-executive Directors and one Executive Directors.

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 (appointed on 22 August 2005).

(iii) Meetings of the Remuneration and Evaluation Committee

The Remuneration and Evaluation Committee meets at least once each year. In 2005, the Remuneration and Evaluation Committee convened two meetings. Attendance at the meetings was as follows:

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

Note: The Remuneration and Evaluation Committee had not convened any meeting subsequent to the appointment of Director Li Jin to the committee on 22 August 2005.

(iv) 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 of shareholders.

CORPORATE GOVERNANCE STRUCTURE

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.

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

The Remuneration and Evaluation Committee held two meetings in 2005 to review the remuneration packages for 2004 and consider the remuneration budget of the Company for 2005. It also conducted an annual performance appraisal in respect of the President of the Company and determined his remuneration for 2005. Mr. Li Jin, Independent Director of the Company, was appointed a member of the Remuneration and Evaluation Committee.

B. *The Nomination Committee*

(i) 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.

The Terms of Reference of the Nomination Committee is available on the website designated for the disclosure of the Company's information.

(ii) Members of the Nomination Committee

The Nomination Committee comprises seven Directors, including four Independent 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 (appointed on 22 August 2005).

(iii) Meetings of the Nomination Committee

The Nomination Committee meets at least once each year. In 2005, the Nomination Committee convened two meetings. Attendance of the meetings was as follows:

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

Note: The Nomination Committee had not convened any meeting subsequent to the appointment of Director Li Jin to the committee on 22 August 2005.

(iv) Procedures for the selection and appointment of Directors and 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.

(v) Work of the Nomination Committee during the year

In 2005, the Nomination Committee held two meetings to approve the resignation of former Independent Director Mr. Tan Zhenhui from the office of Independent Director and submitted the same to the Board of Directors for approval. At the second meeting, Independent Director Mr. Li Jin was appointed as a member of the Nomination Committee.

C. *The Audit Committee*

(i) 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.

The Terms of Reference of the Audit Committee is available on the website designated for the disclosure of the Company's information.

(ii) Members of the Audit Committee

The Audit Committee comprises by seven Directors, 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.

CORPORATE GOVERNANCE STRUCTURE

(iii) Meetings of the Audit Committee

The Audit Committee meets at least twice each year. In 2005, the Audit Committee convened two meetings. Attendance of the meetings was as follows:

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

(iv) Work of the Audit Committee during the year

The Audit Committee reviewed the accounting policies and standards adopted by the Group in close collaboration with the management, including the audited financial reports and annual reports for 2005. It also expressed its review opinion on external auditing, internal auditing and internal controls after considering reports received from relevant departments.

3. The Supervisory Committee

(1) Supervisors

The Supervisory Committee of the Company comprises Mr. Zhang Taifeng (Chairman), Mr. Qu Deqian, Ms. Wang Yan, Mr. Wang Wangxi and Ms. He Xuemei.

- (2) Details of appointments and resignations of the Supervisors, Supervisory Committee meetings convened during the Reporting Period and the work of the Supervisory Committee in 2005 are set out in the section headed "Changes in Supervisors" in this report on page 34 and in the Report of the Supervisory Committee on page 75. Attendance of meetings of the Supervisory Committee for the year is set out as follows:

Supervisor	Attendance in person	Attendance by proxy
Zhang Taifeng	2/2	—
Li Huanru	1/1*	—
Cui Hongwei	—	1/1*
Cao Quansheng	1/1*	—
Li Jinhu	—	1/1*
He Xuemei	2/2	—
Wang Wangxi	1/2	—
Qu Deqian	1/1*	—
Wang Yan	1/1*	—

Note: The resignation of Ms. Li Huanru, Ms. Cui Hongwei, Mr. Cao Quansheng and Mr. Li Jinhu and the appointment of Mr. Qu Deqian and Ms. Wang Yan as Supervisors of the Company were considered and approved at the 2004 Annual General Meeting.

4. Responsibility of the Directors for the financial statements

In addition to the annual report and interim report, the Company also publishes a quarterly report in accordance with PRC GAAP and reconciliation of net profit and shareholders' equity in accordance with HKASs within one month after the end of the first quarter and the third quarter.

The responsibility of the Directors for the financial statements set out below should be read in conjunction with the report of the PRC auditors and the report of the Hong Kong auditors on page 102 and page 181, respectively.

■ *Annual report and accounts*

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.

■ *Accounting policies*

The Directors have consistently applied appropriate accounting policies and complied with all applicable accounting standards in the Group's preparation of the financial statements.

■ *Accounting records*

The Directors are responsible for ensuring that accounting records are being kept by the Group and that such records, in which the Group's financial conditions are disclosed with reasonable accuracy, will facilitate the Group's preparation of its financial statements in accordance with the Companies Ordinance of Hong Kong and applicable accounting standards.

■ *Ongoing concern*

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.

5. Auditors' Remuneration

The term of appointment for the Group's PRC auditors Shenzhen Dahua Tiancheng Certified Public Accountants ended on 1 September 2005. With a view to more efficient coordination between the PRC auditors and the Hong Kong auditors, it was approved at the general meeting of shareholders held on 12 October 2005 that Ernst & Young Hua Ming be appointed as the PRC auditors of the Company for 2005 for a term of one year.

Ernst & Young Hua Ming and Ernst & Young acted as the Group's PRC auditors and Hong Kong auditors, respectively. Ernst & Young was appointed auditors of the Group's annual financial reports for two consecutive years (2004 and 2005).

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

	Amount	Auditors
Audit fees 2005	0.50 million RMB	Ernst & Young Hua Ming
Audit fees 2005	4 million HKD	Ernst & Young

CORPORATE GOVERNANCE STRUCTURE

Changes in auditors of the Group in the past three years:

Year	PRC	Hong Kong
2003	Shenzhen Nanfang Minhe Certified Public Accountants	Ernst & Young
2004	Shenzhen Dahua Tiancheng Certified Public Accountants	Ernst & Young
2005	Ernst & Young Hua Ming	Ernst & Young

6. Internal Control

The Board of Directors carries out daily tracking of the Company's internal control systems through the Audit Department, which reports to the Audit Committee. Through testing procedures of six major systems, namely environmental controls, business controls, accounting systems controls, electronic information systems controls, information transmission controls and internal audit, it also conducts evaluation of a series of control systems, internal procedures and policies in respect of the Group's organisational structure, human resources, application of group funds and assets, transaction certification and confidentiality and disclosure of information. The Audit Department reports twice a year to the Audit Committee to ensure soundness of the Company's internal control system and safeguard shareholders' investments and the Company's assets. In 2005, the Audit Department reported on the Company's internal control in 2004 and the first half of 2005 to the Audit Committee in April and August to further improve the Company's internal control system and increase the effectiveness and efficiency of internal control.

7. Investor Relations and Shareholders' Rights

(1) *Investor relations*

The Company has always maintained sound communications with its shareholders. Shareholders may express their views or exercise their rights through communication channels set up by the Group, such as the investors' hotline and e-mail contacts. Shareholders' Q&A sessions were arranged during the 2004 annual general meeting and the first extraordinary general meeting of 2005 to enable direct dialogue between shareholders on the one hand and the Directors and management on the other.

Information on the procedures, including shareholders' voting and the appointment of proxies relating to the general meeting of shareholders of the Company, is set out in the Articles of Association published by the Company on 11 April 2005 on the website designated for information disclosure.

The Company holds results presentation meetings each year after the announcement of its annual and interim results. In 2005, the Company held two results presentation meetings and four telephone results presentation meetings, and received over 100 attending domestic or international investors.

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

(2) *Amendments to the Articles of Association*

On 31 May 2005, the Company amended its Articles of Association upon approval of the 2004 annual general meeting. For details please refer to the notice of annual general meeting published in the China Securities Journal, Securities Times, Shanghai Securities News, South China Morning Post and Hong Kong Economic Times on 11 April 2005.

The Company amended the Articles of Association (as amended by the 2004 annual general meeting) (the “Existing Articles”) in compliance with the amended Company Law of the People’s Republic of China and the Securities Law of the People’s Republic of China (as approved by the eighteenth meeting of the Standing Committee of the Tenth National People’s Congress on 27 October 2005) and the Code on Corporate Governance Practices contained in the Hong Kong Stock Exchange Listing Rules effective as from 1 January 2005. Such amendments will be tabled at the Company’s annual general meeting to be held on 14 June 2006 for approval by shareholders by way of special resolution. For details of resolutions relating to the proposed amendments, please refer to the notice of annual general meeting published in the China Securities Journal, Securities Times, Shanghai Securities News, The Standard and Hong Kong Economic Times on 7 April 2006.

(3) *Shareholding structure of the Company*

Details of movements in the share capital and changes in shareholders are set out in the section headed “Changes in Share Capital and Shareholders” on pages 19 to 24 of this Annual Report.

(4) *Shareholders’ general meetings held in 2005*

Please refer to the section headed “General Meetings of shareholders” on pages 53 of this Annual Report.

8. Remuneration

(1) *Remuneration of Directors, Supervisors and senior management for the year*

Please refer to the section headed “Changes in Shareholdings and Remunerations of Directors, Supervisors and Senior Management for the year” on pages 31 of this Annual Report.

Further details of the remuneration of Directors and Supervisors for the year are set out in note 7 and note 8 to the financial statements prepared in accordance with HKASs.

(2) *Remuneration package 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 8 to the financial statements prepared in accordance with HKASs.

(3) *The deferred share bonus scheme*

Details of the deferred share bonus scheme are set out in note 40 to the financial statements prepared in accordance with HKASs.

(4) *Retirement benefits*

Details of retirement benefits provided by the Group are set out in note 32 to the financial statements prepared in accordance with HKASs.

9. Interests

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

None of the Directors and Supervisors of the Company have 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) *Directors' and Supervisors' interests in contracts*

None of the Directors and Supervisors of the Company were 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 2005.

(3) *Directors', Supervisors' and the President's interests in shares or debentures*

The interests in shares of the Company held by Directors, Supervisors and the President of the Company as at 31 December 2005 are set out in the section headed "Changes in the Shareholdings and Remuneration of the Company's Directors, Supervisors and Senior Management" on page 31 of this Annual Report.

Save as disclosed above, as at 31 December 2005, 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 as set out in Appendix 10 to the Hong Kong Stock Exchange Listing Rules.

As at 31 December 2005, 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 2005.

(5) *Connected transactions*

Details of connected transactions of the Company during the year are set out on pages 77 to 84 of the annual report.

ANNUAL GENERAL MEETINGS AND EXTRAORDINARY GENERAL MEETINGS OF SHAREHOLDERS

The Company convened an annual general meeting, an extraordinary general meeting and a relevant shareholders' meeting of the A Share market in 2005, details of which are as follows:

- The 2004 annual general meeting was held on site on 31 May 2005. The announcement of resolutions passed at the meeting was published in China Securities Journal, Securities Times and Shanghai Securities News, South China Morning Post and Hong Kong Economic Times on 1 June 2005.
- The first extraordinary general meeting of 2005 was held on site on 12 October 2005. The announcement of resolutions passed at the meeting was published in China Securities Journal, Securities Times and Shanghai Securities News, South China Morning Post and Hong Kong Economic Times on 13 October 2005.
- The relevant shareholders' meeting of the A Share market was held on 16 December 2005 with a combination of on-site voting and online voting to consider and approve the revised share reform plan of the Company. The announcement of resolutions passed at the meeting was published in China Securities Journal, Securities Times and Shanghai Securities News, South China Morning Post and Hong Kong Economic Times on 17 December 2005.

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 2005.

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 page 105 of this annual report for the results of the Group for the year ended 31 December 2005 prepared in accordance with PRC GAAP and page 182 of this annual report for the results of the Group for the year ended 31 December 2005 prepared in accordance with HKASs.

FINANCIAL SUMMARY

Set out on page 15 of this annual report are the results and financial position summary of the Group for the three financial years ended 31 December 2005 prepared in accordance with the PRC GAAP.

Set out on page 17 of this annual report are the results and financial position summary of the Group for the five financial years ended 31 December 2005 prepared in accordance with HKASs, 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 and 31 December 2005 prepared in accordance with HKASs.

BUSINESS REVIEW AND OUTLOOK


1. Business Review

Capital expenditure in China's telecommunications sector declined 4.8% to RMB203.34 billion in 2005, as compared to the previous year. The sector, however, maintained its growth trend in terms of other indicators. Revenue generated from telecommunications operations increased 11.7% to RMB579.90 billion, on the back of continuous growth in operating revenue and the number of users. As at the end of 2005, there were 393 million mobile phone users and 350 million fixed-line users in China (based on data published by the Ministry of Information Industry).

In terms of telecommunications network operations, the GSM network was running smoothly, while capital expenditure in CDMA and PHS networks declined as carriers adopted a strategy of selective development. Meanwhile, networks supported by new technologies such as NGN were gradually replacing traditional wireline networks. The value-added services sector was developing rapidly; while the industry chain from systems to terminals for 3G networks came into shape following favourable results in the trial implementation of 3G standards. Overall, the market for telecommunications systems became increasingly competitive, given growing maturity of the market, changing pattern of market competition and revised business models of carriers.

Overview of the global telecommunications industry in 2005

Globally, the telecommunications sector maintained its growing trend during 2005. According to statistics from Gartner, operating revenue of the global telecommunications sector amounted to USD1,586.2 billion, representing a 9.84% increase as compared to 2004. Capital expenditure of the global telecommunications sector amounted to USD121.8 billion, representing a 7.75% increase as compared to 2004. Latin America, North America and Africa were the fastest-growing markets in terms of investments by carriers in telecommunications equipment.



Operating results of the Group for 2005

The Company achieved the following operating results through persistent efforts of the management in implementing development strategies laid down by the Board of Directors, despite a relatively unfavourable capital expenditure profile prevailing in the domestic market and the fact that our international development initiatives remained in a critical start-up stage.

The domestic market

Domestically, the Group enhanced its leading position in the industry in 2005 on the back of strong sales and distinct competitive edge in products including NGN, fixed line network intelligence, IPTV and GoTa based on our profound understanding of the telecommunications industry and its service providers, effectively mitigating the adverse impact of the substantial decline in CDMA and PHS investments.

The international market

On the international front, significant progress was achieved in our efforts to build regional platforms globally, with coverage of all major markets basically completed. Outstanding market development efforts among mainstream multinational carriers resulted in business partnerships with carriers including France Telecom, Hutchison Telecom and Millicom involving strategic product areas of the Group such as systems and handsets. While such partnerships held out strong potential for development in their own right, they also opened up opportunities for the introduction of other products of the Group to the markets of developed countries.

Wireless communications products

We made progress in each of the TD-SCDMA, CDMA2000 and WCDMA systems to attain leading industry standards. With products fully capable of matching the requirements of large-scale commercial applications, we have laid down solid foundations and are fully prepared for the construction of a 3G network in China, which is set to commence in the near future. The Group achieved outstanding results in the tests for each of the three systems. Large-scale applications of our WCDMA core networks were launched in more than ten countries and regions, including Nigeria, Sri Lanka and Bangladesh.

There was significant growth in the delivery of our GSM products, with breakthroughs in the scale of operations in the Eastern European and Central American markets and progress in establishing our presence in South America, on top of operations in our traditional markets of Africa and South Asia. Stable profitability from our PHS products was maintained on the back of ongoing cost reductions. Having passed technical assessment of the Ministry of Information Industry and was awarded the "Major Technology Inventions in the PRC Information Industry Award," our GoTa products became the first products in respect of which intellectual property licences were granted by a PRC company to its foreign counterparts.

Switch and access products

Investments in traditional switch and access products experienced a significant decline in 2005. The Company followed closely the changing focus of fixed line carriers around the world to launch its "fixed line network intelligence" solution, providing carriers with a conceptual framework and signpost for the construction of fixed line networks as well as facilitating the development of other products.

Data communications

The Group provides a variety of data communications equipment such as NGN, IPTV, DSL systems, routers, routing switches and wireless access data products. By undertaking the construction of the NGN project of China Telecom which covered 31 provinces throughout the nation, the Group tapped the high-end market with related products including business platforms, data, transmission and access products in 2005. We secured leadership for our IPTV

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products in the domestic market. Our optical communications products passed the ASON test of China Telecom during the year, while major breakthroughs were achieved in the bulk-volume, ultra-length transmission technology for our DWDM products.

Handsets

We continued to increase our investment in the research and development of handset terminal products in 2005 and launched a series of handsets with high performance to price ratios. Meanwhile, we were gradually developing core technologies for high-end handset products as additional resources were devoted to the research and development of high-end intelligent handsets and 3G handsets. Sales in the international market were growing rapidly with access to numerous countries and regions around the world. The Group enhanced the research and development of 3G handsets and data cards and secured exports of such products to Europe.

Miscellaneous

Sales of business products grew rapidly in 2005 as carriers generally increased their investments in value-added services. As a major supplier of business products in China, ZTE has launched products in all aspects of value-added services. In 2005, the Group launched customised solutions for integrated business information platforms, electronic transactions, 3G services and messaging gateways.

2. 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 2005 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.

(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 sales from principal operations (RMB in millions)	Gross profit margin	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 gross profit margin (Basis point)
I. By industry						
Manufacturing of communications systems	21,575.9	13,944.8	35.4%	(4.9%)	(3.0%)	(1.3)
II. By product						
Wireless communications systems	8,930.8	4,930.4	44.8%	(7.4%)	(8.4%)	0.7
Wireline switch and access systems	2,752.6	1,240.3	54.9%	(3.5%)	5.2%	(3.8)
Optical and data communications systems	3,353.0	2,665.2	20.5%	30.9%	37.4%	(3.8)
Handsets	4,333.1	3,575.0	17.5%	(28.0%)	(30.6%)	3.1
Telecommunication software systems, services and other products	2,206.4	1,533.9	30.5%	35.4%	114.5%	(25.6)
III. By region						
The PRC	13,874.3	9,364.1	32.5%	(22.1%)	20.6%	(1.2)
Asia (excluding the PRC)	4,568.7	2,692.7	41.1%	73.6%	96.3%	(6.8)
Africa	2,835.4	1,645.3	42%	75.2%	93.6%	(5.5)
Other regions	297.5	242.7	18.4%	(53.9%)	(31.0%)	(27)

(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 (in millions RMB)	Cost of sales of principal operations (in millions RMB)	Gross profit margin
Wireless communications systems	8,930.8	4,930.4	44.8%
Wireline switch and access systems	2,752.6	1,240.3	54.9%
Optical and data communications systems	3,353.0	2,665.2	20.5%
Handsets	4,333.1	3,575.0	17.5%
Telecommunication software systems, services and other products	2,206.4	1,533.9	30.5%

3. Breakdown of the Company's assets

Unit: RMB in millions

Item	2005		2004		Increase/decrease (%)
	Amount	As a percentage of total assets	Amount	As a percentage of total assets	
Amounts receivable	4,994.4	22.93%	5,910.6	28.38%	(15.50)
Fixed assets	2,506.9	11.51%	1,974.6	9.48%	26.96
Long-term equity investments	85.5	0.39%	67.2	0.32%	27.23
Construction in progress	126.7	0.58%	114.7	0.55%	10.46
Short-term borrowings	136.1	0.62%	405.7	1.95%	(66.45) ¹
Inventories	2,519.5	11.57%	1,871.8	8.99%	34.60 ²
Long-term borrowings	767.8	3.53%	1,025.3	4.92%	(25.11)

Note 1: The balance of short-term borrowings decreased by 66.45% compared to the same period last year as bank loans due were repaid during the year.

Note 2: The increase in the balance of inventories by 34.60% mainly reflected the increase in inventories of raw materials for production in tandem with the expansion of the Group's production scale.

4. Expenses and income tax of the Company for the period

Unit: RMB in millions

Item	2005	2004	Increase/decrease (%)
Selling and distribution expenses	3,023.1	2,929.1	3.21
General and administrative expenses	3,137.1	3,899.0	(19.54)
Finance expenses	288.8	285.0	1.33
Income tax	158.5	207.9	(23.76) ³

Note 3: Income tax decreased by 23.76% compared to the same period last year as changes in the Company's accounting estimates in 2004 to the effect that additional provision for asset impairment was not deductible on a pre-tax basis resulted in relatively higher income tax for 2004, whereas no such effect was present in 2005.

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5. Breakdown of cash flow

Unit: RMB in millions

Item	2005	2004	Increase/decrease (%)
Net cash flow from operating activities	177.3	1,644.6	(89.22) ⁴
Net cash flow from investing activities	(984.3)	(566.4)	(73.78) ⁵
Net cash flow from financing activities	(1,195.5)	2,732.4	(143.75) ⁶

Note 4: Net cash flow from operating activities decreased by 89.22% compared to the same period last year mainly as a result of increased expenditure by the Group in overseas market expansion.

Note 5: Net cash outflow from investing activities increased by 73.78% compared to the same period last year mainly as a result of increased expenditure by the Group in the purchase of fixed assets and in construction works in progress.

Note 6: Net cash flow from financing activities decreased by 143.75% compared to the same period last year mainly as a result of the proceeds from the Company's offering of H shares in 2004.

6. Business operations and results of principal subsidiaries

Business operations of the Company's principal subsidiaries:

Company name	Registered capital (RMB in millions)	Percentage of equity interests (%)	Scope of business	Total assets (RMB in millions)	Net profit (RMB in millions)	Income from principal operations (RMB in millions)	Profit from principal operations (RMB in millions)
ZTE Kangxun	50	90	Production of electronic products and related parts (excluding restricted items)	6,438.9	295.9	13,377.2	507.7
ZTE Software	50	95	Development, production and sale of telecommunications systems, software for service-based businesses and provision of related technical consultancy services	1,745.9	680.8	1,853.9	1,840.2

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.

7. Major suppliers and customers

Purchases by the Group from its largest supplier amounted to RMB767 million in 2005, accounting for 6.9% of the total purchases of the Group for the year, while the purchases made from its five largest suppliers amounted to RMB2,320.9 million, accounting for 20.9% 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 HKASs).

Sales by the Group in 2005 to its largest customer amounted to RMB4,376.3 million, accounting for 20.3% of the total sales of the Group for the year, while sales to its five largest customers amounted to RMB10,124.1 million, accounting for 46.9% 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 HKASs).

8. Investments

(1) Use of proceeds from global offering of H shares

In December 2004, the Company made 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 verification certificate (Shenhua (2005) Yanzi No.(003)).

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

- the Group intends 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 intends 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.

As at the end of the reporting period, utilisation of the above proceeds by the Company was as follows:

Application of proceeds from share issue increased 84.18% from RMB1,160,319,000 in 2004 to 2,137,048,000 in 2005.

Unit: RMB in 10,000

Gross amount of proceeds	354,217.8	Gross amount of proceeds utilised during the year	213,704.8
		Gross amount of proceeds utilised on an accumulated basis	329,736.7

Projects committed	Proposed amount of application of proceeds	Any changes to project	Actual amount of application of proceeds	Earnings generated	Whether project schedule has been met	Whether expected earnings has been attained
IP switching platforms for mobile communications	24,039	No	24,039	See below	Yes	Yes
Integrated mobile broadband service systems	22,525	No	16,301.3	See below	Yes	Yes
High speed packet mobile communication base station systems	23,820	No	16,254	See below	Yes	Yes
Intelligent wireless integrated access systems	12,890.1	No	12,890.1	See below	Yes	Yes
Core routers	20,838	No	13,179.6	See below	Yes	Yes
NGN systems	20,118	No	20,118	See below	Yes	Yes
Automated optical switching network systems	17,457	No	14,424	See below	Yes	Yes
Sub-total	141,687.1	—	117,206	—	—	—
Overseas operations	212,530.7	—	212,530.7	See below	Yes	Yes
Total	354,217.8	—	329,736.7	See Note	—	—

Note: In relation to proceeds from the H share offering not currently utilised, the Company applied funds that were temporarily idle as working capital subject to the progress of projects, with a view to enhancing the efficiency of fund application by reducing the demand for bank loans and hence financing costs. The Company will appropriate funds to relevant projects in strict accordance with project schedules.

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Project progress and revenue from the projects are set out as follows:

High-speed packet mobile communications base stations

The research and development work for the project was progressing smoothly with the development of various advanced functions, including high-speed transmission for both forward and reverse channels. Currently, ZTE's CDMA2000 1xEVDO products are being put to large-scale commercial application in global markets, such as Asia-Pacific, Africa, Northern Europe and South America. On the back of CDMA2000 1xEV-DO trial stations operated on in conjunction with domestic carriers, ZTE is expecting to launch within this year the CDMA2000 1xEV-DO Revision A commercial system, an improved model that promises superior performance.

Integrated mobile broadband service systems

Research and development for integrated service platforms was basically completed to cover services such as network paging, network conferences, one-touch dialing, caller tunes, soft terminal communications and others, with related products being extensively used in the networks of domestic carriers. Such products were also being used by telecommunications carriers in Malaysia, the Philippines and Pakistan to provide value-added services. In future, the integrated platform will be able to support services on PSTN, PHS, GSM, CDMA, 3G and NGN networks simultaneously. With such competitive edge in technology, the project should enjoy excellent prospects.

Automated optical switching network systems

The first stage of research and development for the project had been completed and product samples had passed the performance testing for the inspection and acceptance process. The Company is currently conducting research and development on the commercialisation of automated optical switching network systems employing leading advanced technologies domestically. Apart from enhancing the operability and management of optical networks, automated optical switching network technologies also allow ease in incorporating new services to cater to future requirements in telecommunications. Prospects are promising as carriers are expected to deploy automated optical switching systems in the coming years, first in the backbone networks and ultimately extending to urban and regional networks.

IP switching platforms for mobile communications

Research and development of project was progressing as scheduled. The IP switching platforms for mobile communications for the core 3G network and the base station controllers were completed, as well as the production transfer of equipment associated with the NGN network gateways. The products passed the bulk volume test of China Mobile and the bulk volume gateway performance test of China Telecom. Currently, the IP switching platforms for mobile communications and the base station controllers are being put to commercial application in several countries overseas, and are expected to have a positive effect on ZTE's revenue generated from global markets.

Core routers

Most research and development programs for the project were completed. Products developed were capable of simultaneously supporting IPV4/IPV6 dual-protocol, in addition to supporting IPV6 router protocol and the IPV6 transition mechanism. As core equipment for China's model next generation foundational network, high-end routers were selected to be used in the next generation foundational networks of both China Mobile and China Unicom, and will soon be put to commercial application. The ZXR10 series have generated sales revenue of RMB100 million to date.

NGN systems

In 2005, the Company launched the leading bulk-volume media network gateway equipment and softswitch control equipment. We also undertook China Telecom's long-distance softswitch commercial trial network and network intelligence modification projects for fixed line convergence stations at Guangdong, Guangxi, Anhui, Shanghai, Wuhan, Chongqing, Qinghai and Inner Mongolia. The above projects are currently under implementation as planned, while certain completed sections have been put to commercial application, indicating that NGN network systems developed by ZTE are capable of large-scale commercial application.

Intelligent wireless integrated access systems

The first stage of research and development for the project was completed. Selected products had been launched in the domestic and overseas market after passing the testing procedures of China Telecom Research Institute. In 2006, the Company will further its development of products with access to expanded 3G network connections to support integration of fixed line and mobile networks. With their capability to accommodate a broad range of wireless access technologies, intelligent wireless integrated access systems are well-positioned to provide customised and enriched services to end-users. With increasing sophistication of wireless terminal technologies, intelligent wireless integrated access systems hold out enormous potential as a commercial product.

The year 2005 was the Company's "international year", as proceeds from the offering of shares applied in overseas operations contributed to the continuous growth of the Group's overseas revenue in 2005.

(2) Significant investments using funds other than proceeds from share issue

- In April 2005, the Company made an additional investment of USD3 million in cash in Zimax (Cayman) Holding Ltd. Following the additional investment, Zimax (Cayman) Holding Ltd. had a registered capital of USD5.50 million and the Company held 100% of its shares.
- In June 2005, ZTE (H.K.) Limited and ZTE (Australia) Pty Ltd, both wholly-owned subsidiaries of the Company, established ZTE Nigeria Investment Ltd. with an investment USD2.09 million. ZTE Nigeria Investment Ltd. had a registered capital of 5 million Naira, and was mainly engaged in SKD assembly of handsets, import of raw materials, manufacturing, user training and after-sales services for telecommunications products. The Company held 100% of the company through ZTE (H.K.) Limited and ZTE (Australia) Pty Ltd.
- In June 2005, the Company made a capital contribution of RMB6 million and through ZTE (H.K.) Limited an additional RMB10 million to establish Shenzhen Zhongxing Liwei Technology Limited ("Liwei"). The registered capital of Liwei was RMB20 million. The Company and ZTE (H.K.) Limited jointly held 80% of its shares. Liwei was principally engaged in the design and development, sales, installation, testing and services relating to base station control systems, network video control systems, various electronic systems equipment for network control and monitoring systems.

9. Business outlook and risk exposure of the Company

(1) *Business outlook for 2006*

The year 2006 is set to be full of opportunities as well as challenges. The Group will continue to focus on domestic 3G carriers, carriers in developed countries and multinational carriers. On the back of our solid track record, we will focus our development on three areas: from being a mainstream supplier of telecommunications products in China to a leading global mainstream supplier of telecommunications products; from the provision of communications hardware products to the provision of leading software products and services and, finally, from a operations-driven and technology-driven business model to a leading market-driven model. Major objectives set for 2006 are as follows:

- enhancing penetration of the domestic market to ensure balanced development in different sectors of the carrier market;
- targeting multinational carriers in the international market on top of local carriers and striving for breakthroughs;
- striving to lead rather than to follow in terms of product technologies;
- shifting focus from an operations and technical-based business model to a market-based business model;
- enhancing the commercial viability of product lines; and
- deepening the development of regional platforms in the international market to facilitate a more effective team.

To these ends, the Group will facilitate major fund applications using measures including increasing the rate of turnover of funds, and improve operating efficiency. Funding requirements arising from new projects will be satisfied by reasonable and effective use of various financing tools including bank loans, depending on market conditions. The Group will continue to invest in ZTE Industrial Park and R&D centers in Shanghai and Nanjing in a bid to maintain its competitive advantage and ability for sustainable development. At the same time, fixed assets, IT equipment and software will be upgraded or acquired as necessary.

(2) *Risk exposure*

- 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.
- Changing market demands in China — Sales and profitability of the Group's existing product lines may be affected as there has been a substantial decline in investments by PRC carriers in PSTN, CDMA and PHS, 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.
- International market risks — The Group has now established business presence in over 100 countries and regions. Such geographic coverage demands a high level of skills to cope with issues arising from differences in political and legal systems, taxation, market profiles and cultural traditions. Meanwhile, legal differences and rapid changes in economic policies, especially in developing countries, pose challenges to the stable development of the Group's business.

- Financial risks — Accounts receivable, exchange rates and interest rates are areas of particular concern for the Company. Exchange rate and interest rate regimes vary from country to country without any single market or tool for hedging risks. The Group has enhanced its risk control measures to meet the needs of its growing international business.

In relation to operating risks, the Group will continue to explore new markets and products in a pro-active manner and increase investments in the research and development of new products to avoid over-dependence on any single product or market.

In relation to legal and financial risks, the Group will devote additional human resources to improve its management and risk control regimes and adopt a prudent financial policy underpinned by adequate provisions, so that the Group will be able to attain stable development by controlling overall risks.

10. For details of the changes in the method of making provisions for accounts receivable, please refer to note 2.21 to the financial statements prepared under PRC GAAP.
11. 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 7 April 2006.
12. The independent opinion of the Independent Directors on the use of funds by Connected Parties and the Company's accumulated and current guarantees for 2005 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 2005 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 Several Issues of Fund Uses with Connected Persons and Third-party Guarantees for Listed Companies 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.

13. Operation of the Board of Directors

- (1) During 2005, the Board of Directors of the Company convened four regular meetings, the details of which are as follows:
 - The 12th meeting of the third session of the Board of Directors was held at the Company's office on 10 April 2005. The announcement of resolutions of the meeting of the Board of Directors was published in China Securities Journal, Securities Times and Shanghai Securities News, South China Morning Post and Hong Kong Economic Times on 11 April 2005.

REPORT OF THE BOARD OF DIRECTORS

- The 13th meeting of the third session of the Board of Directors was held by way of video conference on 25 April 2005. The announcement of resolutions of the meeting of the Board of Directors was published in China Securities Journal, Securities Times and Shanghai Securities News, South China Morning Post and Hong Kong Economic Times on 26 April 2005.
- The 14th meeting of the third session of the Board of Directors was held at the Company's office on 23 August 2005. The announcement of resolutions of the said meeting of the Board of Directors was published in China Securities Journal, Securities Times and Shanghai Securities News, South China Morning Post and Hong Kong Economic Times on 24 August 2005.
- The 15th meeting of the third session of the Board of Directors was held by way of video conference on 25 October 2005. The announcement of resolutions of the meeting of the Board of Directors was published in China Securities Journal, Securities Times and Shanghai Securities News, South China Morning Post and Hong Kong Economic Times on 26 October 2005.

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

Pursuant to the relevant resolution passed at the 2004 annual general meeting, the Board of Directors of the Company implemented the 2004 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 2004.

Record date for dividend payment for A shares: 7 July 2005. Ex-dividend date: 8 July 2005.

Record date for dividend payment for H shares: 29 April 2005. Dividend payment date: 8 July 2005.

14. The 2005 profit distribution proposal

The audited net profit of the Company for the year 2005 calculated in accordance with PRC GAAP amounted to RMB792.566 million. Profit available for distribution amounted to RMB3,355.95 million after deducting the transfer of 10% to the statutory surplus reserve amounting to RMB79.257 million, the transfer of 5% to the statutory public welfare fund amounting to RMB39.628 million and adding the undistributed profit of RMB2,682.269 million carried forward at the beginning of the year.

The audited net profit of the Company for the year 2005 calculated in accordance with HKASs amounted to RMB1,084.317 million. Profit available for distribution amounted to RMB1,195.262 million after deducting the transfers to the statutory surplus reserve and statutory public welfare totalling RMB118.885 million and adding the undistributed profit of RMB229.83 million carried forward at the beginning of the year.

In accordance with the requirements of the Ministry of Finance of the People's Republic of China and the Articles of Association, profit available for distribution shall be the lower of profit available for distribution as calculated in accordance with PRC GAAP and that calculated in accordance with HKASs. Therefore the amount of profit available for distribution is RMB1,195.262 million. The 2005 profit distribution proposal recommended by the Board of Directors of the Company is as follows: RMB2.5 for every 10 shares (including tax) or a total of RMB239,880 million in cash on the basis of the Company's total share capital of 959,521,650 shares as at 31 December 2005.

15. 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 (South China Morning Post in 2005) (English) and Hong Kong Economic Times (Chinese) have been designated as newspapers for information disclosure by the Company in Hong Kong.

OTHER INFORMATION

1. Fixed assets

Details of changes in the fixed assets of the Company and the Group for the year are set out in note 14 and note 15 to the financial statements prepared in accordance with HKASs.

2. Bank loans and other borrowings

Details of bank loans and other borrowings of the Company and the Group as at 31 December 2005 are set out in note 31 to the financial statements prepared in accordance with HKASs.

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 37 to the financial statements prepared in accordance with HKASs.

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 pro-rata 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 36 to the financial statements prepared in accordance with HKASs and on page 19 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 HKASs. 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.

Unit: RMB in millions

	2005	2004
Revenue		
Wireless communications	8,930.8	8,786.4
Wireline switch and access	2,752.6	2,598.6
Optical and data communications	3,353.0	2,335.3
Handsets	4,333.1	6,014.9
Telecommunications software systems, services and other products	2,206.4	1,484.9
Total	21,575.9	21,220.1
Cost of sales	(14,101.7)	(13,813.5)
Gross profit	7,474.2	7,406.6
Other revenue and gains	681.6	534.1
Research and development costs	(1,959.5)	(2,265.2)
Selling and distribution costs	(3,186.4)	(2,799.6)
Administrative expenses	(1,095.4)	(981.4)
Other operating expenses	(128.6)	(162.4)
Profit from operating activities	1,785.9	1,732.1
Finance costs	(175.9)	(140.4)
Share of profits and losses of jointly-controlled entities and associates	(4.2)	3.1
Profit before tax	1,605.8	1,594.8
Tax	(179.8)	(115.0)
Profit before minority interests	1,426.0	1,479.8
Minority interests	(138.3)	(207.3)
Net profit from ordinary activities attributable to equity holders of the parent	1,287.7	1,272.5
Dividends	239.9	239.9
Earnings per share — basic	RMB1.34	RMB1.57

REVENUE

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

Unit: RMB in millions

Product segment	2005		2004	
	Revenue	Percentage of revenue	Revenue	Percentage of revenue
Wireless communications	8,930.8	41.4%	8,786.4	41.4%
Wireline switch and access	2,752.6	12.8%	2,598.6	12.2%
Optical and data communications	3,353.0	15.5%	2,335.3	11.0%
Handsets	4,333.1	20.1%	6,014.9	28.4%
Telecommunications software systems, services and other products	2,206.4	10.2%	1,484.9	7.0%
Total	21,575.9	100.0%	21,220.1	100.0%

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

Unit: RMB in millions

Region	2005		2004	
	Revenue	Percentage of revenue	Revenue	Percentage of revenue
The PRC	13,874.3	64.3%	16,644.5	78.5%
Asia (excluding the PRC)	4,568.7	21.2%	2,459.9	11.6%
Africa	2,835.4	13.1%	1,513.1	7.1%
Other regions	297.5	1.4%	602.6	2.8%
Total	21,575.9	100.0%	21,220.1	100.0%

The Group's revenue in 2005 increased 1.7% to RMB21,575.9 million, as compared to RMB21,220.1 million in 2004. The increase was mainly attributable to growth in revenue from the optical and data communications segment and the telecommunications software systems, services and other products segment, which was partially offset by the decrease in revenue from handset sales. The Group's international business maintained rapid growth in 2005 with sales revenue rising 68.3% to RMB7,701.6 million as compared to RMB4,575.6 million in 2004, although the growth was partially offset by the decline in domestic sales revenue due to a decrease in capital expenditure of by domestic carriers and who were in the process of adjusting their investment structure.

The Group's revenue from the wireless communications business increased 1.6% to RMB8,930.8 million in 2005, as compared to RMB8,786.4 million in 2004. The increase was mainly attributable to solid increases in domestic and international sales of CDMA and domestic sales of GSM systems, partially offset by the declining PHS revenue resulting from the reduced investments in PHS network construction by domestic carriers who were in the process of re-aligning their investment structure.

MANAGEMENT DISCUSSION AND ANALYSIS

The Group's revenue from the wireline switch and access segment increased 5.9% to RMB2,752.6 million in 2005, as compared to RMB2,598.6 million in 2004. The growth was mainly attributable to increased sales of certain products that were reclassified to this segment from "telecommunications software systems, services and other products" during the year to more accurately reflect product classifications based on actual applications. The growth was also attributable to the growth in international sales revenue of the wireline switch and access business, though this was partially offset by the decline in sales revenue from the domestic market.

The Group's revenue from the optical and data communications segment increased 43.6% to RMB3,353.0 million in 2005, as compared to RMB2,335.3 million in 2004. The growth was mainly attributable to considerable growth in the international sales coupled with solid increase in domestic market share for optical products, while growth in sales revenue was also recorded for wireless access data products.

The Group's revenue from the handsets business amounted RMB4,333.1 million in 2005, down from RMB6,014.9 million in 2004. The decrease was mainly attributable to substantial reductions in PHS investment by domestic carriers in 2005, resulting in a notable decrease in the Group's sales of PHS handsets as compared to the previous year. On the other hand, the Group recorded its first sales revenue from 3G handsets in 2005.

The Group's revenue from the telecommunications software systems, services and other products segment increased 48.6% to RMB2,206.4 million in 2005, as compared to RMB1,484.9 million in 2004, benefiting mainly from sales growth in new innovative products such as fixed terminals and IPTVs. Meanwhile, sales revenue generated by software products as a separate item dropped as most of these products were bundled with system equipment in sales during the year. Moreover, certain products originally in this segment that registered sales growth were reclassified during the year such that their sales revenue was accounted for under the segment of "wireline switch and access" to more accurately reflect product classifications based on actual applications.

COST OF SALES AND GROSS PROFIT

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

Unit: RMB in millions

Product segment	2005		2004	
	Cost of Sales	Percentage of product segment revenue	Cost of Sales	Percentage of product segment revenue
Wireless communications	5,021.6	56.2%	4,973.2	56.6%
Wireline switch and access	1,260.9	45.8%	1,105.6	42.5%
Optical and data communications	2,697.7	80.5%	1,768.6	75.7%
Handsets	3,575.0	82.5%	5,286.2	87.9%
Telecommunications software systems, services and other products	1,546.5	70.1%	679.9	45.8%
Total	14,101.7	65.4%	13,813.5	65.1%

Unit: RMB in millions

Product segment	2005		2004	
	Gross Profit	Gross profit margin	Gross Profit	Gross profit margin
Wireless communications	3,909.2	43.8%	3,813.2	43.4%
Wireline switch and access	1,491.7	54.2%	1,493.0	57.5%
Optical and data communications	655.3	19.5%	566.7	24.3%
Handsets	758.1	17.5%	728.7	12.1%
Telecommunications software systems, services and other products	659.9	29.9%	805.0	54.2%
Total	7,474.2	34.6%	7,406.6	34.9%

The Group's gross profit rose slightly to RMB7,474.2 million in 2005 from RMB7,406.6 million in 2004. The Group's gross profit margin dropped slightly to 34.6% from 34.9% in 2004 due primarily to the decrease in the gross profit margin of the optical and data communications segment, the telecommunications software systems and services, wireline switch and access products, which was largely offset by the increase in the gross profit margin of handset products.

Gross profit margin of the Group's wireless communications business rose slightly to 43.8% in 2005 from 43.4% in 2004 as the increase in the sales of higher-margin CDMA systems as percentage to revenue was largely offset by declining gross profit margin for GSM. Growth in international sales of CDMA systems, which generally commanded a higher gross profit margin, more than offset the slight decline in its domestic sales, resulting in an improved overall gross profit margin for the product. The gross profit margin of GSM system products lost considerable ground due to intense competition in the global market.

Gross profit margin in the Group's wireline switch and access segment dropped to 54.2% in 2005 from 57.5% in 2004 as a result of increasing market competition and the reclassification of certain lower-margin products to this segment from "telecommunications software systems, services and other products" during the year.

Gross profit margin in the Group's optical and data communications business dropped to 19.5% in 2005 from 24.3% in 2004, as gross profit margin for optical communications products decreased as gross profit margin for optical communications products and the price of DSL products experienced a notable decrease amid intense market competition in 2005.

Gross profit margin in the Group's handsets segment rose to 17.5% in 2005 from 12.1% in 2004 in tandem with rising gross profit margin for CDMA handsets and PHS handsets. International sales of CDMA handsets increased further as the Group made further inroads in the international market. Gross profit margin for PHS handsets improved despite decreased sales in 2005 as compared to 2004 owing to reduced investments by carriers, due to effective cost reductions resulting from ongoing upgrades in technology and production processes. Nevertheless, such growth was partially offset by decreased gross profit margin for GSM handsets owing to rapid price concessions in an intensely competitive domestic GSM market.

Gross profit margin in the Group's telecommunications software systems, services and other products segment dropped to 29.9% in 2005 from 54.2% in 2004. This decline was mainly attributable to increased sales of low-margin products coupled with decreased sales revenue from high-margin products such as software and services.



OTHER REVENUE AND GAINS

Other revenue and gains of the Group increased 27.6% to RMB681.6 million in 2005 from RMB534.1 million in 2004. The increase was mainly attributable to the increase in government subsidies for technology projects and VAT subsidy income.

RESEARCH AND DEVELOPMENT COSTS

The Group continued to commit resources to research and development with additional investments in certain areas, although there was a change in the structure of investment. In accordance with HKASs, the development costs of certain products were capitalised by the Group. Moreover, the efficiency of research and development was improved with the Group's active measures in consolidating the core technical platform for research and development, contributing to the decrease in costs for the period. Research and development costs accounted for 9.1% of revenue from principal operations in 2005, as compared to 10.7% in 2004.

SELLING AND DISTRIBUTION COSTS

The Group's selling and distribution costs in 2005 amounted to RMB3,186.4 million, representing an increase of 13.8% comparing to RMB2,799.6 million in 2004. The increase was mainly attributable to the increase in overseas travel and transport expenses and staff costs due to growing international sales and the development of overseas sales platforms, which was partially offset by a significant reduction in sales commission expenses. Selling and distribution costs accounted for 14.8% of revenue from principal operations in 2005, as compared to 13.2% in 2004.

ADMINISTRATIVE EXPENSES

The Group's administrative expenses in 2005 amounted to RMB1,095.4 million, representing an increase of 11.6% comparing to RMB981.4 million in 2004. The increase was mainly attributable to the expansion in operation of its subsidiaries. Administrative expenses accounted for 5.1% of revenue from principal operations in 2005, as compared to 4.6% in 2004.

OTHER OPERATING EXPENSES

Other operating expenses of the Group decreased 20.8% to RMB128.6 million in 2005 from RMB162.4 million in 2004. The decrease mainly reflected reductions in bad debt provisions as a result of the revised method for bad debt provision for the Group's accounts receivable in accordance with requirements of Hong Kong Accounting Standard HKAS 39 (see note 2.2 to the financial statements prepared in accordance with HKASs), although such reductions were partially offset by the increase in goodwill impairment and exchange losses.

PROFIT FROM OPERATING ACTIVITIES

The Group's profit from operating activities increased 3.1% from RMB1,732.1 million in 2004 to RMB1,785.9 million in 2005, while the profit margin from operating activities rose to 8.3% in 2005 from 8.2% in 2004, which was mainly attributable to the decline in research and development costs, which were partially offset by the increases of selling and distribution costs and administrative expenses.

FINANCE COSTS

The Group's finance costs increased 25.3% to RMB175.9 million in 2005 from RMB140.4 million in 2004, mainly as a result of additional expenses associated with increased factoring of accounts receivable of the Group to shorten turnover of working capital. The increase was partially offset by lower financing costs as the balance of interest-bearing bank loans declined.

TAX

The Group's tax expenses increased 56.3% to RMB179.8 million in 2005 from RMB115.0 million in 2004 and its effective tax rate increased to 11.2% in 2005 from 7.2% in 2004, reflecting mainly the increase in overseas tax expenses from the Group's growing international sales.

MINORITY INTERESTS

The Group's minority interests decreased 33.3% to RMB138.3 million from RMB207.3 million in 2004. This was primarily attributable to the decrease in minority shareholdings in certain subsidiaries. Minority interests as a percentage of profit before minority interests decreased to 9.7% in 2005 from 14.0% in 2004.

GEARING RATIO AND THE BASIS OF CALCULATION

The Group's gearing ratio for 2005 was 6.0%, down 7.0% from 13.0% in 2004. The decrease was mainly attributable to the decrease in interest-bearing loans and the increase in equity. The gearing ratio represented outstanding amounts under total interest-bearing loans as a percentage of total capital.

LIQUIDITY AND CAPITAL RESOURCES

In 2005, the Group's development funds were financed mainly by the proceeds from the Company's H share offering, cash generated from its operations and bank loans. The Group's cash requirements related primarily to production and operating activities, repayment of due liabilities when due, capital expenditure, interest and dividend payments and other unforeseeable cash requirements.

Cash and cash equivalents of the Group as of 31 December 2005 amounted to RMB5,397.2 million.

CASH FLOW DATA

Unit: RMB in millions

	2005	2004
Net cash inflow/(outflow) from operating activities	(285.9)	1,240.0
Net cash inflow/(outflow) from investing activities	(1,067.3)	(620.6)
Net cash inflow/(outflow) from financing activities	(735.0)	3,314.2
Net increase/(decrease) in cash and cash equivalents	(2,088.2)	3,933.6
Cash and cash equivalents at the end of the year	5,397.2	7,509.2

OPERATING ACTIVITIES

Net cash outflow from the Group's operating activities amounted to RMB285.9 million in 2005 compared to net cash inflow amounted to RMB1,240.0 million in 2004, consisting mainly of an increase of RMB1,937.1 million in amounts due from customers for contract work and a decrease in contract work amounts payable of RMB1,585.3 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; a decrease in operating profit before working capital changes from RMB2,413.8 million in 2004 to RMB2,222.9 million in 2005 because of increased selling and distribution costs and administrative expenses during the year, but partially offset by an increase in trade and bills payable due to delay in payment resulting from higher credit limit granted to the Group by its suppliers; and an increase in prepayments and other receivables of RMB526.4 million owing to an external loan granted by the Group in 2005. In 2005, the Group's receivables turnover rate was 4.0 compared to 3.8 in 2004. Inventory turnover rate was 7.1 compared to 9.1 in 2004. Payables turnover rate was 2.7 compared to 3.1 in 2004.

INVESTING ACTIVITIES

Net cash outflow from the Group's investing activities in 2005 amounted to RMB1,067.3 million, as compared to RMB620.6 million in 2004. The cash outlay in 2005 was mainly used in business and production expansion, comprising RMB641.9 million for the purchase of machinery and equipment, testing instruments, computers and replacements of and additions to office equipment, RMB161.9 million for the construction of the research and development centre in Shenzhen and RMB206.8 million for the purchase of software and other intangible assets.

FINANCING ACTIVITIES

Net cash outflow from the Group's financing activities in 2005 amounting to RMB735.0 million, as compared to net cash inflow of RMB3,314.2 million in 2004, was mainly used in the repayment of bank loans of RMB869.0 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	2005	2004
Purchases of fixed assets and additions to construction in progress	803.8	647.0

The Group's capital expenditure in 2005 amounting to RMB803.8 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

	As at 31 December 2005	2004
Secured bank loans	47.7	361.6
Unsecured bank loans	632.0	1,085.4

Unit: RMB in millions

	As at 31 December 2005	2004
Short-term bank loans	599.7	421.7
Long-term bank loans	80.0	1,025.3

Credit facilities available to the Group included long-term and short-term bank loans. Long-term loans were mainly used for capital expenditures, while short-term loans were mainly used as working capital. The Group's long-term loans were subject to interest at fixed rates. The Group's borrowings were mainly denominated in RMB, with some loans which were denominated in US dollars.

The Group's bank loans in 2005 decreased as a result of the increase in available cash balances as the proceeds from the H share offering were applied in the Group's operations and increase in cash receipt from sales.

CONTRACTUAL OBLIGATIONS

Unit: RMB in millions

	Total	As at 31 December 2005		
		Less than one year	Two to five years	More than five years
Bank loans	679.7	599.7	80.0	—
Operating lease obligations	183.4	97.0	79.1	7.3

CONTINGENT LIABILITIES

Unit: RMB in millions

	As at 31 December 2005	2004
Discounted bills	—	440.9
Factored trade receivables	438.5	691.7
Guarantees given to banks in respect of performance bonds	2,823.8	1,626.1
Total	3,262.3	2,758.7

CAPITAL COMMITMENTS

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

Unit: RMB in millions

	As at 31 December 2005	2004
Land and buildings		
Contracted, but not provided for	231.6	282.4
Investment in an associate		
Contracted, but not provided for	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 2005 are set out in notes 18, 19 and 20 to the financial statements prepared in accordance with HKASs.

PROSPECTS FOR NEW BUSINESS

Details of the prospects for new business of the Group are set out section headed "Report of the Board of Directors" on pages 54 to 65 in this annual report.

EMPLOYEES

Details of the number of employees, remuneration, remuneration policy, bonus and training programs of the Group as at 31 December 2005 are set out in the section headed "Directors, Supervisors, Senior Management and Employees" on pages 25 to 35 and the section headed "Corporate Governance" on pages 38 to 52 in this Annual Report.

CHARGES ON ASSETS

Details of charges on the Group's assets as at 31 December 2005 are set out in note 31 to the financial statements prepared under HKASs.

PLANS FOR MATERIAL INVESTMENTS OR ACQUISITION OF CAPITAL ASSETS

Details of the Group's material investments and their performance and prospects as at 31 December 2005 are set out section headed "Report of the Board of Directors" on pages 54 to 65 in this annual report.

Details of plans for material investments or acquisition of capital assets are set out section headed "Report of the Board of Directors" on pages 54 to 65 in this annual report.

MARKET RISKS

Cash flow interest rate risk

The Group's exposure to cash flow interest rate risk is minimal.

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. Approximately 35% (2004: 22%) of the Group's sales are denominated in currencies other than the functional currency of the operating units making the sale, whilst almost 70% (2004: 65%) of costs are denominated in the unit's functional currency.

The Group attempts to include terms relating to foreign currency exchange risk avoidance or allocation when entering into purchase and sales contracts. The Group takes rolling forecasts on foreign currency revenue and expenses, and matches the currency and amount received or incurred, so as to alleviate the impact to the business due to exchange rate fluctuation.

1. SUPERVISORY COMMITTEE MEETINGS

The Supervisory Committee held two meetings in 2005, details of which are as follows:

1. The sixth meeting of the third session of the Supervisory Committee of the Company was held on 10 April 2005. The Supervisory Committee considered and approved the full text of the 2004 annual report, the 2004 annual report summary and results announcement of the Company, the 2004 financial statements of the Company, the 2004 profit distribution plan of the Company, the 2004 report of the Supervisory Committee, the proposed 2005 connected transactions framework agreements, the resolution regarding the proposed application for composite credit facilities for 2005, the resolutions appointing Ernst & Young as Hong Kong auditors and confirming PRC auditors and Hong Kong auditors' 2004 audit fees, the resolution regarding the appointment of additional supervisors and the resolution regarding 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, South China Morning Post and Hong Kong Economic Times on 11 April 2005.

2. The seventh meeting of the third session of the Supervisory Committee of the Company was held on 23 August 2005. The Supervisory Committee considered and approved the full text of the 2005 interim report, and the 2005 interim report summary and results announcement of the Company, the financial analysis report of the Company for the six months ended 30 June 2005 and the resolution for the appointment of new PRC auditors of the Company.

The announcement of the resolutions of the Supervisory Committee was published in China Securities Journal, Securities Times, and Shanghai Securities News, South China Morning Post and Hong Kong Economic Times on 24 August 2005.

2. INDEPENDENT OPINION OF THE SUPERVISORY COMMITTEE

An independent opinion regarding the Company's condition for the year 2005 has been furnished by the Supervisory Committee, as follows:

1. The Company has established a proper internal controls system and comprehensive provisions have been laid down in the Articles of Association. The management systems of the Company have been further refined. The Company's decision-making procedures have complied with relevant provisions of the Company Law of the Peoples' Republic of China and the Articles of Association. The proceedings, transaction of business and implementation of resolutions in connection with shareholders' general meetings and Board of Directors' meetings of the Company were in compliance with relevant provisions of laws, regulations and the Articles of Association. The information disclosure obligations have diligently performed.
2. The Directors and the management diligently performed their duties, abided by the laws and executed all resolutions of the general meetings of shareholders and Board of Directors meetings with due care. In exercising their duties, the Directors have not violated any laws, regulations and the Articles of Association and have not acted against the interests of the Company and its shareholders.
3. The Company has formulated proper accounting systems. The 2005 financial report of the Company gives a true and accurate view of the financial position and operating results of the Company for 2005.
4. All connected transactions entered into between the Company and its connected parties have been conducted on an arm's length basis without adversely affecting the interests of the Company and its shareholders.
5. After due examination by the Supervisory Committee, the use of proceeds from the offering of overseas-listed foreign shares in 2004 has been consistent with intended use stated in the prospectus.

MATERIAL MATTERS



1. MATERIAL LITIGATION OR ARBITRATION

During the year, the Group had no material litigation or arbitration. Other litigation and arbitration proceedings included the following:

1. Litigation instituted by Beijing Success Communications and Electronic Engineering Co., Ltd. against the Company's subsidiary Yangzhou Zhongxing Mobile Telecom Equipment Co., Ltd. ("Yangzhou Zhongxing"), and the Company. For further details of the litigation, please refer to the announcement published by the Company on 21 December 2005 in China Securities Journal, Securities Times, Shanghai Securities News, South China Morning Post and Hong Kong Economic Times. The date of the hearing has not been determined. As the case is currently under trial, the final outcome of the litigation cannot at this stage be ascertained with any reasonable certainty. Based on the legal opinion furnished by the Company's lawyers, the Directors are of the opinion that Yangzhou Zhongxing and the Company have sufficient and valid defences and the outcome of the arbitration will not have any material adverse impact on the Group's financial position.
2. Litigation instituted by the Group against Fairchild Semiconductor Corporation. For details of the litigation, please refer to the 2005 Third Quarterly Report published by the Company on 26 October 2005 the section headed "Material legal proceedings" in China Securities Journal, Securities Times, Shanghai Securities News, South China Morning Post and Hong Kong Economic Times. The case is currently under trial.
3. On 16 December 2005, a supplier of the Company alleged that the Company had breached its contract and infringed its intellectual property and claimed indemnity for a total amount of US\$36.45 million. Details of the arbitration claim are as follows:
 - not less than USD4 million in respect of wasted expenditure incurred by the supplier in the development, production and the acquisition of requisite software, hardware and design;
 - not less than USD7 million in respect of anticipated profit for one year during the term of the cooperation agreement;
 - not less than USD7 million in respect of losses arising from infringements of design patent and other intellectual property rights after the expiry of the one year term of the cooperation agreement;
 - not less than USD18 million, for account of profits as a result of the alleged infringement of intellectual property rights and breach of contract;
 - USD300,000 in respect of outstanding payment for delivered goods;
 - USD150,000 for refund of software application deposit under the cooperation agreement and interest accrued.

As at the date of publication of this report, the arbitration tribunal had been formed and the Company had filed its defences, for which the arbitration authority had yet to issue an award. As the case is currently under trial, the final outcome of the arbitration cannot at this stage be ascertained with any reasonable certainty. Based on the legal opinion furnished by the Company's lawyers, the Directors are of the opinion that the Company have sufficient and valid defences and the outcome of the arbitration will not have any material adverse impact on the Group's financial position.

4. On 18 August 2005, an Indian consultant firm issued an arbitration notice to the Company to claim indemnity for a total amount of approximately RMB10.736 million in respect of advisory fees, agency fees and related damages. As at the date of this annual report, the arbitration tribunal has yet to issue

an award. As the case is currently under trial, the final outcome of the arbitration cannot at this stage be ascertained with any reasonable certainty. Based on the legal opinion furnished by the Company's lawyers, the Directors are of the opinion that the Company has sufficient and valid defences and the outcome of the arbitration award would not have any material adverse impact on the Group's financial position.

5. An administrative penalty notice had been served upon Zhongxing Telecom Pakistan (Pvt) Ltd, a subsidiary of the Company, by the Collectorate of Customs, Sales Tax and Central Excise (Adjudication/ Appeals), Rawalpindi, in respect of a claim of additional custom duties of approximately RMB23.9 million and a penalty of approximately RMB324 million for the misdeclaration of the imported goods. On 5 September 2005, all the disputes relating to this action were referred to Alternate Dispute Resolution Committee (ADRC) for resolution at the direction of Central Board of Revenue, the governing authorities of the Rawalpindi Customs, after Zhongxing Telecom Pakistan (Pvt) Ltd raised an appeal. ADRC issued a report after in-depth investigation and analysis, which fully supported the grounds of appeal furnished by Zhongxing Telecom Pakistan (Pvt) Ltd and held that Zhongxing Telecom Pakistan (Pvt) Ltd had completed customs declarations correctly in respect of all import goods. The report also held that the Rawalpindi Customs should withdraw the administrative penalty. 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 Central Board of Revenue will give a just ruling based on the ADRC report and this matter would not have any material adverse impact on the Group's financial position.

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

2. ACQUISITIONS, DISPOSALS OF ASSETS, MERGERS AND TAKEOVERS

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

3. 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 reporting period, 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 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 reporting period 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

MATERIAL MATTERS

agreements between the Group and the connected parties, estimated transaction amounts for 2005 under each agreement, impact of the connected transactions on the Group, necessity of the connected transactions and review of the connected transactions by the shareholders' general meeting of shareholders or the Board of Directors of the Company, please refer to the announcement on ongoing connected transactions published by the Company on 11 April 2005 in China Securities Journal, Securities Times, Shanghai Securities News, South China Morning Post and Hong Kong Economic Times.)

Classification of Transaction	Subject Matter	Member of the Group (Party to Connected Transaction)	Connected person (Counterparty to Connected Transaction)	Pricing Basis	Amounts for Connected Transactions for January to December, 2005 (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	Various telecommunications products such as cabinets, cases, distribution frames, soft circuit boards and other raw materials	ZTE Kangxun	Zhongxingxin and its subsidiaries, Zhongxing Xinyu and Zhongxing Xindi	Consistent with market prices (as per contract)	43,096.40	3.12%	banker's acceptance bill	No
	Circuit protectors and other electronic products	ZTE Kangxun	Xi'an Microelectronics	Consistent with market prices (as per contract)	771.8	0.06%	banker's acceptance bill	No
	Printers and other electronic products	ZTE Kangxun	Chung Hing Hong Kong	Consistent with market prices (as per contract)	816.6	0.06%	banker's acceptance bill	Exceeded by RMB7.366 million*
	Soft circuit boards and other products	Lead	Zhongxing Xinyu	Consistent with market prices (as per contract)	695.60	0.05%	banker's acceptance bill	Exceeded by RMB4.456 million*
	IC, connector assemblies, optical devices, modules and other ancillary equipment	ZTE Kangxun	Zhongxing WXT and its investee entity, Shenzhen Gaodonghua Communication Technique Co., Ltd	Consistent with market prices (as per contract)	18,432.6	1.31%	banker's acceptance bill	No
Products sales	Handsets and other products	The Company	Xi'an Microelectronics	Consistent with market prices (as per contract)	647.8	0.03%	banker's acceptance bill	No
	Electric components etc.	ZTE Kangxun	Zhongxing WXT	Consistent with market prices (as per contract)	523.3	0.02%	banker's acceptance bill	Exceeded by RMB 0.233 million*

Note: The excess was mainly attributable to the rapid expansion of the Group's overseas business resulting in an increase of the transaction amount relating to the Group's purchase of certain electronic equipment from Chung Hing Hong Kong and soft circuit boards and other products from Zhongxing Xinyu, both of which were connected parties. However, the gross amount of connected transactions for the Group under the purchases of raw materials category as a whole did not exceed the original estimate.

Connected transactions involving sales of products or provision of labour services to Zhongxingxin and its subsidiaries by Company during the year amounted to RMB558,000.

The Company will enter into the 2006 connected transactions framework agreements with the connected persons and submit the same for review at the 2005 Annual General Meeting. For details please refer to the announcement regarding ongoing connected transactions published by the Company in China Securities Journal, Securities Times, Shanghai Securities News, The Standard and Hong Kong Economic Times on 7 April 2006.

(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 a 90% stake in ZTE Kangxun:

The Company holds a 63.2% stake in Ruide through its subsidiaries, being Shenzhen Changfei Investment Company, Limited and ZTEIC Design Co., Ltd. The other substantial shareholder of Ruide is Zhongxing Xindi with approximately a 23.0% stake. The remaining stake of approximately 13.8% 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 a 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 2005:

Approximately RMB152,421,000

- 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.

- 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 2005:

Approximately RMB18,650,000

- 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 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.

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 60% 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 55.0% 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 2005:

Approximately RMB430,964,000

- 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 will expire 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 co-operative 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 constitutes 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 see above for further details of Lead.

- Total transaction amount of 2005:

Approximately RMB233,985,000

- 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 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. In order to capture the growing market demand, 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.

Note: the Company noted the following when reviewing its continuing connected transactions:

The total transaction amounts for 2005 for each of the categories of connected transactions listed below, entered into between the Group and its connected persons in compliance with the de minimis provision under Rule 14A.33 of the Hong Kong Stock Exchange Listing Rules as disclosed in the Company's prospectus dated 29 November 2004, exceeded the estimated total transaction amounts for 2005 for such connected transactions as disclosed in the prospectus. The details are as follows:

Parties to the transaction	Nature of the transaction	2005 estimated total transaction amount disclosed in the prospectus (RMB10,000)	2005 actual total transaction amount (RMB10,000)
Lead as one party Zhongxing Xinyu as another party	Purchases of flexible printed circuit board materials by Lead from Zhongxing Xinyu	250	696
ZTE Kangxun as one party Chung Hing Hong Kong as another party	Purchases of printers and other electronic equipment by ZTE Kangxun from Chung Hing Hong Kong	80	817

Although amounts for 2005 for each of the categories of connected transactions listed above exceeded the estimated total transaction amounts as disclosed in the prospectus, the above connected transactions remain within the threshold specified for de minimis transactions under Rule 14A.33 of the Hong Kong Stock Exchange Listing Rules, that is, the percentage ratios (other than profits ratio) calculated by reference to Rule 14.07 of the Hong Kong Stock Exchange Listing Rules on an annual basis for 2005 were less than 0.1%.

During 2005, ZTE Integration Telecom Ltd., a subsidiary of the Company, purchased wood cases and trays from Zhongxing Xindi and purchased telecommunications equipment from Zhongxing Xinyu for an annual total amount of RMB1,255.9 and RMB12,043.6 respectively. Such category of connected transactions was not disclosed in the prospectus. However, this falls within the threshold specified for de minimis transactions under Rule 14A.33 of the Hong Kong Stock Exchange Listing Rules, that is, the percentage ratios (other than profits ratio) calculated by reference to Rule 14.07 of the Hong Kong Stock Exchange Listing Rules on an annual basis for 2005 were less than 0.1%. Such category of transactions is not subject to the relevant reporting, announcement and independent shareholders' approval requirements.

During 2005, the Company sold telecommunications products and power supplies to Zhongxingxin and Zhongxing Xindi respectively for the annual total transaction amounts of RMB545,343.85 and RMB12,552.14 respectively. Such category of connected transactions was not disclosed in the prospectus. However, this falls within the threshold specified for de minimis transactions under Rule 14A.33 of the Hong Kong Stock Exchange Listing Rules, that is, the percentage ratios (other than profits ratio) calculated by reference to Rule 14.07 of the Hong Kong Stock Exchange Listing Rules on an annual basis for 2005 were less than 0.1%. Such category of transactions is not subject to the relevant reporting, announcement and independent shareholders' approval requirements.

2. The Independent Non-executive Directors of the Company have reviewed the connected transactions 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;

MATERIAL MATTERS



- 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 Group and its connected parties during the reporting period 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.

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. Third-party guarantee by the Group
 - (1) During the year, the Company did not have any new third-party guarantees.
 - (2) In relation to guarantees granted before the reporting period, the progress during the reporting period is as follows:

The guarantee granted in respect of Chengdu Information Port Company Limited ("Chengdu Information Port") in favour of the China Construction Bank, Minjiang, Chengdu Branch involving the RMB 4 million loan. Juyou Network Industrial Group Limited ("Juyou Network"), being a shareholder of Chengdu Information Port, provided a counter-guarantee for the guarantee. Upon maturity, Chengdu Information Port was unable to settle the entire loan and the bank requested the Company to repay under the guarantee. The Company repaid RMB3.5 million for Chengdu Information Port. As Juyou Network is liable under the counter-guarantee, the Company entered into the Settlement Plan Agreement with Juyou Network ("Settlement Agreement"). As at 31 December 2005, an amount of RMB1.40 million has been repaid, leaving an outstanding amount of RMB2.10 million. The Company will continue to demand repayment of the outstanding amount.

3. During the year, the Company did not have any entrusted investments.
4. During the year, the Company and Indian company Atlas Interactive India (Private) Limited have entered into a contract for the supply of broadband network equipment. Please refer to the announcement published by the Company on 15 April 2005 in China Securities Journal, Securities Times, Shanghai Securities News, South China Morning Post and Hong Kong Economic Times. Save as disclosed above, the Company did not have any other material contracts during the year.

6. UNDERTAKINGS

1. Undertaking in respect of Share Reform

The statutory undertakings given by the nine holders of shares of the Company that are subject to lock-up from the Share Reform for the A share market and the special undertaking of Zhongxingxin, the largest shareholder of the Company, 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" on page 23 of this report.

2. The above undertakings had been properly fulfilled and there had been no circumstances of violations of such undertakings.
3. No other undertakings had been made by the Company or shareholders holding 5% or more of the Company's shares.

7. ENGAGEMENT OF AUDITORS BY THE COMPANY

Details are set out in the section headed "Remuneration of Auditors" in the corporate governance report on page 49 to page 50 of this report.

8. AMENDMENTS TO THE ARTICLES OF ASSOCIATION

Resolutions approving amendments to certain articles in the Articles of Association were passed by the 2004 annual general meeting of the Company held on 31 May 2005.

9. INVESTIGATIONS, ADMINISTRATIVE PENALTIES, PUBLIC CENSURES AND REPRIMANDS

During the reporting period, 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.

10. SIGNIFICANT EVENTS

During the reporting period, 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.

11. OTHER MATERIAL MATTERS

The Company and its subsidiaries were not involved in any material matters requiring disclosure that have not been disclosed.

NOTICE OF 2005 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 2005 will be held in accordance with the resolution passed by the sixteenth meeting of the third session of the Board of Directors of the Company held on 6 April 2006. 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 14 June 2006.

(2) Venue

The AGM will be held at the Novotel Bauhinia Shenzhen Hotel.

Address: Qiaocheng E., Road, Huaqiao City, Shenzhen, Guangdong Province, People’s Republic of China (hereinafter referred to as the “PRC”) (near the western entrance of Yuanboyuan)

Tel: +86 755 82829966

(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 on Friday, 12 May 2006 at 3:00 p.m. (hereinafter referred to as “Domestic Shareholders”);
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 Friday, 12 May 2006 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 Monday, 15 May 2006 to Tuesday, 13 June 2006 (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 12 May 2006 at 4:00 p.m. Details of the record date, dividend payment method and dividend payment date for Domestic Shareholders will be announced separately.

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 2005 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 2005;
3. to consider and approve the report of the Supervisory Committee of the Company for the year ending 31 December 2005;
4. to consider and approve the report of the President of the Company for the year ending 31 December 2005;
5. to consider and approve the final financial accounts of the Company for the year ending 31 December 2005;
6. to consider and approve the profit distribution plan of the Company for the year ending 31 December 2005;
7. to consider and approve the Connected Transactions Framework Agreements proposed to be entered into by the Company in 2006:
 - 7.1 the *2006 Framework Purchase Agreement* to be entered into between ZTE Kangxun Telecom Company, Limited, a subsidiary of the Company, and Shenzhen Zhongxingxin Telecommunications Equipment Company, Limited, a connected party of the Company, and its subsidiaries;
 - 7.2 the *2006 Framework Purchase Agreement* to be entered into between ZTE Kangxun Telecom Company, Limited, a subsidiary of the Company, and Xi'an Microelectronics Technology Research Institute, a connected party of the Company;
 - 7.3 the *2006 Framework Sales Agreement* to be entered into between the Company and Xi'an Microelectronics Technology Research Institute, a connected party of the Company;
 - 7.4 the *2006 Framework Purchase Agreement* to be entered into between ZTE Kangxun Telecom Company, Limited, a subsidiary of the Company, and Chung Hing (Hong Kong) Development Limited, a connected party of the Company;
 - 7.5 the *2006 Framework Purchase Agreement* to be entered into between Shenzhen Lead Communications Company, Limited, a subsidiary of Shenzhen Changfei Investment Company Limited, which is in turn a subsidiary of the Company, and Shenzhen Zhongxing Xinyu FPC Company, Limited, a connected party of the Company;
 - 7.6 the *2006 Framework Purchase Agreement* to be entered into between ZTE Kangxun Telecom Company, Limited, a subsidiary of the Company, and Shenzhen Zhongxing WXT Equipment Company, Limited, a connected party of the Company, and its investee company;

NOTICE OF 2005 ANNUAL GENERAL MEETING



- 7.7 the *2006 Framework Sales Agreement* to be entered into between entered into between ZTE Kangxun Telecom Company, Limited, a subsidiary of the Company and Shenzhen Zhongxing WXT Equipment Company, Limited, a connected party of the Company;
- 7.8 the *2006 Framework Purchase Agreement* to be entered into between ZTE Kangxun Telecom Company, Limited, a subsidiary of the Company, and Shenzhen Zhongxing Information Technology Company, Limited, a connected party of the Company; and
- 7.9 the *2006 Framework Sales Agreement* to be entered into between the Company and ZTE Kangxun Telecom Company, Limited, a subsidiary of the Company, on the one hand and Shenzhen Zhongxing Information Technology Company, Limited, a connected party of the Company.

The above connected transactions framework agreements relate to ongoing connected transactions as defined in the Rules Governing Listing of Stocks on Shenzhen Stock Exchange which require shareholders' approval of such transactions. Details of such ongoing connected transactions are set out in a separate ongoing connected transactions announcement published by the Company on 7 April 2006.

- 8. to consider and approve the appointment of the PRC auditors and the Hong Kong auditors of the Company for the year ending 31 December 2006:
 - 8.1 That Ernst & Young Hua Ming be re-appointed as the PRC auditors of the Company for 2006 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 2006 based on specific audit work to be conducted.
 - 8.2 That Ernst & Young be re-appointed as the Hong Kong auditors of the Company for 2006 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 2006 based on the specific audit work to be conducted.

Special Resolutions

- 9. To consider and, if thought fit, pass the following resolution 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;
 - (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;
- (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 of shares 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 their jurisdictions of residence) 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).
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."

NOTICE OF 2005 ANNUAL GENERAL MEETING



10. To consider and, if thought fit, pass the following resolution as a special resolution:

“THAT:

the amendments to the *Articles of Association of ZTE Corporation* submitted by the Board of Directors of the Company be and are hereby approved, and the Board of Directors be authorised to modify the wording of the amendments and do all things in respect of the amendments as may be appropriate, in accordance with the requirements of any relevant approval authorities and any rules of any stock exchange(s) on which the shares of the Company are listed.”

The following is a summary of certain significant amendments proposed to be made to the Articles of Association. Details of the amendments and a full text of the Articles of Association as amended will be published on the information disclosure website designated by the Company (<http://www.cninfo.com.cn>) and included in a circular which is expected to be delivered to H Shareholders on or before 30 April 2006. **Shareholders of the Company should note that the following is a summary of the proposed amendments only and does not cover all of the proposed amendments. Shareholders should read carefully the full text of the proposed revised Articles of Association provided on the information disclosure website designated by the Company and in the circular.**

10.1 *Proposed amendments to the Articles of Association due to changes to relevant laws and regulations of the PRC*

The Company proposes to make comprehensive amendments to the Articles of Association of ZTE Corporation in compliance with the PRC Company Law, the PRC Securities Law (both as amended and approved by the eighteenth session of the Standing Committee of the Tenth National People’s Congress on 27 October 2005), the Guidelines for Articles of Association of Listed Companies (as amended in 2006) (Zheng Jian Gong Si Zi [2006] No. 38) and the Rules for Shareholders’ General Meetings of Listed Companies (Zheng Jian Fa [2006] No. 21) issued by the China Securities Regulatory Commission on 16 March 2006. Selected amendments are summarised as follows:

10.1.1. Amendments to the scope of investments to be made by the Company and the deletion of proportionate restrictions on investments by the Company

The proposed revised Article 11 stipulates that the Company may invest in other entities instead of other limited liability companies or joint stock limited companies only. The approval of examining and approving authorities delegated by the State Council is no longer required for the Company to operate as a holding company.

10.1.2. Same rights for same shares

The proposed revised Article 18 clarifies that “same shares carry same rights” and “same shares carry same benefits” shall mean that each of the shares of the same class shall carry the same rights, that each of the shares of the same class shall be issued under the same conditions and at the same price in each issuance, and that the same price shall be paid for each of the shares subscribed for by any entity or individual.

10.1.3. Amending the share capital structure of the Company

The proposed revised Article 24 stipulates that the Company has issued 959,521,650 shares since its establishment, comprising 160,151,040 H shares (representing 16.7% of the total number of ordinary shares issued by the Company) and 799,370,610 domestic shares (representing 83.3% of the total number of ordinary shares issued by the Company).

10.1.4. Easing restrictions on transfer of shares by relevant parties

The proposed revised Article 31 stipulates that shares held by promoters shall not be transferred within one year from the date of establishment of the Company. During their terms of office, directors, supervisors, the president and other senior officers shall periodically report to the Company their shareholdings in the Company and changes therein and shall not transfer during their terms of office more than 25% per year of the total number of shares of the Company which they hold; the shares held by them shall not be transferred within one year from the date on which the shares of the Company are first listed and traded; and the aforesaid persons shall not transfer the shares of the Company held by them within six months from the date on which their resignation from the Company comes into effect.

10.1.5. Adding a restriction on any sale or purchase of domestic shares within six months after the purchase or sale

The proposed revised Article 32 stipulates that any gains from any sale of domestic shares of the Company by any director, supervisor, senior officer or shareholder holding 5% or more of the shares of the Company within six months after their purchase of the same, and any gains from any purchase of domestic shares of the Company by any of the aforesaid parties within six months after sale of the same shall be disgorged and paid to the Company, and the Board of Directors of the Company shall recover such gains from the abovementioned parties, except that this provision shall not apply to any holding of 5% or more of the shares of the Company by any securities company as a result of its purchase of remaining shares sold under an underwriting obligation.

10.1.6. Easing the announcement and timing requirements for reduction of registered capital, mergers, division and liquidation of the Company

The proposed revised Article 34 stipulates that the Company shall notify its creditors within ten days of the date of the Company's resolution for reduction of registered capital and shall publish a public announcement in newspapers within thirty days of the date of such resolution. A creditor of the Company shall be entitled, within thirty days of the date of receipt of the notice from the Company or, in case of a creditor who has not received such notice, within forty-five days of the date of the public announcement, to require the Company to repay its debts or provide a corresponding guarantee for such debt.

The proposed revised Article 248 stipulates that in the event of a merger, all parties to the merger shall execute a merger agreement and prepare balance sheets and a list of assets. The Company shall notify its creditors within ten days of the date of the Company's merger resolution and shall make public announcements in newspapers which are in compliance with relevant regulations within thirty days from the date of the Company's resolution on merger.

The proposed revised Article 249 stipulates that the creditors shall be entitled to request the Company to repay its debts or provide appropriate guarantees within thirty days of the receipt of the notification, or where no such notification is received, within forty-five days from the date of the first public announcement.

The proposed revised Article 250 stipulates that in the event of a division of the Company, the parties to the division shall execute a division agreement and prepare balance sheets and a list of assets. The Company shall notify its creditors of the resolution with respect to the division within ten days of the date of the Company's division resolution and make public announcements in newspapers which are in compliance with the relevant regulations within thirty days from the date of the Company's resolution on division.

The proposed revised Article 251 stipulates that creditors shall have the right to request the Company to repay its debts or provide appropriate guarantees within thirty days of receipt of the notification, or where no such notification is received, within forty-five days from the date of the first public announcement. The liabilities of the Company prior to the division shall be assumed in accordance with the agreement between the Company and its creditors. Where there is no agreement, the liabilities of the Company shall be assumed jointly and severally by the companies resulting from the division.

The proposed revised Article 256 stipulates that the liquidation committee shall notify the creditors within ten days of its establishment, and issue public announcements in newspapers which are in compliance with relevant regulations within sixty days. The liquidation committee shall register all claims.

The proposed revised Article 257 stipulates that the creditors shall report their claims to the liquidation committee within thirty days of the receipt of the written notification, or in the event that no such notification is received, within forty-five days of the date of the first public announcement. When the creditors report their claims, they shall make clear relevant matters regarding the claims and provide supporting evidence. The liquidation committee shall register the claims.

10.1.7. Addition of clauses relating to share repurchases

The proposed revised Article 35 provides for additional circumstances under which shares may be repurchased, for the purpose of granting shares as incentive compensation to the staff of the Company and to acquire the shares of shareholders who vote against any resolution adopted by the shareholders' general meeting on merger or division of the Company.

If the Company repurchases its shares for the purpose of reducing its registered capital, the shares shall be cancelled within ten days of the repurchase. If the Company repurchases its shares as a result of its merger with any other company which holds shares in the Company, or as a result of any repurchase request made by any shareholder who is in opposition to any resolution adopted by the shareholders' general meeting as aforesaid, the shares so purchased shall be transferred or cancelled within six months.

If the Company repurchases its shares for the purpose of granting the shares to its employees as incentive compensation, the shares so repurchased shall not exceed 5% of the total number of shares issued by the Company. The repurchase shall be funded with the post-tax profit of the Company, and the shares so repurchased shall be transferred to the employees within one year.

10.1.8. Augmenting the scope of shareholders' rights to information

The proposed revised Article 57 adds the following information under the scope of shareholders' right of inspection of the Company's bond certificates, resolutions of the Board of Directors, resolutions of the Supervisory Committee and financial and accounting reports.

10.1.9. Augmenting the scope of shareholders' rights to sue the Company

The proposed revised Article 58 stipulates that a resolution of a general meeting of shareholders or the Board of Directors which violates any law or administrative regulation shall be invalid. If the procedures for convening a meeting or the method of voting at a shareholders' general meeting or of the Board of Directors violates any law, administrative regulation or the Articles of Association, or the content of a resolution violates the Articles of Association, shareholders may petition the People's Court to rescind as such resolution within sixty days from the date on which such a resolution is passed. If the Company has carried out the change of registration particulars in accordance with the resolution of the general meeting of shareholders or the Board of Directors and the People's Court has declared that the resolution is invalid or the resolution has been rescinded, the Company shall apply to the company registration authority for rescission of the change in registration.

The proposed revised Article 59 stipulates that where the Company incurs losses as a result of directors and senior officers having violated any provision of law, administrative regulation or the Articles of Association in the course of performing their duties with the Company, shareholders alone or in aggregate holding 1% or more of the Company's shares for one hundred and eighty consecutive days or more shall be entitled to request in writing the Supervisory Committee to initiate proceedings in the People's Court; where the Company incurs losses as a result of the Supervisory Committee having violated any provision of law, administrative regulation or the Articles of Association in the course of performing its duties with the Company, shareholders alone or in aggregate holding 1% or more of the shares for one hundred and eighty consecutive days or more shall be entitled to request in writing that the Board of Directors should initiate proceedings in the People's Court. In the event that the Supervisory Committee or the Board of Directors refuses to initiate proceedings after receiving the written request of shareholders stated in the foregoing paragraph, or fails to initiate such proceedings within 30 days from the date on which such request is received, or in case of emergency where failure to initiate such proceedings immediately will result in irreparable damage to the Company's interests, these shareholders shall have the right to initiate proceedings in the People's Court directly in their own name in the interest of the Company; these shareholders may also initiate proceedings in the People's Court under these provisions in the event that the lawful interests of the Company was infringed upon by third parties.

The proposed revised Article 218 stipulates that shareholders may initiate proceedings in the People's Court if a director or any other senior management violates any law, administrative regulation or the Articles of Association and harms the interests of shareholders.



10.1.10. Additional obligations of shareholders

The proposed revised Article 60 contains a new obligation of shareholders as follows: Shareholders shall not withdraw their shares unless required by laws and regulations; shall not abuse their shareholders' rights to harm the interest of the Company or other shareholders; and shall not abuse the independent legal person status of the Company and the limited liability of shareholders to harm the interest of any creditor.

The proposed revised Article 61 contains a new obligation of any shareholder holding 5% or more of the Company's voting domestic shares by requiring that such shareholder, in the event that he pledges any domestic shares in his possession, shall report the same to the Company in writing on the day on which he pledges his shares.

10.1.11. Augmenting the definition of a person who exercises effective control over the Company and its relevant fiduciary duty

The proposed revised Article 64 defines that persons who exercise effective control over the Company as the person, not being a shareholder of the Company, who is able to exercise control over the acts of the Company through an investment relationship, agreement or other arrangement. The controlling shareholder and the person who exercises effective control over the Company have a fiduciary duty towards the Company and its public shareholders. They shall not take advantage of their connected relationship with the Company to act in detriment to the interests of the Company. If they have violated the aforesaid provision and caused damage to the Company, they are liable for the damages to the Company.

10.1.12 Augmenting the scope of authority of the shareholders' general meeting

The proposed revised Article 67 adds the following matters requiring examination and approval at the shareholders' general meeting: (1) to examine and approve the provision of guarantees in accordance with relevant provisions of the Articles of Association; (2) to change the form of the Company; (3) to consider motions raised by shareholders who represent 3% or more of the total number of voting shares of the Company; (4) to examine and approve the Company's significant acquisition or disposal of material assets with a value exceeding 30% of the latest audited total assets of the Company during the year; (5) to examine and approve changes in the use of proceeds; and (6) to examine and approve share incentive schemes.

10.1.13. Amendments to the procedures for convening extraordinary shareholders' general meetings

The proposed revised Article 72 stipulates that an Independent Director shall be entitled to propose the convening of extraordinary general meetings of shareholders to the Board of Directors. The Board of Directors shall, in accordance with provisions of the laws, administrative regulations and the Articles of Association, furnish a written reply stating its agreement or disagreement to the convening of an extraordinary general meeting within ten days after receiving such proposal of the same from the Independent Director. In the event that the Board of Directors agrees to convene an extraordinary general meeting, the notice of general meeting shall be issued within five days after the passing of the relevant resolution of the Board of Directors. In the event that the Board of Directors does not agree to convene an extraordinary general meeting, reasons for such disagreement shall be given by way of announcement.

The proposed revised Article 73 stipulates that the Supervisory Committee shall be entitled to propose the convening of extraordinary general meetings of shareholders to the Board of Directors, provided that such proposal shall be made in writing. The Board of Directors shall, in accordance with provisions of the laws, administrative regulations and the Articles of Association, furnish a written reply stating its agreement or disagreement to the convening of an extraordinary shareholder general meeting within ten days after receiving such proposal of the same. In the event that the Board of Directors agrees to convene an extraordinary general meeting, the notice of general meeting shall be issued within five days after the passing of the relevant resolution of the Board of Directors. Any changes to the original proposal made in the notice shall require prior approval of the Supervisory Committee. In the event that the Board of Directors does not agree to convene an extraordinary general meeting or does not furnish any reply within ten days after receiving such proposal, the Board of Directors shall be deemed as incapable of performing or failing to perform the duty of convening a general meeting, in which case the Supervisory Committee may convene and preside over such meeting on an unilateral basis.

The proposed revised Article 74 stipulates that shareholders alone or in aggregate holding 10% or more of the Company's shares shall be entitled to request the Board of Directors to convene extraordinary general meetings of shareholders, provided that such request shall be made in writing. The Board of Directors shall, in accordance with provisions of the laws, administrative regulations and the Articles of Association, furnish a written reply stating its agreement or disagreement to the convening of an extraordinary general meeting within ten days after receiving such proposal of the same. In the event that the Board of Directors agrees to convene an extraordinary general meeting, the notice of shareholders' general meeting shall be issued within five days after the passing of the relevant resolution of the Board of Directors. Any changes to the original request made in the notice shall require prior approval of the shareholders concerned. In the event that the Board of Directors does not agree to convene an extraordinary general meeting or does not furnish any reply within ten days after receiving such proposal, shareholders alone or in aggregate holding 10% or more of the Company's shares shall be entitled to propose to the Supervisory Committee the convening of the extraordinary general meeting, provided that such proposal shall be made in writing. In the event that the Supervisory Committee agrees to convene an extraordinary general meeting, the notice of general meeting shall be issued within five days after receiving such request. Any changes to the original request made in the notice shall require prior approval of the shareholders concerned. Failure of the Supervisory Committee to issue a notice of general meeting within the stipulated period shall be deemed as failure of the Supervisory Committee to convene and preside over a general meeting, and shareholders alone or in aggregate holding 10% or more of the Company's shares for ninety consecutive days or more shall be entitled to convene and preside over the meeting on an unilateral basis.

The proposed revised Article 75 stipulates that if the Supervisory Committee or shareholders determine to convene a general meeting of shareholders on their own, they shall give a written notice to the Board of Directors and file the same with the local office of China Securities Regulatory Commission at the place where the Company is located and the stock exchange for the record. The shareholding proportion of the convening shareholders shall not be lower than 10% prior to the announcement of the resolutions of the general meeting. The convening shareholder shall submit relevant evidence to the local office of China Securities Regulatory Commission at the place where the Company is located and the stock exchange upon the issuance of the notice of general meeting and the announcement of the resolutions of the general meeting.

10.1.14. Amendments to conditions for proposing *ex tempore* motions

The proposed revised Article 78 stipulates that whenever the Company convenes an annual general meeting of shareholders, the Board of Directors, the Supervisory Committee and shareholder(s) alone or in aggregate holding 3% or more of the total number of the Company's shares shall have the right to propose motions to the Company. Shareholder(s) alone or in aggregate holding 3% or more of the total number of the Company's shares shall have the right to propose an *ex tempore* motion ten days prior to the general meeting by furnishing the same to the convener in writing. The convener shall issue a supplemental notice of general meeting within two days after receiving the proposed motion to make public the contents of the *ex tempore* motion. Save as provided above, the convener shall not amend motions stated in or add new motions to the notice of general meeting after the same has been issued and announced. No voting or resolution shall be effected or adopted at the general meeting for motions that have not been stated in the notice of the general meeting or that do not comply with the Articles of Association.

10.1.15. Amendments to the procedures of instating the chairman of the meeting

The proposed revised Article 97 stipulates that the general meeting of shareholders shall be chaired by the Chairman. If the Chairman is unable to attend the meeting for any reason, the meeting shall be convened and chaired by the Vice-chairman upon nomination by half or more of the number of the directors. In the event that both the Chairman and Vice-chairman are unable to attend the meeting, a director nominated by half or more of the number of the directors shall be the chairman of the meeting. Where a general meeting is convened by the Supervisory Committee on its own, the meeting shall be presided over by the chairman of the Supervisory Committee. In the event that the chairman of the Supervisory Committee is incapable of performing or fails to perform his duties, the meeting shall be presided over by the vice-chairman of the Supervisory Committee. In the event that the vice-chairman of the Supervisory Committee is incapable of performing or fails to perform his duties, the meeting shall be presided over by a supervisor nominated by half or more of the number of supervisors. Where a general meeting is convened by shareholders on their own, the meeting shall be presided over by a representative nominated by the convening shareholders. In the event that the person presiding over the general meeting violates the rules of procedures so that the meeting could not proceed, another person may be nominated to preside over the meeting with the approval of shareholders present at the meeting entitled to more than half of the voting rights.

10.1.16. Additional matters requiring approval of the general meeting of shareholders by way of special resolution

The proposed revised Article 107 adds the following as matters requiring approval of the shareholders' general meeting by way of special resolution as follows: (1) change of the form of the Company; (2) any acquisition or disposition of major assets, or any provision of a guarantee by the Company within one year that are in excess of 30% of the latest audited total assets of the Company; and (3) share incentive schemes.

10.1.17. Clarification that shares of the Company held by the Company shall have no voting rights

The proposed revised Article 108 stipulates that when voting at a general meeting of shareholders, a shareholder (including proxies) shall exercise his voting rights based on the number of voting shares represented by him. Each share shall carry one vote, provided that shares of the Company held by the Company shall have no voting rights and shall not be counted in the total number of voting shares represented at the general meeting.

10.1.18. Amending regulations relating to the provision of guarantees by the Company in favour of a third party

The proposed revised Article 160 stipulates that the Company shall comply with the following requirements when determining the provision of a guarantee (including but not limited to a guarantee in the form of security, pledge, lien or deposit) for an amount less than 10% of the Company's latest audited net asset value in favour of a third party: (1) With respect to matters relating to the provision of a guarantee in favour of a third party considered by the Board of Directors, an affirmative vote of not less than two-thirds of all members of the Board of Directors shall be obtained therefor; with respect to matters relating to the provision of a guarantee in favour of a third party considered at a general meeting of shareholders, the Board of Directors shall prepare a proposal related thereto and submit the same to the general meeting for approval. The provision of a guarantee in favour of a shareholder or a person who exercises effective control over the Company is subject to the approval at a general meeting. (2) The Company shall neither provide a guarantee in favour of a unit without legal person status nor an individual. The maximum amount of any single guarantee provided by the Company in favour of a third party shall not be more than 5% of the net asset value recorded on the consolidated financial statements for the most recent accounting year, and the maximum accumulated amount of guarantees provided by the Company to any one party shall not be more than 10% of the net asset value recorded on the consolidated financial statements for the most recent accounting year.

The following guarantees shall be subject to the approval of shareholders' general meeting provided that the same have been considered and approved by Board of Directors' meetings prior to being tabled at general meetings: (1) any guarantee to be provided by the Company and subsidiaries controlled by it in favour of a third party, with the total amount of which exceeds 50% of the audited net asset value for the most recent period; (2) guarantees to be provided in favour of an entity which has a gearing ratio of over 70%; (3) guarantees to be provided in favour of any shareholder, person who exercises effective control over the Company and its related parties, and (4) other guarantees subject to the approval of general meetings in accordance with laws, regulations and the Articles of Association.

The aforesaid shareholders or shareholders who are under the control by persons who exercise effective control over the Company shall abstain from voting on resolutions in respect of guarantees to be provided in favour of shareholders, persons who exercise effective control over the Company and its related parties. Votes representing more than half of the voting rights represented by other shareholders attending the meeting must be exercised in favour of the resolution in order for it to be passed.

10.1.19. Augmenting shareholders' rights to convene extraordinary board meetings

The proposed revised Article 165 stipulates that an extraordinary board meeting shall be convened at the request of shareholders representing more than one-tenth of the voting rights.

10.1.20. Change of the minimum number of meetings required to be held by the Board of Directors

The proposed revised Article 165 stipulates that the Board of Directors shall hold at least four meetings each year.

NOTICE OF 2005 ANNUAL GENERAL MEETING



10.1.21. Change of the length of board meeting notices

The proposed revised Article 168 stipulates that notice of a board meeting shall be served on all directors and supervisors fourteen days before the date of the meeting. Notice of an extraordinary board meeting shall be served on all directors and supervisors three days before the date of the meeting.

10.1.22. Change of the quorum for meetings of Board of Directors

The proposed revised Article 169 stipulates that meetings of Board of Directors shall be held only if more than half of the directors are present.

10.1.23. Change of the convening time for Supervisory Committee meetings

The proposed revised Article 193 stipulates that meetings of the Supervisory Committee shall be held at least once every six months and shall be convened by the chairman of the Supervisory Committee.

10.1.24. Adding a clause that allows the proposal to convene an extraordinary meeting of the Supervisory Committee

The proposed revised Article 193 stipulates that supervisors may propose to convene an extraordinary meeting of the Supervisory Committee.

10.1.25. Extending the power of the Supervisory Committee

The proposed revised Article 195 provides for the duties of the Supervisory Committee as follows:

- (1) to monitor the Company's financial affairs;
- (2) to supervise the directors, president and senior officers in their performance of duties and to propose the removal of directors, president and other senior officers who have contravened any law, administrative regulations, the Articles of Association or resolution of a general meeting of shareholders;
- (3) to demand any director, president and other senior officer of the Company who acts in a manner which is harmful to the Company's interests to rectify such behavior;
- (4) to review periodic reports of the Company prepared by the Board of Directors and to furnish written review opinions, to verify the financial information such as the financial reports, business reports, and plans for distribution of profits to be submitted by the Board of Directors to the shareholders' general meeting and to appoint, in the Company's name, certified public accountants and practicing auditors to assist in the re-examination of such information should any doubts arise in respect thereof;
- (5) to propose to convene an extraordinary general meeting of shareholders and to convene and preside over general meetings of shareholders when the Board of Directors fails to perform the duty of convening and presiding over general meetings in accordance with the Articles of Association;
- (6) to propose resolution at a general meeting of shareholders;

- (7) to initiate proceedings against the directors, president and other senior officers in accordance with the relevant laws;
- (8) to conduct investigations into any irregularities in the Company's operations identified; and
- (9) to exercise other functions and powers conferred by the Articles of Association and shareholders' general meeting.

Supervisors may attend board meetings to raise queries or suggestions in respect of resolutions of the Board of Directors.

The Supervisory Committee may express its opinion on the certified public accountant engaged by the Company and, where necessary, may appoint another certified public accountant in the name of the Company to carry out independent investigations of the Company's financial affairs and report its findings directly to the securities regulatory authorities under the State Council and other relevant authorities.

10.1.26. Change of the quorum for Supervisory Committee's meetings

The proposed revised Article 196 stipulates that meetings of the Supervisory Committee shall be held only if not less than two-thirds of the supervisors are present.

10.1.27. Removal of the mandatory allocation to public reserve funds

The proposed revised Article 230 removes the requirements for mandatory allocations to be made to public reserve funds before distribution of profits.

10.1.28. Change of the procedures for property distribution upon liquidation

The proposed revised Article 259 adds the requirement of paying wages, labour insurance contributions and statutory compensation of employees of the Company prior to payment of tax from the assets of the Company upon liquidation.

10.2. *Additional requirements for eligibility to act as Chairman*

The proposed revised Article 143 includes an additional requirement for eligibility to act as Chairman: The Chairman must be elected from among persons who have served as directors or members of the senior management of the Company for 3 years or more.

10.3. *Restrictions on the composition of the Board of Directors*

The proposed revised Article 159 increases the minimum proportion of senior officers of the Company serving as directors: At least one-fifth of the directors shall be members of the senior management of the Company.

11. To consider and, if thought fit, pass the following resolution as a special resolution:

"THAT:

the amendments to the Rules of Procedure for General Meetings of Shareholders of ZTE Corporation be and are hereby approved. (These amendments are made pursuant to the above amendments to the Articles of Association and will not be inconsistent with the provisions of relevant laws and the Articles

NOTICE OF 2005 ANNUAL GENERAL MEETING



of Association. For further details of the amended Rules of Procedure for General Meetings of Shareholders of ZTE Corporation, please refer to the designated website for information disclosure by the Company (<http://www.cninfo.com.cn>)."

12. To consider and, if thought fit, pass the following resolution as a special resolution:

"THAT:

the amendments to the Rules of Procedure for Board of Directors Meetings of ZTE Corporation be and are hereby approved. (These amendments are made pursuant to the above amendments to the Articles of Association and will not be inconsistent with the provisions of relevant laws and the Articles of Association. For further details of the amended Rules of Procedure for Board of Directors Meetings of ZTE Corporation, please refer to the designated website for information disclosure by the Company (<http://www.cninfo.com.cn>).)"

13. To consider and, if thought fit, pass the following resolution as a special resolution:

"THAT:

the amendments to the Rules of Procedure for Supervisory Committee Meetings of ZTE Corporation be and are hereby approved. (These amendments are made pursuant to the above amendments to the Articles of Association and will not be inconsistent with the provisions of relevant laws and the Articles of Association. For further details of the amended Rules of Procedure for Supervisory Committee Meetings of ZTE Corporation, please refer to the designated website for information disclosure by the Company (<http://www.cninfo.com.cn>).)"

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.
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 19 May 2006 to 25 May 2006

(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 within 24 hours at the registered address of the Company 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 shareholding.

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 Sixteenth Meeting of the Third Session of the Meeting of the Board of Directors of ZTE Corporation

By Order of the Board of Directors
Hou Weigui
Chairman

Shenzhen, the PRC
 7 April 2006

AUDITORS' REPORT



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 2005, 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. The preparation of these financial statements is the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with Independent Auditing Standards for Certified Public Accountants in PRC. Those Standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management in the preparation of the financial statements, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above conform with the Accounting Standards for Business Enterprises and the "Accounting System for Business Enterprises" promulgated by the People's Republic of China and present fairly, in all material respects, the financial position of the Group and the Company as at 31 December 2005 and the results of its operations and its cash flows for the year then ended.

Ernst & Young Hua Ming

Beijing, the People's Republic of China

Ge Ming
Chinese Certified Public Accountant

Jin Xin
Chinese Certified Public Accountant

6 April 2006

CONSOLIDATION BALANCE SHEET

(Prepared under PRC GAAP)

(All amounts in RMB'000 unless otherwise stated)
(English Translation for Reference Only)

ASSETS	Note V	31 Dec, 2005	31 Dec, 2004 (Restated)
Current assets			
Cash in banks and on hands	1	5,573,132	7,598,223
Notes receivable	2	1,244,853	2,258,088
Trade receivables	3	3,441,922	3,652,506
Factored trade receivables	4	36,416	—
Other receivables	5	279,975	257,595
Accounts prepaid	6	151,174	145,398
Inventories	7	2,519,547	1,871,767
Amount due from customers for contract work	8	4,689,157	2,752,024
Prepaid expenses		—	478
Total current assets		17,936,176	18,536,079
Long-term investment			
Long-term equity investments	9	85,459	67,176
Total long-term investments		85,459	67,176
Fixed assets			
Fixed assets — cost	10	3,623,940	2,785,789
Less: accumulated depreciation	10	1,148,789	830,873
Net fixed assets	10	2,475,151	1,954,916
Less: fix assets impairment provision	10	94,980	94,980
Fixed assets — net book value	10	2,380,171	1,859,936
Construction in progress	11	126,741	114,677
Total fixed assets		2,506,912	1,974,613
Intangible and other assets			
Intangible assets	12	160,264	146,214
Long-term prepaid expenses	13	—	1,315
Long-term trade receivables	3	307,666	—
Factored long-term trade receivables	4	687,765	—
Long-term deferred assets	14	13,996	—
Total intangible and other assets		1,169,691	147,529
Deferred taxes			
Deferred taxes assets	15	80,893	104,625
TOTAL ASSETS		21,779,131	20,830,022

Notes on pages 115 to pages 175 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)

LIABILITIES AND OWNER'S EQUITY	Note V	31 Dec, 2005	31 Dec, 2004 (Restated)
Current liabilities			
Short-term loans	16	99,695	405,695
Bank advances on factored trade receivables	4	36,416	—
Notes payable	17	1,977,584	1,422,401
Accounts payable	18	4,292,208	2,919,483
Amount due to customers for contract work	8	733,455	2,318,731
Advances from customers	19	861,024	292,023
Accrued payroll		622,804	1,031,464
Welfare payable		394,216	437,786
Dividends payable	20	163,008	40,921
Taxes payable	21	(670,282)	52,459
Other levies		7,134	13,197
Other payables	22	626,066	698,727
Accrued expenses	23	346,668	268,534
Provision	24	20,035	20,000
Long-term loans due within 1 year	25	500,000	16,900
Total current liabilities		10,010,031	9,938,321
Non-current liabilities			
Long-term loans	26	80,000	1,025,263
Bank advances on factored long-term trade receivables	4	687,765	—
Specific payables	27	405,511	227,320
Total non-current liabilities		1,173,276	1,252,583
Total liabilities		11,183,307	11,190,904
Minority interests		470,729	464,679
Owner's equity:			
Share capital	28	959,522	959,522
Capital surplus	29	5,506,424	5,491,658
Surplus reserves	30	1,264,060	985,356
of which: statutory public welfare fund		344,908	252,006
Undistributed profits	31	2,171,190	1,495,431
Exchange differences		(15,981)	2,592
Declared cash dividends		239,880	239,880
Total owner's equity		10,125,095	9,174,439
TOTAL LIABILITIES AND OWNER'S EQUITY		21,779,131	20,830,022

Notes on pages 115 to pages 175 form part of these financial statements.

The financial statements on pages 103 to pages 175 were signed by the followings:

Legal representative
Hou Weigui

Chief Financial Officer:
Wei Zaisheng

Head of Finance Division
Shi Chunmao

CONSOLIDATED INCOME STATEMENTS & STATEMENTS OF INCOME DISTRIBUTION

(Prepared under PRC GAAP)

(All amounts in RMB'000 unless otherwise stated)
(English Translation for Reference Only)

	Note V	31 Dec, 2005	31 Dec, 2004
Revenue from principal operations	32	21,575,920	22,698,153
Less: Cost of sales	32	13,944,797	14,369,106
Taxes and surcharges	33	105,660	70,912
Profit from principal operations		7,525,463	8,258,135
Add: Profit from other operations	34	15,779	41,339
Less: Operating expenses		3,023,126	2,929,110
General and administrative expenses		3,137,066	3,899,003
Finance expenses	35	288,751	284,978
Operating profit		1,092,299	1,186,383
Add: Investment income	36	(59,354)	(3,669)
Subsidy income	37	458,014	378,698
Non-operating income	38	27,627	18,041
Less: Non-operating expenses	39	16,722	160,637
Total profit		1,501,864	1,418,816
Less: Income tax		158,545	207,935
Minority interests		148,976	202,011
Net profit		1,194,343	1,008,870
Add: Undistributed profits at beginning of year		1,495,431	1,221,165
Distributable profit		2,689,774	2,230,035
Less: Statutory surplus reserves		185,802	240,843
Statutory public welfare fund		92,902	120,422
Profit available for distribution to owners		2,411,070	1,868,770
Less: Proposed ordinary shares dividends		239,880	239,880
Ordinary shares dividends converted to shares		—	133,459
Undistributed profits at year-end		2,171,190	1,495,431

Supplemental Information

Item	2005	2004
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	(238,637)
5. Losses resulting from debt restructuring	—	—
6. Others	—	—

Notes on pages 115 to pages 175 form 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	2005	2004
1. Cash flows from operating activities			
Cash received from sale of goods or rendering services		21,315,221	23,200,614
Cash received from taxes returned		458,014	369,663
Cash received relating to other operating activities		119,215	184,514
Sub-total of cash inflow		21,892,450	23,754,791
Cash paid for goods and services		13,915,822	15,560,704
Cash paid to and on behalf of employees		2,793,854	2,278,869
Payments of taxes and levies		1,679,312	1,490,169
Cash paid relating to other operating activities	40	3,326,157	2,780,430
Sub-total of cash outflow		21,715,145	22,110,172
Net cash flows from operating activities		177,305	1,644,619
2. Cash flows from investing activities			
Cash received from sale of investments		331	95,213
Net cash received from (paid for) the disposal of subsidiaries		(31,555)	—
Cash received from gains of investment		—	2,619
Net cash received from disposal of fixed asset, intangible assets and other long-term assets		41,372	990
Sub-total of cash inflow		10,148	98,822
Cash paid to acquire fixed asset, intangible assets and other long-term assets		921,463	542,178
Cash paid for acquisition of equity investments		72,955	122,976
Cash paid relating to other investing activities		—	85
Sub-total of cash outflow		994,418	665,239
Net cash flow from investing activities		(984,270)	(566,417)

CONSOLIDATED CASH FLOW STATEMENT

(Prepared under PRC GAAP)

(All amounts in RMB'000 unless otherwise stated)
(English Translation for Reference Only)

Items	2005	2004
3. Cash flows from financing activities		
Cash received from investment	25,227	3,540,417
Cash received from borrowings	108,695	2,775,971
Cash received relating to other financing activities	—	31,112
Sub-total of cash inflow	133,922	6,347,500
Cash paid for debt repayments	869,867	3,237,824
Cash payments for distribution of dividends and interest expenses	459,553	344,042
Cash paid relating to other financing activities	—	33,227
Sub-total of cash outflow	1,329,420	3,615,093
Net cash flow from financing activities	(1,195,498)	2,732,407
4. Effect of foreign exchange rate changes on cash	(22,628)	2,592
5. Net increase (decrease) in cash and cash equivalents	(2,025,091)	3,813,201

Notes on pages 115 to pages 175 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	2005	2004
1. Reconciliation of net profit to cash flows from operating activities		
Net profit	1,194,343	1,008,870
Add: Minority interests	148,976	202,011
Provision for impairment of assets	362,300	1,166,771
Depreciation of fixed assets	394,984	307,691
Amortization of intangible assets	51,009	53,928
Amortization of long-term prepaid expenses	1,616	6,359
Decrease in prepaid expenses	478	2,011
Increase in accrued expenses (less: decrease)	78,134	(54,963)
Losses on disposal of fixed assets, intangible assets and other long-term assets (less: gains)	(909)	84
Losses on retirement of fixed assets	7,072	43,785
Finance expense	175,884	151,182
Losses on investment	59,354	9,367
Deferred tax credit (less: debit)	23,732	(38,211)
Decrease in inventories (less: increase)	(866,316)	2,194,557
Increase in operating receivable items	(2,015,438)	(4,097,689)
Increase in operating payable items	562,086	688,866
Net cash flows from operating activities	177,305	1,644,619
2. Net increase (decrease) in cash and cash equivalents		
Cash at end of year	5,573,132	7,598,223
Less: Cash at beginning of year	7,598,223	3,785,022
Add: Cash equivalents at end of year	—	—
Less: Cash equivalents at beginning of year	—	—
Net increase (decrease) in cash and cash equivalents	(2,025,091)	3,813,201

Notes on pages 115 to pages 175 form part of these financial statements.

BALANCE SHEET

(Prepared under PRC GAAP)

(All amounts in RMB'000 unless otherwise stated)
(English Translation for Reference Only)

ASSETS	Note V	31 Dec, 2005	31 Dec, 2004 (Restated)
Current assets			
Cash in banks and on hands		4,258,936	6,463,165
Notes receivable		1,209,151	2,240,530
Dividends receivable		16,465	1,371
Trade receivables	3	4,481,796	4,016,330
Factored trade receivables		5,007	—
Other receivables	5	1,230,352	751,559
Accounts prepaid		67,305	58,380
Inventories		1,557,312	1,350,130
Amount due from customers for contract work		4,440,842	3,414,540
Total current assets		17,267,166	18,296,005
Long-term investment			
Long-term equity investments	9	2,833,305	2,992,995
Total long-term investments		2,833,305	2,992,995
Fixed assets			
Fixed assets — cost		2,491,000	1,877,501
Less: accumulated depreciation		712,768	469,997
Net fixed assets		1,778,232	1,407,504
Less: fix assets impairment provision		87,002	87,002
Fixed assets — net book value		1,691,230	1,320,502
Construction in progress		77,261	98,100
Total fixed assets		1,768,491	1,418,602
Intangible and other assets			
Intangible assets		87,081	94,358
Long-term trade receivables	3	327,122	—
Factored long-term accounts receivable		683,598	—
Total intangible and other assets		1,097,801	94,358
Deferred taxes			
Deferred taxes assets		76,419	76,419
TOTAL ASSETS		23,043,182	22,878,379

Notes on pages 115 to pages 175 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, 2005	31 Dec, 2004 (Restated)
Current liabilities			
Short-term loans		—	340,344
Bank advances on factored trade receivables		5,007	—
Notes payable		1,918,831	1,453,282
Accounts payable		6,538,622	5,295,321
Amount due to customers for contract work		688,876	2,162,901
Advances from customers		493,438	249,004
Accrued payroll		367,583	663,925
Welfare benefits payable		326,370	362,467
Dividends payable		928	920
Taxes payable		(844,875)	(175,111)
Other levies		2,996	900
Other payables		1,084,091	1,078,453
Accrued expenses		286,561	248,486
Provision		16,000	20,000
Long-term loans due within 1 year		500,000	—
Total current liabilities		11,384,428	11,700,892
Non-current liabilities			
Long-term loans		—	950,000
Bank advances on factored long-term trade receivables		683,598	—
Other long-term liabilities		359,220	177,800
Total non-current liabilities		1,042,818	1,127,800
Total liabilities		12,427,246	12,828,692
Owner's equity			
Share capital		959,522	959,522
Capital surplus		5,532,896	5,515,822
Surplus reserves		769,603	650,718
of which: statutory public welfare fund		242,464	202,836
Undistributed profits		3,116,070	2,682,269
Exchange differences		(2,035)	1,476
Declared cash dividends		239,880	239,880
Total owner's equity		10,615,936	10,049,687
TOTAL LIABILITIES AND OWNER'S EQUITY		23,043,182	22,878,379

Notes on pages 115 to pages 175 form an integral part of these financial statements.

The financial statements on pages 103 to pages 175 were signed by the followings:

Legal representative
Hou Weigui

Chief Financial Officer:
Wei Zaisheng

Head of Finance Division
Shi Chunmao

INCOME STATEMENTS & STATEMENTS OF INCOME DISTRIBUTION

(Prepared under PRC GAAP)

(All amounts in RMB'000 unless otherwise stated)
(English Translation for Reference Only)

	Note V	31 Dec, 2005	31 Dec, 2004
Revenue from principal operations	32	20,565,052	21,572,945
Less: Cost of sales	32	16,671,822	16,285,819
Taxes and surcharges		56,009	55,427
Profit from principal operations		3,837,221	5,231,699
Add: Profit from other operations		149,282	160,095
Less: Operating expenses		2,360,822	2,852,561
General and administrative expenses		1,451,749	1,952,482
Finance expenses		294,898	256,903
Operating profit		(120,966)	329,848
Add: Investment income	36	919,713	1,149,900
Subsidy income		8,259	38,179
Non-operating income		19,834	7,486
Less: Non-operating expenses		6,321	152,878
Total profit		820,519	1,372,535
Less: Income tax		27,953	210,252
Net profit		792,566	1,162,283
Add: Undistributed profits at beginning of year		2,682,269	2,067,667
Distributable profit		3,474,835	3,229,950
Less: Statutory surplus reserve		79,257	116,228
Statutory public welfare fund		39,628	58,114
Profit available for distribution to owners		3,355,950	3,055,608
Less: Proposed ordinary shares dividends		239,880	239,880
Ordinary shares dividends converted to shares		—	133,459
Undistributed profits at year-end		3,116,070	2,682,269

Notes on pages 115 to pages 175 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	2005	2004
1. Cash flows from operating activities		
Cash received from sale of goods or rendering services	22,269,031	21,978,079
Cash received from taxes returned	8,259	29,444
Cash received relating to other operating activities	205,278	100,510
Sub-total of cash inflow	22,482,568	22,108,033
Cash paid for goods and services	18,549,739	16,082,179
Cash paid to and on behalf of employees	1,788,552	1,367,834
Payments of taxes and levies	724,097	705,936
Cash paid relating to other operating activities	1,756,749	2,498,971
Sub-total of cash outflow	22,819,137	20,654,920
Net cash flows from operating activities	(336,569)	1,453,113
2. Cash flows from investing activities		
Cash received from sale of investments	331	—
Cash received from gains of investment	2,621	2,516
Net cash received from disposal of fixed assets, intangible assets and other long-term assets	172,186	136
Sub-total of cash inflow	175,138	2,652
Cash paid to acquire fixed assets, intangible assets and other long-term assets	796,746	423,726
Cash paid for equity investment	43,552	225,645
Cash paid relating to other investing activities	—	—
Sub-total of cash outflow	840,298	649,371
Net cash flow from investing activities	(665,160)	(646,719)

CASH FLOW STATEMENT

(Prepared under PRC GAAP)

(All amounts in RMB'000 unless otherwise stated)
(English Translation for Reference Only)

Items	2005	2004
3. Cash flows from financing activities		
Cash received from investment	—	3,504,747
Cash received from borrowings	—	1,286,924
Cash received relating to other financing activities	—	30,859
Sub-total of cash inflow	—	4,822,530
Cash paid for debt repayments	790,344	1,593,483
Cash payments for distribution of dividends and interest expenses	407,651	310,361
Cash paid relating to other financing activities	—	32,500
Sub-total of cash outflow	1,197,995	1,936,344
Net cash flow from financing activities	(1,197,995)	2,886,186
4. Effect of foreign exchange rate changes on cash	(4,505)	1,476
5. Net increase (decrease) in cash and cash equivalents	(2,204,229)	3,694,056

Notes on pages 115 to pages 175 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	2005	2004
1. Reconciliation of net profit to cash flows from operating activities		
Net profit	792,566	1,162,283
Add: Provision for impairment of assets	236,168	1,136,149
Depreciation of fixed assets	392,118	207,105
Amortization of intangible assets	16,004	35,204
Amortization of long-term prepaid expenses	—	3,852
Decrease in prepaid expenses	—	990
Increase in accrued expenses (less: decrease)	38,075	(72,421)
Losses on disposal of fixed assets, intangible assets and other long-term assets	—	(136)
Losses on retirement of fixed assets	3,558	40,338
Finance expenses	167,779	129,822
Losses on investment	(919,713)	(1,162,936)
Deferred tax debit	—	(10,005)
Decrease in inventories	(335,921)	1,060,307
Increase in operating receivable items	(2,171,944)	(2,972,220)
Increase in operating payable items	1,444,741	1,894,781
Net cash flows from operating activities	(336,569)	1,453,113
3. Net increase (decrease) in cash and cash equivalents		
Cash at end of year	4,258,936	6,463,165
Less: Cash at beginning of year	6,463,165	2,769,109
Add: Cash equivalents at end of year	—	—
Less: Cash equivalents at beginning of year	—	—
Net increase (decrease) in cash and cash equivalents	(2,204,229)	3,694,056

Notes on pages 115 to pages 175 form an integral part of these financial statements.

I. COMPANY BACKGROUND

ZTE Corporation ("The Company") is 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, Shaanxi Shunda Communications Corporation (now renamed Shaanxi Telecommunications Industrial Company), No. 7 Research Institute of Post, Telegraphs & Telephones Ministry (邮电部第七研究所) (now renamed China Mobile Telecommunications No. 7 Research Institute), 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 within the network 58,500,000 ordinary shares with a par value of RMB1.00 per share through the Shenzhen Stock Exchange and issued 6,500,000 ordinary shares with a par value of RMB1.00 per share to its employees at an issue price of RMB6.81 per share.

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 engage in 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 electronics devices, micro-electronics 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 labors 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 18 November 1997, the 58,500,000 ordinary shares publicly issued by the Company to the general public were listed and traded on the Shenzhen Stock Exchange.

NOTES TO FINANCIAL STATEMENTS

(Prepared under PRC GAAP)

(All amounts in RMB'000 unless otherwise stated)

I. COMPANY BACKGROUND (continued)

On 11 September 1998, as approved by Document Shen Zheng Ban Fu (1998) No. 72 issued by the Securities Administration Office of Shenzhen, the Company increased its capital by a total of 75,000,000 shares by way of an issue of 3 shares transferred from its capital surplus reserves as at 30 June 1998 for every 10 shares. Thereupon the Company's registered capital was increased to RMB325,000,000.

On 27 May 1999, pursuant to the consent under Document Shen Zheng Ban Zi (1999) No. 78 issued by the Securities Administration Office of Shenzhen and the approval under Document Zheng Jian Gong Si Zi (1999) No. 42 issued by China Securities Regulatory Commission, the Company placed 19,500,000 ordinary shares to the public shareholders. The placing was completed on 18 August 1999. Thereupon the Company's registered capital was increased to RMB344,500,000.

On 20 May 2000, pursuant to the approval at the Company's shareholders' general meeting, the Company increased its capital by a total of 68,900,000 shares by way of an issue of 2 shares transferred from its capital surplus reserves as at 31 December 1999 for every 10 shares. Thereupon the Company's registered capital was increased to RMB413,400,000.

On 20 March 2001, as approved under Document Zheng Jian Gong Si Zi (2001) No. 25 issued by China Securities Regulatory Commission, the Company issued an additional of 50,000,000 ordinary shares to the public at an issue price of RMB32.70 per share. Thereupon the Company's registered capital was increased to RMB463,400,000.

On 16 October 2001, pursuant to the approval at the Company's shareholders' general meeting, the Company increased its capital by a total of 92,680,000 shares by way of a bonus issue on the basis of 2 shares for every 10 shares then held based on its share capital as at 30 June 2001. Thereupon the Company's registered capital was increased to RMB556,080,000.

On 25 April 2003, pursuant to a resolution passed at the Company's shareholders' general meeting, the Company increased its capital by a total of 111,216,000 shares by way of an issue of 2 shares transferred from its capital surplus reserves as at 31 December 2002 for every 10 shares. Thereupon the Company's registered capital was increased to RMB667,296,000.

On 17 May 2004, pursuant to a resolution passed at the Company's shareholders' general meeting, the Company increased its capital by a total of 133,459,200 shares by way of a bonus issue on the basis of 2 shares for every 10 shares then held based on its share capital as at 31 December 2003. Thereupon the Company's registered capital was increased to RMB800,755,000. The alteration formalities for industrial and commercial registration have been completed.

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. The Company's registered capital after alteration was RMB959,522,000.

I. COMPANY BACKGROUND (continued)

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, but had undertaken not to transfer or trade within the first twelve months. In the event that Shenzhen Zhongxingxin Telecommunications Equipment Company, Limited ("Zhongxingxin") intends to sell its shares subsequent to the expiry of the said moratorium, it will not sell more than five percent and ten percent of the total share capital of the Company during the period from the thirteenth month to the twenty-fourth month and the period from the twenty-fifth month to the thirty-sixth month after such shares have been granted the right of listing and circulation and without limitation thereafter. Zhongxingxin further undertakes that where it sells its shares during the period from the thirteenth month to the twenty-fourth 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 115% of the arithmetic 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, that is, RMB30.76 (such price to be on an ex-rights basis and net of any dividends, bonus issues and capitalisation of capital reserve between the period from the implementation date of the Share Reform Plan to the respective dates of sale). The proceeds from any sale in breach of such undertaking shall be reverted to the Company's account for the benefits of all shareholders of the Company. Sales restrictions of other restricted shares are released twelve months after such shares have been granted the right of listing and circulation. Shareholders of tradable A Shares whose names appeared on the register of shareholders on the registration date for entitlement of the Share Reform Plan received 2.5 Shares for every 10 Shares held. Following the implementation of the share reform plan, namely compensation arrangements of the non-circulating shareholders, the shareholding structure of the Company was changed. As at 31 December 2005, the total accumulated share capital in issue of the Company was 959,522,000 shares. Please see Notes V.28 for details.

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 are Renminbi. The amounts in the financial statements are denominated in Renminbi, unless otherwise stated.

NOTES TO FINANCIAL STATEMENTS

(Prepared under PRC GAAP)

(All amounts in RMB'000 unless otherwise stated)

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

4. Recording basis and accounting principle

The Company adopts the accrual basis as basis of accounting. All items are 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 are translated to Renminbi at the exchange rates prevailing at the balance sheet date; shareholders' equity, with the exception of "undistributed profit", are translated at the exchanged rates prevailing at the transaction date; "undistributed profit" are 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 are dealt with in the exchange fluctuation reserve as a separate allocation of "exchange differences". All statement of income and profit appropriation items are translated at the average exchange rates during the year. All cash flow statement items are translated at exchange rate prevailing at the balance sheet date. All opening balances and last year actual amounts are stated at last year translated amounts.

7. Cash equivalents

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

8. Bad debts provision

(1) Recognition criteria for bad debts:

- the irrecoverable amount of a bankrupt or deceased debtor who has insufficient assets or estate to repay the debt;
- the irrecoverable receivables, supported by evident characteristics, of a debtor who is unable to comply with the repayment obligation after the debt fell due.

(All amounts in RMB'000 unless otherwise stated)

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

8. Bad debts provision (continued)

- (2) The Group adopted the provision method to account for bad debt losses, whereby specific and general provisions were 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.

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

Provision for bad debts of accounts prepaid is made as follows:

Ageing	Percentage of provision for bad debts (%)	Remark
1-6 months	—	Applicable to all accounts prepaid
6-12 months	—	Applicable to accounts prepaid for the purchase of fixed assets
6-12 months	50%	Applicable to accounts prepaid for the purchase of raw materials
12-24 months	75%	Applicable to accounts prepaid for the purchase of raw materials
12-24 months	50%	Applicable to accounts prepaid for the purchase of fixed assets
Over 24 months	100%	Applicable to all accounts prepaid

For details of changes in accounting estimates relating to the method of calculating bad debt provision for trade receivables, please refer to Note II.21.

NOTES TO FINANCIAL STATEMENTS

(Prepared under PRC GAAP)

(All amounts in RMB'000 unless otherwise stated)

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

9. 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 record at actual costs and recognized using the weighted moving average method when dispatched.

Cost of finished products and work in progress comprises direct materials, direct labor and an appropriate proportion of manufacturing overheads.

Inventories are valued using the perpetual inventories system.

Inventories at the end of the year are stated at the lower of cost or net realizable value. Provision for impairment of inventories is made on the basis of individual categories in respect of any shortfall where the net realizable value is 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.

At the end of the period, the carrying values of all mouldy stocks or expired stocks with no transferred value or stocks that are no longer required in production process as well as stocks that are sufficiently proved to be of no use value and transferred value are transferred into gains or losses for the current period for reducing the amount of provision for inventories.

10. Construction contract works

The amount of construction contract works is represented by costs incurred to date and recognized 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 recognized gross profit (loss) in excess of progress billings is recognized as assets; whereas, the amount of progress billings in excess of contract costs incurred to date plus recognized gross profit (loss) is recognized as liabilities.

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

Turnover of raw materials used is accounted for on a one-off basis.

Provision for anticipated contract losses is made in respect of contracts for which the amount of estimated total contract costs exceeds 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 recognized losses.

Upon the realisation of anticipated contract losses of contracts for which estimated losses have been provided for, the estimated contract losses provided for will be written back and the actual amount of loss will be recognized.

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

11. 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 difference is amortized over a period of not more than 10 years (including 10 years). The amount of initial cost of the investment fall short of the investor's share of the owner's equity in the investee company is credited to the capital reserve. In the event of that 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 not 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 recognized as investment income or loss for the current period accordingly. It recognizes net losses incurred by the investee enterprise to the extent that the book value of the investment is reduced to zero.

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

At the end of the year, long-term investments are 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. Any shortfall will be dealt with in the current profit and loss.

12. 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 recognized at cost. The cost of purchasing fixed assets comprises 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 that possible inflow of economic benefits into the enterprise resulting from such expenses exceed original estimates.

NOTES TO FINANCIAL STATEMENTS

(Prepared under PRC GAAP)

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

12. Fixed assets (continued)

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 recognized as an impairment provision and charged to the current period's profit and loss. Recoverable amount refers to the higher of the net selling price and the value in use of the fixed asset. Value in use refers 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 are made on an individual basis.

13. 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. Cost comprises direct materials, direct labor, equipment cost, installation and management fee, net profit or loss from trial run and borrowings cost for capitalization.

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

Provision for construction-in-progress impairment shall be made and be recognized 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 is ultimately uncertain with inferior construction quality and backward technology.

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

14. 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 recognized as an impairment provision and is charged to the income statement in the current year.

15. Long-term prepaid expenses

Long-term prepaid expenses of the Group refer to expenses incurred by the company with an amortization period of over 1 year. Long-term prepaid expenses are amortized by equal installments over the beneficial period.

16. Recognition of revenue

Telecommunications systems contracts

Operating income from telecommunications systems contracts is recognized 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 will be accounted for where the total revenue and total costs can be measured reliably and where transaction-related amounts are allowed to pass into the Company, and costs will be accounted for accordingly.

Sales of goods:

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

Supply of labor service:

The revenue from labor service is recognized 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 do not take place in the same accounting year, when transaction result of the supply of labor service can be measured reliably, related revenue from labor service is recognized according to the percentage of completion on the balance sheet date, otherwise revenue is recognized only to the extent of cost incurred that are expected to be recoverable.

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

17. Provision

The Group recognizes as liability an obligation that fulfill that following criteria and relate to contingent matters: the obligation in question is a present obligation of the Group that can be reliably measured and it will probably results in an outflow of economic resources.

18. Income tax

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

19. Subsidy income

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

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.

21. Changes in accounting estimates

Save as discussed below, the accounting estimates adopted in these financial statements are consistent with those adopted in respect of the previous year.

It was resolved at the sixteenth meeting of the third session of Board of Directors that, effective from 1 January 2005, the Group has revised its method of making bad debt provision for trade receivables taking into account actual circumstances and with reference to international practices as the method of bad debt provision for trade receivables varies according to the credit rating and repayment profile of debtors. The Group is of the view that the revised bad debt provision method will more accurately reflect the financial conditions and operating results of an enterprise.

Prior to the change: bad debt provision is made, using ageing analysis, in respect of the balance of trade receivables less amounts due from related companies and amounts for which there is concrete evidence for recoverability: The proportions concerned are as follows:

Age	Proportion
1-6 months	—
6-12 months	15%
12-18 months	50%
18-24 months	75%
Over 24 months	100%

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

21. Changes in accounting estimates (continued)

After the change: specific bad debt provision shall be separately made in respect of trade receivables for which there is direct evidence that impairment has occurred. Separate impairment tests shall be conducted in respect of individual trade receivables with a significant amount or prolonged overdue period, and specific bad debt shall be made if there is objective evidence that impairment has occurred. For trade receivables in respect of which no separate test has been carried out or no impairment has been recorded in separate test shall be consolidated into an asset portfolio that shows similar credit risk features for impairment tests and a specific bad debt provision will be made. The grading of credit risk and its corresponding empirical impairment ratios are differentiated and determined on the basis of with the current financial conditions of customers, historical trading records and overdue periods of trade receivables.

As a result of the change in such accounting estimates, net profit and net assets of the Group increased by RMB145,920,000 and net profit and net assets of the Company increased by RMB75,342,000, respectively, under the new bad debt provision method, as compared to the previous method.

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 owns 50% or above of its voting capital, or in which it exercises effective control even though it does not own 50% or above of the voting capital.

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

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

On combination, reporting years and accounting policies consistent with those adopted by the parent will 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 2005.

NOTES TO FINANCIAL STATEMENTS

(Prepared under PRC GAAP)

(All amounts in RMB'000 unless otherwise stated)

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
Overseas tax	Overseas taxes are payable in accordance with tax laws of various countries and regions.
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.

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

Taxation policy of parts of the company's subsidiaries is as follows:

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

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

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, is 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 not yet to record a profitable year, it was exempted from enterprise income tax.

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, is entitled to enterprise income tax exemption in the first and second profitable years and a 50% reduction of enterprise income tax in the third to fifth years. As the current year was the first profitable year for the company, it was exempted from enterprise income tax.

III. TAXATION (continued)

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, is entitled to enterprise income tax exemption in the first and second profitable years and a 50% reduction of enterprise income tax in the third to fifth years. As the current year was the first 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 the period commencing 1 January 2005 and ending 31 December 2006.

Pursuant to the document Ke Gao (2002) No. 21 issued by the Science and Technology Department of Anhui, the Finance Department of Anhui, the Regional Tax Bureau of Anhui, Anhui Wantong Posts and Telecommunications Company, Limited is entitled to the enterprise income tax preferential treatment as enjoyed by high-tech enterprises. The enterprise income tax is subject to refund and the tax rate and the refund rate of which are 33% and 18% respectively and the actual tax rate is 15%.

Pursuant to the Approval Notice for Deduction and Exemption of Tax (Document Shen Guo Shui Nan Zi (2005) No. 0034) issued by the Nanshan State Tax Bureau in Shenzhen, it is agreed that Shenzhen Zhongxing Software Company, Limited, as a software enterprise, is entitled to enterprise income tax exemption in the first and second profitable year and is entitled to 50% reduction in enterprise income tax from the third to fifth year. The current year is the third profitable year and is subject to a reduced enterprise income tax of 7.5%.

Guangdong New Pivot Technology & Service Company, Limited was entitled to enterprise income tax exemption for 2005 pursuant to Document Sui Tian Guo Shui Suo Mian A (2005) No. 373 issued by Guangzhou Tianhe District State Tax Bureau.

Pursuant to the Document Shen Guo Shui Nan Jian Mian (2004) No. 0217 issued by the Nanshan State Tax Bureau in Shenzhen, 深圳中興力維技術有限公司 is entitled to enterprise income tax exemption in the first and second profitable years and a 50% reduction of enterprise income tax in the third to fifth years. As the current year was the first profitable year for the company, it was exempted from enterprise income tax.

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 is entitled to enterprise income tax exemption in the first and second profitable years and a 50% reduction of enterprise income tax in the third to fifth years. As the current year was the first profitable year for the company, it was exempted from enterprise income tax.

Yangzhou Zhongxing Mobile Telecom Equipment Co., Limited is subject to an enterprise income tax rate of 33%.

Shenzhen Guoxin Electronics Development Company Limited, Shenzhen Changfei Investment Company, Limited and Shenzhen Zhongxing Mobile Telecom Equipment Co., Ltd. are subject to an enterprise income tax rate of 15%.

NOTES TO FINANCIAL STATEMENTS

(Prepared under PRC GAAP)

(All amounts in RMB'000 unless otherwise stated)

IV. CONTROLLING SUBSIDIARIES AND JOINTLY-CONTROLLED ENTITIES

Except for the notes (1) and (2) below, the scope of consolidated financial statements is 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	Percentage of equity interests
Anhui Yalong Communications Technology Company, Ltd.	RMB6,000	Manufacturing, installation, maintenance of telecommunication equipment and design and construction and telecommunication projects	RMB5,400	90%
深圳市興飛科技有限公司	RMB5,000	Four technical services of electronic products, manufacturing, sales and after-sales services of electronic products and corporate management consultancy	RMB4,000	80%
ZTE Istanbul Trading Ltd. Co.	USD50	Sales of telecommunication products and provision of after-sales services and technical support	USD49.5	100%
ZTE Hrvatska D.O.O.	EUR3	Sales of telecommunication products and provision of after	EUR3	100%
ZTE Corporation Bulgaria Ltd.	USD3.5	Sales of telecommunication products and provision of after	USD3.5	100%
ZTE Deutschland GmbH	EUR150	Sales of telecommunication products and provision of after	EUR150	100%
ZTE Poland Sp.zo.o.	USD50	Sales of telecommunication products and provision of after	USD50	100%
深圳中興力維技術有限公司	RMB20,000	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	RMB16,000	80%
Newinfo Holdings Limited	USD50	Acquisition, shareholding and investment of telecom carriers	USD4.299	100%
WANAAG COMMUNICATIONS LIMITED	USD200	IDD forwarding for Africa	USD100	100%
ZTE Canada Inc.	CAD200	Sales of telecommunication products and provision of after	USD38	100%
ZTE NETHERLANDS B.V.	EUR90	Sales of telecommunication products and provision of after	EUR18	100%
Congo-Chine Telecom International Network (CCTNET)	USD100	Data products, provision of telecom services and manufacturing of telecom equipment	USD100	100%

(All amounts in RMB'000 unless otherwise stated)

IV. CONTROLLING SUBSIDIARIES AND JOINTLY-CONTROLLED ENTITIES (continued)

(1) Subsidiaries acquired during the year (continued)

Name of investee company	Registered Capital '000	Scope of business	Investment by the Company	Percentage of equity interests
ZTE GHANA LIMITED	USD300	Sales of telecommunication products and provision of after-sales services and technical support	USD300	100%
深圳中興無線通信有限公司	USD5,000	R&D, production and sales of GSM, PHS and other telecom equipment	USD750	100%
Shenzhen Hongde Battery Company, Limited	RMB15,000	Production and sales of batteries, sales of raw materials for batteries and electronic products (excluding products under exclusive rights); import and export trade	RMB12,500	83%
ZTE Nigeria Investment Limited	USD39	Import and export trade, manufacturing, testing, sales, installation, development of raw materials for telecom products, user training and after-sales services	USD540	100%
ZTE (HK) Ltd. Saudi Arabia	USD534.76	Sales of telecommunication products and provision of after	USD534.76	100%
ZTE Sweden AB	USD360	Sales of telecommunication products and provision of after	USD360	100%
PT ZTE Indonesia	USD200	Sales of telecommunication products and provision of after	USD200	100%
西安中興精誠通訊有限公司 ("Xi'an Zhongxing") (Note 1)	RMB15,000	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	RMB11,390	70%
ZiMax Technologies Inc (Note 2)	USD20,000	Wireless communication technology research	USD5,379.7	100%
Guangzhou Nanfang Telecommunications System Software Co., Ltd. (Note 3)	RMB12,430	Development, manufacturing, sales and services for software products, telecom equipment and data equipment	RMB11,500	84%

Note (1): In May 2005, the Group acquired a 34% equity interest in Xi'an Zhongxing for injection of assets received from the deregistration of Shanxi Zhongxing Telecom Equipment Company, Limited ("Shanxi Zhongxing"). In November 2005, the Company entered into a share transfer agreement with a third party to acquire from it a 36% equity interest in Xi'an Zhongxing. As at 31 December 2005, the Company held a 70% interest in Xi'an Zhongxing, whose results were consolidated by the Group.

Note (2): In September 2005, Zimax (Cayman) Holdings Ltd, a subsidiary of the Group, entered into a share transfer agreement with a third party to acquire a 100% equity interest in ZiMax Technologies Inc. Accordingly, the results of ZiMax Technologies Inc. were consolidated as from 1 October 2005.

Note (3): ZTE Soft Development Technology Co., Ltd ("ZTE Soft"), a subsidiary of the Group, entered into a share transfer agreement with 廣東國智投資有限公司, a third party, in March 2005 to acquire a 54% equity interest in Guangzhou Nanfang Telecommunications System Software Co., Ltd. ("Nanfang Telecom"). Accordingly, Nanfang Telecom's results were consolidated as from 1 April 2005. ZTE Soft entered into another share transfer agreement with a third party in September 2005 to acquire a further 30% equity interest in Nanfang Telecom. Since 1 October 2005, ZTE Soft had been holding an 84% interest in Nanfang Telecom.

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IV. CONTROLLING SUBSIDIARIES AND JOINTLY-CONTROLLED ENTITIES (continued)

(1) Subsidiaries acquired during the year (continued)

Assets and liabilities of subsidiaries described in Notes (1), (2) and (3) as at the date of consolidation.

Date of consolidation	Note (1) Xi'an Zhongxing 1 December 2005	Note (2) ZiMax Technologies Inc. At 1 October 2005	Note (3) Nanfang Telecom 1 April 2005
Current assets	22,920	6,321	53,107
Fixed assets	1,070	10,641	1,109
Intangible assets	47	—	—
Other assets	—	—	—
TOTAL ASSETS	24,037	16,962	54,216
Current Liabilities	(7,416)	(24,130)	(23,501)
Long-term liabilities	—	—	—
TOTAL LIABILITIES	(7,416)	(24,130)	(23,501)

Operating results of subsidiaries acquired during the year from the date of consolidation to 31 December 2005 are as follows:

Date of consolidation	Note (1) Xi'an Zhongxing 1 December 2005	Note (2) ZiMax Technologies Inc. At 1 October 2005	Note (3) Nanfang Telecom 1 April 2005
Revenue from principal operations	7,753	—	20,463
Profit from principal operations	1,787	—	5,558
Profit from other operations	—	11,928	—
Total profit	947	(10,639)	(32,131)
Income tax	—	—	—
Net profit	947	(10,639)	(32,131)

(All amounts in RMB'000 unless otherwise stated)

IV. CONTROLLING SUBSIDIARIES AND JOINTLY-CONTROLLED ENTITIES (continued)

(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
ZTE Future Tel Co. Ltd (Note 1)	KRW427,550	Development of handset products and design R&D of integrated circuits ("IC")	USD3,250	54.14%
Shanxi Zhongxing Telecom Equipment Company, Limited (Note 2)	RMB8,000	Technology R&D, development of computer soft/hardware; systems integration of computer network; technical services, maintenance and training services, manufacturing and sales of telecom equipment	RMB4,080	51%
ZTE IC Design Co., Ltd (Note 3)	RMB50,000	Design, development, production and operation of various ICs and related electronic application products	RMB30,000	60%

Note (1): In May 2005, the Board of Directors of the Company approved the transfer of an 54.14% equity interest in ZTE Future Tel Co. Ltd to a third party. The transfer had subsequently been completed.

Note (2): In April 2005, the Board of Directors of the Company approved the deregistration of Shanxi Zhongxing and re-invest the assets into Xi'an Zhongxing. The deregistration of Shanxi Zhongxing was completed in May 2005 and the additional investment in Xi'an Zhongxing was completed in June 2005.

Note (3): In January 2005, the Board of Directors of the Company approved the additional investment in ZTE IC Design Co., Ltd. The Company sold the 17.6% shareholdings in ZTE IC Design Co., Ltd for a consideration of 4.40 million, which was invested in the company as additional capital. The Company's shareholding in ZTE IC Design Co., Ltd was reduced to 40% in May 2005 following the completion of the capital increase.

NOTES TO FINANCIAL STATEMENTS

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IV. CONTROLLING SUBSIDIARIES AND JOINTLY-CONTROLLED ENTITIES (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 2005 to the date of disposal/deregistration, as shown in the following:

	ZTE Future Tel Co. Ltd. 1 January to 30 April 2005	Shanxi Zhongxing 1 January to 13 April 2005	ZTE IC 1 January to 31 January 2005
Revenue from principal operations	—	—	4,097
Profit from principal operations	—	(231)	407
Total profit	—	—	407
Income tax	—	—	—
Net profit	—	(231)	407

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

	ZTE Future Tel Co. Ltd. 1 January to 30 April 2005	Shanxi Zhongxing 1 January to 13 April 2005	ZTE IC 1 January to 31 January 2005
Current assets	1,958	14,450	58,436
Long-term investments	1,582	—	—
Fixed assets	2,509	1,313	2,306
Intangible assets	—	—	3,709
Total assets	6,049	15,763	64,451
Current liabilities	(2,454)	(5,217)	(52,669)
Total liabilities	(2,454)	(5,217)	(52,669)

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IV. CONTROLLING SUBSIDIARIES AND JOINTLY-CONTROLLED ENTITIES (continued)

(3) Subsidiaries included in the scope of consolidation

Full name of subsidiaries	Place of registration	Registered capital '000	Shareholding percentage of the Company			Investment of the Group	Principal operations
			Direct	Indirect	Effective		
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 sale 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
Shenzhen Zhongxing Mobile Telecom Equipment Co., Ltd.	Shenzhen	RMB10,000	90%	10%	100%	RMB10,000	Research, manufacture and sale of CDMA digital mobile communications system equipment and related products
Yangzhou Zhongxing Mobile Telecom Equipment Co., Limited	Yangzhou	RMB6,000	65%	—	65%	RMB3,900	R&D, manufacture and sale of electronics, computer and communications products
ZTE Mobile Tech Co., Limited	Shenzhen	RMB33,333	95%	—	95%	RMB31,666	Technical development and sale of communications products; manufacture of handset batteries, hands-free ear piece; manufacture of handset charger
Congo-Chine Telecom S.A.R.L.	The Democratic Republic of Congo	USD9,800	51%	—	51%	USD5,000	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	Data products, provision of telecom services, production of telecom equipment

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IV. CONTROLLING SUBSIDIARIES AND JOINTLY-CONTROLLED ENTITIES (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			Investment of the Group	Principal operations
			Direct	Indirect	Effective		
ZTE Soft Technology Co., Ltd.	Nanjing	USD7,231	76%	—	76%	RMB45,040	Development, manufacture and sale of software products, communications equipment, data equipment and provision of related services
Guangzhou Nanfang Telecommunications System Software Co., Ltd.	Guangzhou	RMB12,430	—	84%	84%	RMB11,500	Development, manufacturing, sale and servicing of software products, telecommunication equipment, data equipment
Shenzhen Zhongxing Software Company, Limited	Shenzhen	RMB50,000	70%	25%	95%	RMB47,500	Development, manufacture and sale 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 sale of electronics components; domestic businesses, 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 sale of related products and provision of technical services
Shenzhen Force Science and Technology Company, Limited	Shenzhen	RMB3,000	—	80%	80%	RMB2,400	Development of optoelectronics technologies and manufacture and sale of related products and provision of technical services

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IV. CONTROLLING SUBSIDIARIES AND JOINTLY-CONTROLLED ENTITIES (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			Investment of the Group	Principal operations
			Direct	Indirect	Effective		
Anhui Wantong Posts and Telecommunications Company, Limited	Hefei	RMB22,214.4	51%	—	51%	RMB15,697.7	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%	RMB1,530	Design and installation of communications projects
Anhui Wantong Tower Installation Company, Limited	Hefei	RMB2,000	—	90%	90%	RMB1,800	Installation of towers
Anhui Yalong Communications Technology Company, Ltd.	Hefei	RM6,000	—	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 sale of communications products and provision of technical services
ZTE Portugal Co.,Ltd-Projectos de Telecomunicacoes, Unipessoal, Lda	Portugal	EUR50	—	100%	100%	EUR50	Sale of communications products and provision of after-sale services
ZTE (USA) Inc.	Edison, United States of America	USD20	100%	—	100%	USD650	Sale of communications products
Shenzhen Special Equipment Company, Limited	Shenzhen	RMB1,000	54%	—	54%	RMB540	Technical development, services, consultation and purchase and sale of communications products
Telrise (Cayman) Telecom Co., Ltd.	Cayman Islands	USD50	52.85%	—	52.85%	USD2,550	R&D of softswitch technologies

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IV. CONTROLLING SUBSIDIARIES AND JOINTLY-CONTROLLED ENTITIES (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			Investment of the Group	Principal operations
			Direct	Indirect	Effective		
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	Sale of communications products and provision of after-sale services and technical support
ZTE Do Brasil LTDA.	Brazil	USD200	100%	—	100%	USD900	Sale 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	THB2,000	49%	51%	100%	THB980	Sale 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	Sale of communications products and provision of after-sale services and technical support
ZTE Integration Telecom Ltd.	Shenzhen	RMB55,000	75%	5%	80%	RMB41,250	Research and manufacture, production and sale 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
OOO ZTE Russia Co., Limited	Russia	USD760	100%	—	100%	USD760	Sales of telecommunication products, provision of after-sales 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

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IV. CONTROLLING SUBSIDIARIES AND JOINTLY-CONTROLLED ENTITIES (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			Investment of the Group	Principal operations
			Direct	Indirect	Effective		
Shenzhen Changfei Investment Company, Limited	Shenzhen	RMB30,000	51%	—	51%	RMB15,300	Investment and promotion of industries, and sale of electronics and communications parts and components
Shenzhen Lead Communications Company, Limited	Shenzhen	RMB10,000	—	62.5%	62.5%	RMB6,250	Sale 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 sale of handset accessories; sale of electronics products; operation of I/E businesses
Shenzhen Kangquan Electromechanical	Shenzhen	RMB16,000	—	57.5%	57.5%	RMB9,200	Manufacture and sale of handset case and accessories; purchase and sale of electromechanical products; self operation of I/E businesses
Shanghai Xingfei Science and Technology Company, Limited	Shanghai	RMB1,000	—	80%	80%	RMB800	Four skill services of the electronics products sector, manufacture, sale and after-sale services of electronics products, and corporate management consultation (subject to license where a license is required)
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

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IV. CONTROLLING SUBSIDIARIES AND JOINTLY-CONTROLLED ENTITIES (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			Investment of the Group	Principal operations
			Direct	Indirect	Effective		
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 sale 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 sale 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 and hardware and data equipment, and sale and technical assignment of related products and provision of related services
Closed Joint Stock Company TK Mobile	Tadjikistan	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 Kangxun 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

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IV. CONTROLLING SUBSIDIARIES AND JOINTLY-CONTROLLED ENTITIES (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			Investment of the Group	Principal operations
			Direct	Indirect	Effective		
ZTE Romania SRL	Romania	USD100	100%	—	100%	RMB827	Sale 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	Sale 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
Shenzhen Hongde Battery Company, Limited	Shenzhen	RMB15,000	—	83%	83%	RMB12,500	Manufacture and sale of batteries, sale of battery raw materials and electronics products (excluding franchised, state-controlled and monopolized merchandises and restricted items); operate import and export business
ZTE (HK) Ltd. Saudi Arabia	Saudi Arabia	USD534.76	—	100%	100%	USD534.76	Sale of communications products, provision of aftersale services and technical support
ZTE Nigeria Investment Limited	Nigeria	USD39	—	100%	100%	USD540	Import and export of raw materials, manufacture, testing, sale, installation, development, user training and after-sale services of telecommunications products

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IV. CONTROLLING SUBSIDIARIES AND JOINTLY-CONTROLLED ENTITIES (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			Investment of the Group	Principal operations
			Direct	Indirect	Effective		
ZTE Sweden AB	Sweden	USD360	—	100%	100%	USD360	Sale of communications products, provision of aftersale services and technical support
PT ZTE Indonesia	Indonesia	USD200	99.5%	0.5%	100%	USD200	Sale of communications products, provision of aftersale services and technical support
ZTE Istanbul Trading Ltd. Co.	Turkey	USD50	—	100%	100%	USD49.5	Sale of communications products, provision of aftersale services and technical support
ZTE Hrvatska D.O.O	Croatia	EUR3	—	100%	100%	EUR3	Sale of communications products, provision of aftersale services and technical support
ZTE Corporation Bulgaria Ltd	Bulgaria	USD3.5	—	100%	100%	USD3.5	Sale of communications products, provision of aftersale services and technical support
ZTE Deutschland GmbH i.Gr.	Germany	EUR150	—	100%	100%	EUR150	Sale of communications products, provision of aftersale services and technical support
ZTE Poland Sp.zo.o.	Poland	USD50	—	100%	100%	USD50	Sale of communications products, provision of aftersale 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
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

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(All amounts in RMB'000 unless otherwise stated)

IV. CONTROLLING SUBSIDIARIES AND JOINTLY-CONTROLLED ENTITIES (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			Investment of the Group	Principal operations
			Direct	Indirect	Effective		
ZiMax Technologies Inc	United States	USD20,000	—	100%	100%	USD5,379.7	R&D of wireless communication technology
Newinfo Holdings Limited	Hong Kong	USD50	—	100%	100%	USD4.299	Acquisition, shareholding and investment of telecom carriers
WANAAG Communications Limited	Hong Kong	USD200	—	100%	100%	USD100	IDD forwarding for Africa
ZTE Canada Inc	Canada	USD200	—	100%	100%	USD38	Sale of communications products, provision of after sales service and technical support
ZTE Netherlands B.V.	Holland	EUR90	—	100%	100%	EUR18	Sale of communications products, provision of after sales service and technical support
ZTE Ghana Limited	Ghana	USD300	—	100%	100%	USD300	Sale of communications products, provision of after sales service and technical support
ZTE (Australia) Pty Ltd.	Australia	USD200	—	100%	100%	USD200	Sale of communications products, provision of after sales service and technical support
深圳中興無線通信有限公司	Shenzhen	USD5,000	—	100%	100%	USD750	Development, production and sales of GSM and PHS telecommunication equipment

(4) Jointly-controlled entities

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

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IV. CONTROLLING SUBSIDIARIES AND JOINTLY-CONTROLLED ENTITIES (continued)

(5) Associates

Full name of associates	Place of registration	Registered capital '000	Shareholding percentage of the Company			Investment of the Group	Principal operations
			Direct	Indirect	Effective		
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, sale 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 sale of single-layered, double-layered, multi-layered and rigid-flexible releasable printed integrated circuits; I/E 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 sale 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 is required for specific items)
Beijing Zhongxing Yuanjing Technology Co., Ltd.	Beijing	RMB10,000	30%	—	30%	RMB3,000	Development and research No Technology Co., Ltd. manufacture of data centre and metropolitan/Campus networks integrated core software products

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IV. CONTROLLING SUBSIDIARIES AND JOINTLY-CONTROLLED ENTITIES (continued)

(5) Associate companies (continued)

Full name of associates	Place of registration	Registered capital '000	Shareholding percentage of the Company			Investment of the Group	Principal operations
			Direct	Indirect	Effective		
KAZNURTEL Limited Liability Company	Kazakstan	USD3,000	49%	—	49%	RMB3,988.4	Manufacture and sale of telecom equipment and provision of corresponding technical support, after-sale services, trainings and consultation; installation and construction of CDMA450MWLL and provision of corresponding telecom services and value-added services
深圳思碼特電子有限公司	Shenzhen	HKD15,000	—	32%	32%	HKD3,200	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
Shenzhen Decang Technology Company Limited	Shenzhen	RMB2,500	—	40%	40%	RMB1,000	Technology development of optoelectronic products; production and sales of blue light source products and light guide plates; sales of electronic products, telecommunication products and optoelectronic products; import and export of goods and technologies

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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

Item		Original currency	2005 Exchange rate	RMB equivalent	Original currency	2004 Exchange rate	RMB equivalent
Cash	RMB	387	1.0000	387	366	1.0000	366
	HKD	125	1.0403	130	353	1.0603	389
	USD	1,138	8.0702	9,184	1,625	8.2705	13,481
	BRL	1	3.4522	3	72	2.8899	224
	THB	1,540	0.1968	303	—	—	—
	FEC	69	7.3633	508	—	—	—
	GBP	—	—	—	2	15.91	27
	JPY	—	—	—	151	0.0807	11
	CDF	—	—	—	15,018	0.0157	282
	PKR	574	0.1350	77	456	0.1495	68
	SAR	92	2.1521	198	—	—	—
	SOS	42	2.5225	106	—	—	—
	Others			150			16
	Sub-total			11,046			14,864

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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	2005			2004		
	Original currency	Exchange rate	RMB equivalent	Original currency	Exchange rate	RMB equivalent
Bank deposits RMB	3,609,771	1.0000	3,609,771	2,081,252	1.0000	2,081,252
HKD	33,408	1.0403	34,754	2,910,758	1.0603	3,086,167
USD	154,588	8.0702	1,247,556	219,675	8.2750	1,815,532
BRL	8,858	3.4522	30,580	41,913	2.8899	130,768
PKR	651,989	0.1350	88,019	215,941	0.1495	32,278
EGP	65,376	1.4035	91,755	12,947	1.3482	17,454
GBP	945	14.1349	13,357	170	15.91	2,496
SEK	2,442	1.0154	2,480	1,640	1.1290	1,852
DZD	35,070	0.0897	3,146	—	—	—
COP	5,334,654	0.0035	18,671	—	—	—
CEDI	3,509,473	0.0008	2,808	—	—	—
EUR	19,778	9.5797	189,467	6,696	11.2627	74,380
NGN	334,439	0.0576	19,264	—	—	—
RUR	—	—	—	1,928	0.2996	578
THB	2,747	0.1968	541	2,088	0.2068	432
JPY	—	—	—	308,288	0.0807	22,380
INR	—	—	—	23,129	0.1861	4,305
ROL	—	—	—	121,142	0.0066	794
CDF	—	—	—	85,935	0.0157	1,615
SAR	1,514	2.1521	3,258	—	—	—
SOS	613	2.5225	1,546	—	—	—
RUB	38,287	0.2803	10,732	—	—	—
Others			1,452			1,384
Sub-total			5,369,157			7,273,667

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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		Original currency	2005 Exchange rate	RMB equivalent	Original currency	2004 Exchange rate	RMB equivalent
Other currencies	RMB	79,435	1.0000	79,435	304,656	1.0000	304,656
	USD	1,400	8.0702	11,298	118	8.2705	977
	HKD	14,700	1.0403	15,292	—	—	—
	PKR	54,131	0.1350	7,308	24,741	0.1495	3,698
	XOF	5,543,000	0.0143	79,265	—	—	—
	SEK	—	—	—	320	1.1290	361
	Others			331			—
Sub-total				192,929			309,692
Total				5,573,132			7,598,223

Cash in banks and on hands of the Group at the end of the period comprised a bank guarantee deposit of RMB175,899,000.

2. Notes receivable

	2005	2004
Bank acceptance bills	448,693	743,356
Commercial acceptance bills	796,160	1,514,732
	1,244,853	2,258,088

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 decreased by 44.87% compared to the balance at the beginning of the year mainly as a result of cash settlement of certain notes receivable during the year.

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V. EXPLANATORY NOTES TO MAJOR ITEMS IN THE CONSOLIDATED FINANCIAL STATEMENTS (THE FOLLOWING REPRESENTS GROUP FIGURES UNLESS OTHERWISE STATED) (continued)

3. Trade receivables

Ageing analysis of trade receivables is as follows:

The Group

	2005				2004			
	Amount	Percentage of the total amount	Provision for bad debts	Percentage of provision	Amount	Percentage of the total amount	Provision for bad debts	Percentage of provision
Within one year	3,535,496	84.28%	109,961	3.11%	3,513,954	86.08%	124,909	3.55%
Between one to two years	545,333	13.00%	232,046	42.55%	420,742	10.31%	224,275	53.3%
Between two to three years	47,377	1.13%	36,826	77.73%	113,999	2.79%	67,346	59.08%
Over three years	66,628	1.59%	66,413	99.68%	33,416	0.82%	13,075	39.13%
	4,194,834	100%	445,246		4,082,111	100%	429,605	
Less: accounts due within one year	3,887,168	92.67%	445,246		4,082,111	100%	429,605	
Long-term portion	307,666	7.33%	—		—	—	—	

Of the balance of trade receivables as at the end of the year, RMB177,000 was due from shareholders holding 5% or more in the shares. Please refer to Note VII to the financial statements — Relationship and transactions with connected parties.

The top five amounts amounted to RMB2,018,544,000, accounting for 48.12% of the total amount of trade receivable.

Bad debt provision of trade receivables is as follows:

	2005	2004
Balance at the beginning of the year	429,605	77,470
Provided for the year	217,537	352,135
Reversed for the year	(201,896)	—
Balance at the end of the year	445,246	429,605

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V. EXPLANATORY NOTES TO MAJOR ITEMS IN THE CONSOLIDATED FINANCIAL STATEMENTS (THE FOLLOWING REPRESENTS GROUP FIGURES UNLESS OTHERWISE STATED) (continued)

3. Trade receivables (continued)

The Company

	2005				2004			
	Amount	Percentage	Provision for bad debts	Percentage of provision	Amount	Percentage	Provision for bad debts	Percentage of provision
Within one year	4,426,106	84.78%	97,303	2.20%	3,887,109	87.61%	123,773	3.18%
Between one to two years	648,024	12.42%	219,505	33.87%	410,416	9.25%	216,698	52.80%
Between two to three years	46,038	0.88%	34,166	74.21%	110,457	2.49%	67,244	60.88%
Over three years	100,487	1.92%	60,763	60.47%	28,946	0.65%	12,883	44.51%
	5,220,655	100%	411,737		4,436,928	100%	420,598	
Less: accounts due within one year	4,893,533	93.73%	411,737		4,436,928	100%	420,598	
Long-term portion	327,122	6.27%	—		—	—	—	

The top five amounts of trade receivables amounted to RMB3,097,760,000, accounting for 59.34% of the total trade receivables at the end of the year.

Bad debt provision of trade receivables is as follows:

	2005	2004
Balance at the beginning of the year	420,598	76,076
Provided for the year	193,035	344,522
Reversed for the year	(201,896)	—
Balance at the end of the year	411,737	420,598

Of the balance of trade receivables, RMB8,000 was due from shareholders holding 5% or more in the shares as at the end of the year.

- As at 31 December 2005, the Company and one of its subsidiaries entered into an agreement with a bank during the year, trade receivables amounting to RMB724,181,000 were factored to obtain bank advances. According to the factoring agreement, if the client delays repayment, the Company and its subsidiary will 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 "essence should prevail over form," as the risks and rewards associated with the creditor rights had not been fully transferred.

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V. EXPLANATORY NOTES TO MAJOR ITEMS IN THE CONSOLIDATED FINANCIAL STATEMENTS (THE FOLLOWING REPRESENTS GROUP FIGURES UNLESS OTHERWISE STATED) (continued)

5. Other receivables

Ageing analysis of other receivables is as follows:

The Group

	2005				2004			
	Amount	Percentage	Provision for bad debts	Percentage of provision	Amount	Percentage	Provision for bad debts	Percentage of provision
Within one year	712,063	70.65%	487,678	68.49%	291,783	39.69%	175,946	60.3%
Between one to two years	122,012	12.10%	82,721	67.80%	271,113	36.88%	137,116	50.58%
Between two to three years	83,238	8.26%	71,825	86.29%	42,628	5.80%	41,418	97.16%
Over three years	90,627	8.99%	85,741	94.61%	129,564	17.63%	123,013	94.94%
	1,007,940	100%	727,965		735,088	100%	477,493	

Bad debt provision for other receivables is as follows:

	2005	2004
Balance at the beginning of the year	477,493	271,161
Provide for the year	487,678	206,332
Reverse for the year	(237,206)	—
Balance at the end of the year	727,965	477,493

The top five amounts of other receivables amounted to RMB91,186,000, accounting for 9.05% of the total 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.

The balance of other receivables included two loan receivables amounting to RMB46,165,000 to potential customers granted by Group. A loan of SEK43,000,000 bears an annual interest of STIBOR + 3% to 8%, repayable in March 2006 and are secured by certain properties. Another loan of EUR3,150,000 bears an annual interest of three months EURIBOR + 1% to 3%, repayable in 4 installments which will be fully repaid by February 2007 and are secured by shares of the customer's immediate holding company and ultimate holding company. Subsequent to the balance sheet date, SEK loan of approximately SEK14,940,000 and the first installment payment of EURO dollar loan were both overdue in March 2006 and February 2006, respectively, and the respective borrowers are in the process of negotiating with the management for a two months deferred payment. The executive directors had taken necessary measures with the potential customers to recover the loans receivables and in view of the securities on hand, are of the opinion that no provision is necessary for these loans receivable.

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V. EXPLANATORY NOTES TO MAJOR ITEMS IN THE CONSOLIDATED FINANCIAL STATEMENTS (THE FOLLOWING REPRESENTS GROUP FIGURES UNLESS OTHERWISE STATED) (continued)

5. Other receivables (continued)

The Company

	2005				2004			
	Amount	Percentage	Provision for bad debts	Percentage of provision	Amount	Percentage	Provision for bad debts	Percentage of provision
Within one year	1,058,754	54.55%	481,644	45.49%	794,686	65.30%	166,872	21.00%
Between one to two years	656,484	33.83%	82,103	12.51%	257,046	21.12%	135,531	52.73%
Between two to three years	102,262	5.27%	62,013	60.64%	41,667	3.42%	41,156	98.77%
Over three years	123,248	6.35%	84,636	68.67%	123,527	10.16%	121,808	98.61%
	1,940,748	100%	710,396		1,216,926	100%	465,367	

Bad debt provision for other receivables is as follows:

	2005	2004
Balance at the beginning of the year	465,367	271,161
Increase for the year	481,644	194,206
Reverse for the year	(236,615)	—
Balance at the end of the year	710,396	465,367

The top five amounts of other receivables amounted to RMB91,186,000, accounting for 4.70% of the total 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.

6. Accounts prepaid

Ageing analysis of accounts prepaid is as follows:

	2005		2004	
	Amount	Percentage	Amount	Percentage
Within one year	150,991	99.88%	145,151	99.83%
Between one to two years	53	0.03%	247	0.17%
Between two to three years	130	0.09%	—	—
	151,174	100%	145,398	100%

No outstanding amount due from shareholders holding 5% or more in the shares as at the end of the year.

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V. EXPLANATORY NOTES TO MAJOR ITEMS IN THE CONSOLIDATED FINANCIAL STATEMENTS (THE FOLLOWING REPRESENTS GROUP FIGURES UNLESS OTHERWISE STATED) (continued)

7. Inventories

	2005	2004
Raw materials	1,221,858	1,146,676
Materials under sub-contract processing	102,958	—
Work-in-progress	538,703	356,899
Finished goods	892,766	641,265
Science and technology R&D cost*	279,220	146,700
Less: impairment provision	515,958	419,773
	2,519,547	1,871,767

* 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 will be set off against specific payables in respect of the project.

An analysis of inventories provision is as follows:

	2005	2004
Balance at the beginning of year	419,773	282,187
Increase for the year	96,185	137,586
Reverse for the year	—	—
Balance at the end of the year	515,958	419,773

8. Construction contracts

	2005	2004
Amount due from customers for contract work (Note 1)	4,689,157	2,752,024
Amount due to customers for contract work	(733,455)	(2,318,731)
	3,955,702	433,293
Cost of contract construction in progress to date and gross profit (loss) of contract construction in progress recognized to date	19,420,235	15,327,336
Less: progress billings	(15,464,533)	(14,894,043)
	3,955,702	433,293

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V. EXPLANATORY NOTES TO MAJOR ITEMS IN THE CONSOLIDATED FINANCIAL STATEMENTS (THE FOLLOWING REPRESENTS GROUP FIGURES UNLESS OTHERWISE STATED) (continued)

8. Construction contracts (continued)

Note 1:

Category	2005	2004
Construction work	2,420,118	(1,695,270)
Dispatch of goods	1,535,584	2,128,563
	3,955,702	433,293

The balance of amount due from customers for contract work at year-end increased by 70.39% compared to that at the beginning of the year mainly as a result of the speeding up of the completion of the Group's telecommunication system construction works ahead of the payment of progress billings.

9. Long-term investments

The Group

		2005	2004
Long-term equity investments			
Equity investments under cost method	(1)	43,288	44,346
Equity investments under equity method			
Equity interest in associates	(2)	35,583	8,841
Equity interest in jointly-controlled entities	(3)	6,588	8,304
Differences in equity investment	(4)	13,036	18,721
		98,495	80,212
Less: Provision for impairment of long-term investments	(5)	13,036	13,036
		85,459	67,176

(1) Equity investments under cost method

	Share of registered capital	Initial investment	Balance at the beginning	Increase during the period	Decrease during the period	Balance at year-end	
Name of investee							
深圳市創新科技投資集團有限公司	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	
Spread Telecom	4.5%	176	176	—	(176)	—	
Edmotech Co. Ltd	18%	1,406	1,406	—	(1,406)	—	
Shenzhen Zhongxing Xinyu FPC Company, Limited	22.73%	2,500	2,500	—	(2,500)	—	
中移鼎訊通訊股份有限公司	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	
			47,370	44,346	3,024	(4,082)	43,288

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V. EXPLANATORY NOTES TO MAJOR ITEMS IN THE CONSOLIDATED FINANCIAL STATEMENTS (THE FOLLOWING REPRESENTS GROUP FIGURES UNLESS OTHERWISE STATED) (continued)

9. Long-term investments (continued)

The Group (continued)

(2) Equity interest in associates

Name of investee	Share of registered capital	Initial investment	Balance at the beginning	Increase/decrease of investment cost during the period	Increase/decrease of equity during the period	Balance at year-end
ZTE IC Design Co., Ltd	40%	30,000	—	10,899	2,319	13,218
Beijing Zhongxing Yuanjing Technology Co., Ltd	30%	3,000	329	—	(46)	283
Kaznurte Limited Liability Company	49%	1,012	1,012	2,976	(1,511)	2,477
WuXi KaiEr Technology Company, Limited	30.88%	3,500	3,500	—	98	3,598
Shenzhen Zhongxing Xinyu FPC Company, Limited	22.73%	2,500	—	2,500	(125)	2,375
Shenzhen Weigao Semiconductor Company, Limited	40%	4,000	4,000	—	(1,024)	2,976
Shenzhen Decang Technology Company Limited	40%	1,000	—	1,000	(189)	811
深圳市聚飛光電有限公司	30%	4,500	—	4,500	(152)	4,348
中興軟件技術(南昌)有限公司	30%	4,500	—	4,500	(2,146)	2,354
深圳思碼特電子有限公司	32%	3,335	—	3,335	(192)	3,143
		57,347	8,841	29,710	(2,968)	35,583

(3) Equity interest in jointly-controlled entities

Name of investee	Share of registered capital	Initial investment	Balance at the beginning	Increase/decrease of investment cost during the period	Increase/decrease of equity during the period	Balance at year-end
Beijing Zhongxingxin Communication Equipment Company Limited	50.00%	2,500	6,311	—	(1,698)	4,613
Bestel Communications Ltd.	50.00%	2,050	1,993	—	(18)	1,975
		4,550	8,304	—	(1,716)	6,588

(4) Differences in equity investments

Name of investee	Balance at the beginning	Increase during the year	Amortized during the year	Impairment during the year	Remaining value
Shenzhen Guoxin Electronics Development Company, Limited	13,036	—	—	—	13,036
ZTE Mobile Tech Co., Ltd	5,685	—	(812)	(4,873)	—
ZiMax Technologies Inc	—	50,583	—	(50,583)	—
	18,721	50,583	(812)	(55,456)	13,036

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V. EXPLANATORY NOTES TO MAJOR ITEMS IN THE CONSOLIDATED FINANCIAL STATEMENTS (THE FOLLOWING REPRESENTS GROUP FIGURES UNLESS OTHERWISE STATED) (continued)

9. Long-term investments (continued)

The Group (continued)

(5) Provision for impairment of long-term investment:

Item	Balance at the beginning and year-end
Shenzhen Guoxin Electronics Development Company, Limited	13,036

The Company

		2005	2004
Long-term equity investment			
Equity investment under equity method			
Subsidiaries	(1)	2,779,384	2,951,428
Jointly-controlled entities	(2)	4,613	6,311
Associates	(3)	18,336	1,342
Equity investment under cost method	(4)	41,288	40,264
Difference in equity investment	(5)	2,720	6,686
		2,846,341	3,006,031
Less: Provision for impairment of long-term investment	(6)	13,036	13,036
		2,833,305	2,992,995

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V. EXPLANATORY NOTES TO MAJOR ITEMS IN THE CONSOLIDATED FINANCIAL STATEMENTS (THE FOLLOWING REPRESENTS GROUP FIGURES UNLESS OTHERWISE STATED) (continued)

9. Long-term investments (continued)

The Company (continued)

(1) Subsidiaries

Investee	Share of registered capital	Balance at the beginning	Increase/decrease of investment cost during the year	Increase/decrease of equity during the year	Cash bonus for the year	Balance at year-end
ZTE Kangxun Telecom Co., Ltd.	90%	1,036,766	—	266,348	—	1,303,114
Shenzhen Zhongxing Mobile Telecom Equipment Co., Ltd	90%	9,340	—	74	—	9,414
Shanxi Zhongxing Telecom Equipment Co., Ltd.	51%	5,587	(5,587)	—	—	—
ZTE (USA) Inc.	100%	4,173	—	(13,463)	—	(9,290)
Wuxi Zhongxing Optoelectronics Technologies Company, Limited	65%	29,487	—	4,210	(2,080)	31,617
ZTE IC Design Co., Ltd	40%	6,808	(10,899)	4,091	—	—
ZTE (H.K) Limited	100%	400,368	—	54,359	—	454,727
Anhui Wantong Posts and Telecommunications Company, Limited	51%	18,617	—	5,303	(1,133)	22,787
Telrise (Cayman) Telecom Co., Ltd.	52.85%	5,965	—	(3,042)	—	2,923
ZTE Future Tel Co. Ltd.	54.14%	561	(561)	—	—	—
Shenzhen Guoxin Electronics Development Company Limited	90%	3,292	—	64	—	3,356
Congo-Chine Telecom S.A.R.L.	51%	32,155	—	(7,422)	(477)	24,256
Yangzhou Zhongxing Mobile Telecom Equipment Co., Limited	65%	(9,890)	—	(19,022)	—	(28,912)
ZTE Mobile Tech Co., Limited	95%	9,034	—	20,095	—	29,129
ZTE Soft Development Technology Co., Ltd	76%	55,705	(4,298)	52,269	—	103,676
ZTE(UK) Limited	51%	(6,876)	—	(9,771)	—	(16,647)
ZTE do Brasil Ltda	100%	(1,138)	—	(9,207)	—	(10,345)
Shenzhen Zhongxing Software Company, Limited	70%	1,175,302	(28,058)	644,262	(1,093,925)	697,581
ZTE Integration Telecom Ltd	75%	36,922	—	41,336	—	78,258
ZTE Wistron Telecom AB	100%	1,714	—	902	—	2,616
OOO ZTE Russia Co. Ltd	100%	5,563	—	(453)	—	5,110
ZTE Corporation Mexico S.DER.L PE C.V.	100%	(5,775)	—	(7,550)	—	(13,325)
Shenzhen Changfei Investment Company, Limited	51%	42,885	—	19,010	(12,240)	49,655
Zhongxing Telecom Pakistan (Private) Limited	93%	3,468	3,729	(41,099)	—	(33,902)
Guangdong New Pivot Technology & Service Company, Limited	90%	4,774	2,700	1,806	—	9,280
Shenzhen Zhongxing Telecom Equipment Technology & Service Company Limited	90%	44,931	—	(10,553)	—	34,378
Shanghai Zhongxing Telecom Equipment Technology & Service Company Limited	51%	5,431	—	6,943	(1,785)	10,589
ZTE Holdings (Thailand) Co., Ltd	49%	(6)	—	(6)	—	(12)
ZTE (Thailand) Co. Ltd	49%	(1,745)	—	723	—	(1,022)
Shenzhen Zhongxing Special Equipment Company Limited	54%	488	—	1,362	—	1,850
ZTE Kangxun Telecom Company India Private Ltd.	100%	1,599	—	(53,741)	—	(52,142)
ZTE Romania SRL	100%	449	—	(7,932)	—	(7,483)
ZTE Malaysia Corporation SDH.BHD	100%	(134)	—	(2,445)	—	(2,579)
ZiMAX(Cayman) Holdings Co. Ltd	100%	20,673	24,810	(12,316)	—	33,167
西安中興精誠通訊有限公司	70%	—	11,396	902	—	12,298
Closed Joint Stock Company TK Mobile	51%	14,935	—	(606)	—	14,329
PT ZTE Indonesia	99.5%	—	1,654	3,923	—	5,577
深圳中興力維技術有限公司	30%	—	6,000	9,356	—	15,356
		2,951,428	886	938,710	(1,111,640)	2,779,384

* RMB925,116,000 included in Increase/decrease of equity during the year was current year's equity.

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9. Long-term investments (continued)

The Company (continued)

(2) Jointly-controlled entities

Investee	Share of registered capital	Balance at the beginning	Increase/decrease of equity during the year	Dividends of cash during the year	Balance at year-end
Beijing Zhongxingxin Communication Equipment Company Limited	50%	6,311	(1,698)	—	4,613

(3) Associates

Investee	Share of registered capital	Balance at the beginning	Increase/decrease of investment cost during the year	Increase/decrease of equity during the year	Balance at year-end
Beijing Zhongxing Yuanjing Technology Co., Ltd.	30%	329	—	(43)	286
KAZNURTEL Limited Liability Company	49%	1,013	2,976	(1,511)	2,478
中興軟件技術(南昌)有限公司	30%	—	4,500	(2,146)	2,354
ZTE IC Design Co., Ltd	40%	—	10,899	2,319	13,218
		1,342	18,375	(1,381)	18,336

(4) Equity investments under cost method

Investee	Share of registered capital	Balance at the beginning	Increase/decrease of investment cost during the year	Balance at year-end
深圳市創新科技投資集團有限公司	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
中移鼎訊通訊股份有限公司	16%	32,000	—	32,000
		40,264	1,024	41,288

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9. Long-term investments (continued)

The Company (continued)

(5) Difference in equity investments

Investee	Balance at the beginning	Amortization in current year	Increase/ decrease of equity during the year	Balance at year-end
Congo-Chine Telecom S.A.R.L.	(12,035)	1,719	—	(10,316)
Shenzhen Guoxin Electronics Development Company Limited	13,036	—	—	13,036
ZTE Mobile Tech Co., Ltd	5,685	(812)	(4,873)	—
	6,686	907	(4,873)	2,720

(6) Provision for impairment of long-term investment:

	Balance at the beginning and year-end
Shenzhen Guoxin Electronics Development Company Limited	13,036

There is no significant restriction relating to the Group's realization of investment.

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10. Fixed Assets (continued)

	Buildings	Leasehold improvement	Motor Vehicles	Machinery equipment	Electronic equipment	Other equipment	Total
Cost:							
At the beginning of the year	692,156	60,020	177,271	879,133	898,749	78,460	2,785,789
Additions	4,537	12,949	47,437	133,908	557,165	4,180	760,176
Acquisition of subsidiaries	—	—	475	11,145	5,446	—	17,066
Transferred from Construction in progress	221,000	—	—	—	11,594	—	232,594
Disposal and retirement	(11)	(21,338)	(14,037)	(14,320)	(32,399)	(68,514)	(150,619)
Disposal of subsidiaries	—	—	(927)	(331)	(20,815)	—	(22,073)
Exchange realignments	(59)	—	150	407	138	371	1,007
At year-end	917,623	51,631	210,369	1,009,942	1,419,878	14,497	3,623,940
Accumulated depreciation:							
At the beginning of the year	81,452	37,550	24,839	250,080	432,085	4,867	830,873
Provision	29,006	11,834	48,635	87,887	214,437	3,185	394,984
Acquisition of subsidiaries	—	—	—	2,116	2,130	—	4,246
Transfer	(4)	(21,338)	(8,867)	(8,214)	(25,862)	(1,135)	(65,420)
Disposal of subsidiaries	—	—	(387)	(210)	(15,348)	—	(15,945)
Exchange realignments	(3)	—	9	26	(6)	25	51
At year-end	110,451	28,046	64,229	331,685	607,436	6,942	1,148,789
Fixed assets, net:							
At year-end	807,172	23,585	146,140	678,257	812,442	7,555	2,475,151
At the beginning of the year	610,704	22,470	152,432	629,053	466,664	73,593	1,954,916
Provision for impairment:							
At the beginning and year end	7,708	—	—	1,475	85,797	—	94,980
Fixed assets, net:							
At year-end	799,464	23,585	146,140	676,782	726,645	7,555	2,380,171
At the beginning of the year	602,996	22,470	152,432	627,578	380,867	73,593	1,859,936

Book value of currently idle fixed assets was RMB911,000. Book value at cost of fixed assets in continued use for which full depreciation had been made was RMB150,503,000. Book value of retired fixed assets or fixed assets pending disposal was RMB607,000.

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11. Construction in progress

Name of construction project	Budget	Amount at the beginning of the year	Increase/ (decrease) during the year	Transfer to fixed assets during the year	Other decrease	Amount at the end of the year	Source of funds	Status of project
Science and Technology Park R&D Center	300,000	71,269	161,926	221,000	—	12,195	Internal resources	Partially completed
Liuxiandong ZTE Industrial Park	1,300,000	24,446	22,219	—	—	46,665	Internal resources	Work in progress
Network expansion phase IV	—	11,407	—	11,407	—	—	Internal resources	Completed
New plant in Wuxi	—	5,169	9,420	—	—	14,589	Internal resources	Work in progress
IT chamber of R&D complex	—	—	9,440	—	—	9,440	Internal resources	Work in progress
TK Phase II expansion	—	—	33,955	—	—	33,955	Internal resources	Work in progress
Others	—	2,386	22,236	187	14,538	9,897	Internal resources	Work in progress
	1,600,000	114,677	259,196	232,594	14,538	126,741		

12. Intangible assets

	Initial amount	Method of possession	Amount at the beginning of the year	Increase (decrease) during the year	Acquisition of subsidiaries	Disposal of subsidiaries	Amortization in the year	Accumulated amortization	Amount at the end of the year	Remaining years for amortization
Software	240,736	Acquisition	116,587	40,639	—	(3,709)	44,524	131,743	108,993	5
Patent technology	2,396	Acquisition	5,877	(4,129)	47	—	441	1,042	1,354	1-10
Land use rights	19,844	Acquisition	10,741	2,442	—	—	324	6,985	12,859	48
Operating concession	77,364	Acquisition	39,630	29,771	—	—	5,387	13,350	64,014	20
Other intangible assets	444	Investment	333	—	—	—	333	444	—	—
			173,168	68,723	47	(3,709)	51,009	153,564	187,220	

Provision for impairment of intangible assets:

	Amount at the beginning of the year	Addition in the year	Diminution in the year		Amount at the end of the year
			Increase in value	Other transfer	
Software	12,882	2	—	—	12,884
Land use rights	6,322	—	—	—	6,322
Operating concession	7,750	—	—	—	7,750
	26,954	2	—	—	26,956

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V. EXPLANATORY NOTES TO MAJOR ITEMS IN THE CONSOLIDATED FINANCIAL STATEMENTS (THE FOLLOWING REPRESENTS GROUP FIGURES UNLESS OTHERWISE STATED) (continued)

13. Long-term prepaid expenses

	Initial amount	Amount at the beginning of the year	Addition in the year	Amortization in the year	Accumulated amortization	Amount at the end of the year
Modules	2,174	1,315	301	1,616	2,174	—
		1,315	301	1,616	2,174	—

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 2005, the project was not completed and the equipment supplied by the Group was accounted for as long-term deferred assets. Such assets will be amortized over a period of 5 years after the commissioning of the project.

15. Deferred tax debit

	2005	2004
Unrealized profit of stock	4,474	25,827
Provision for maintenance	37,350	33,934
Inventories provision	39,069	44,864
Deferred tax debit	80,893	104,625

16. Short-term loans

	2005		2004	
	Original currency	RMB equivalent	Original currency	RMB equivalent
Credit loans	RMB52,000	52,000	RMB12,000	12,000
	—	—	USD5,000	41,340
Mortgage loans	—	—	RMB2,021	2,021
Pledged loans	PKR353,300	47,695	RMB350,334	350,334
		99,695		405,695

The balance of short-term loans at year-end decreased by 75.43% compared to that at the beginning of the year. The decrease reflected repayment of loans during the year.

V. EXPLANATORY NOTES TO MAJOR ITEMS IN THE CONSOLIDATED FINANCIAL STATEMENTS (THE FOLLOWING REPRESENTS GROUP FIGURES UNLESS OTHERWISE STATED) (continued)

17. Notes payable

No outstanding amount due to shareholders holding 5% or more in the shares as at the year end.

The balance of notes payable at year-end increased by 39.03% compared to that at the beginning of the year. The increase mainly reflected increased settlement of payment by bills.

18. Accounts payable

Included in the balance of the account, such amount of shareholders holding 5% or more in the shares of the Company was RMB104,563,000. Please refer to Note VII to the financial statements-Relationship and transactions with connected parties.

The balance of accounts payable at year-end increased by 47.02% compared to that at the beginning of the year. The increase mainly reflected increased credit amount granted to the Group by suppliers allowing deferred payments.

19. Advances from customers

No outstanding amount of shareholders holding 5% or more in the shares of the Company.

The balance of accounts payable at year-end increased by 194.85% compared to that at the beginning of the year, reflecting mainly an increased number of construction contracts for which deposits were paid by customers.

20. Dividends payable

	2005	2004
Holders of State-owned corporate shares	3,186	936
Holders of domestic corporate shares/domestic investors	159,822	39,985
	163,008	40,921

The balance of dividends payable at year-end increased by RMB122,087,000 compared to that at the beginning of the year. The increase mainly reflected dividend due to minority shareholders by subsidiaries of the Company.

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V. EXPLANATORY NOTES TO MAJOR ITEMS IN THE CONSOLIDATED FINANCIAL STATEMENTS (THE FOLLOWING REPRESENTS GROUP FIGURES UNLESS OTHERWISE STATED) (continued)

21. Taxes payable

	2005	2004
Value-added tax ("VAT")	(802,209)	(223,852)
Business tax	5,508	13,815
City maintenance and construction tax	(794)	2,763
Income tax		
PRC tax	42,020	228,648
Overseas tax	72,652	—
Property tax	18	10
Individual income tax	12,523	31,075
	(670,282)	52,459

The bases of taxes calculation and tax rate of taxes payable are set out in Note III "Tax" to the financial statements.

The balance of taxes payable decreased by RMB722,741,000, reflecting mainly the increase in VAT credit that have not been deducted and the increase in refundable export VAT.

22. Other payables

The balance of the account comprised RMB313,000 payable to shareholders holding 5% or more in the shares of the Company.

23. Accrued expenses

	2005	2004
Interest expenses	395	3,072
Rent and water and electricity charges	4,541	3,966
Work installation expenses	14,972	1,063
Product maintenance fee	248,998	186,227
Commission	—	26,336
Others	77,762	47,870
	346,668	268,534

24. Provision

	2005	2004
Provision of guarantees for external parties	4,035	—
Guarantees for quality of products	16,000	20,000
	20,035	20,000

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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	2005	2004
Long-term loans	26	500,000	16,900

26. Long-term loans

Category of loans	2005		2004	
	Original currencies	RMB equivalent	Original currencies	RMB equivalent
Pledged loans	—	—	EUR1,000	11,263
Credit loans	—	—	RMB450,900	450,900
Guaranteed loans	USD9,648	80,000	USD9,648	80,000
	RMB500,000	500,000	RMB500,000	500,000
Less: long-term loans due within one year		500,000		16,900
		80,000		1,025,263

27. Specific payables

	2005	2004
Technology appropriations	405,511	227,320

The balance at year-end increased by 78.39% as compared to that at the beginning of the year, mainly as a result of the increase in technology research grants received during the year.

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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 are classified and structured as follows:

		Balance at the beginning		Increase (decrease) during the year			Balance at year-end	
		Number of Shares	Percentage	Bonus issue	Others	Sub-total	Number of Shares	Percentage
I.	Non-circulating shares							
(I)	Promoters' shares							
1.	State owned corporate shares	462,273	48.18%	—	(462,273)	(462,273)	—	—
2.	Domestic corporate shares	13,478	1.40%	—	(13,478)	(13,478)	—	—
(II)	Non-promoters' shares							
	Domestic corporate shares	21,566	2.25%	—	(21,566)	(21,566)	—	—
Total non-circulating shares		497,317	51.83%	—	(497,317)	(497,317)	—	—
II.	Circulating shares							
(I)	Restricted Shares							
1.	State owned corporate shares	—	—	—	392,080	392,080	392,080	40.86%
2.	Other domestic shares	1,025	0.11%	256	11,433	11,689	12,714	1.32%
	Including:							
	Domestic corporate shares	—	—	—	11,433	11,433	11,433	1.19%
	Domestic natural person shares	1,025	0.11%	256	—	256	1,281	0.13%
3.	Foreign shares							
	Foreign corporate shares	—	—	—	18,291	18,291	18,291	1.91%
Total number of restricted shares		1,025	0.11%	256	421,804	422,060	423,085	44.09%
(II).	Unrestricted shares							
1.	RMB ordinary shares	301,029	31.37%	75,257	—	75,257	376,286	39.22%
2.	Overseas listed foreign shares	160,151	16.69%	—	—	—	160,151	16.69%
Total number of unrestricted shares		461,180	48.06%	75,257	—	75,257	536,437	55.91%
Total circulating shares		462,205	48.17%	75,513	421,804	497,317	959,522	100.00%
III.	Total of shares	959,522	100.00%	75,513	(75,513)	—	959,522	100.00%

V. EXPLANATORY NOTES TO MAJOR ITEMS IN THE CONSOLIDATED FINANCIAL STATEMENTS (THE FOLLOWING REPRESENTS GROUP FIGURES UNLESS OTHERWISE STATED) (continued)

29. Capital reserve

	Amount at the beginning of the year	Increase in the period	Decrease in the period	Amount at the end of the year
Share premium	5,462,657	—	—	5,462,657
Provision for equity investments*	28,939	9,459	—	38,398
Provision for acceptance of non-cash asset donation	62	—	—	62
Other capital reserve**	—	5,307	—	5,307
	5,491,658	14,766	—	5,506,424

* The increase in equity investment provision was attributable to the acquisition of Nanfang Telecom by ZTE Soft, a subsidiary of the Group.

** Other capital reserve represented the disposal of accounts payable overdue for 3 years by the Group.

30. Surplus reserves

	Amount at the beginning of the year	Increase in the period	Decrease in the period	Amount at the end of the year
Statutory surplus reserve	733,350	185,802	—	919,152
Statutory public welfare fund	252,006	92,902	—	344,908
	985,356	278,704	—	1,264,060

In accordance with Article 177 of the Company Law and the Company's articles of association, and as resolved by the board of directors on 6 April 2006, 10% of the net profit of the Company was appropriated to the statutory surplus reserve. Such appropriation will cease when the reserve balance has reached 50% of the registered capital of the Company.

In accordance with Article 177 of the Company Law and the Company's articles of association, and as resolved by the board of directors on 6 April, 2006, 5% of the net profit of the Company was appropriated to the statutory public welfare fund.

The Company may make appropriation to its discretionary surplus reserve fund after appropriations to the statutory surplus reserve and the statutory public welfare fund. Upon approval, the discretionary surplus reserve can be utilized to make up prior years' losses or to increase capital.

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V. EXPLANATORY NOTES TO MAJOR ITEMS IN THE CONSOLIDATED FINANCIAL STATEMENTS (THE FOLLOWING REPRESENTS GROUP FIGURES UNLESS OTHERWISE STATED) (continued)

31. Undistributed profit

	At the beginning of the year	Increase during the year	Decrease during the year	Balance at year-end
	1,495,431	1,194,343	518,584	2,171,190

The decrease during the year comprised the payment of RMB2.5 in cash for every 10 shares or an aggregate of RMB239,880,000 on the basis of the total share capital as at 31 December 2005 according to the 2005 profit distribution plan declared by the sixteen meeting of the third session of the Board of Directors of the Company and transfers to the statutory surplus reserve and the statutory public welfare fund.

32. Revenue and cost of sales

Revenue from principal operations refers to the revenue from sale of products and labor services. Segment information of the Group and the Company is set out in the business and geographical segments described in note VI.

Sale to the top five customers of the Group generated revenue of RMB10,124,082,000 and RMB15,163,377,000 in 2005 and 2004 respectively, accounting for 46.92% and 66.80% of the sales revenue of the Group respectively.

33. Taxes and surcharges

	2005	2004
Business tax	16,499	31,532
City maintenance and construction tax	20,260	10,272
Education surcharge	44,632	29,108
Others	24,269	—
	105,660	70,912

Taxes and surcharges increased by 49%. The increase mainly reflected increased overseas taxes in tandem with growth in overseas sales.

34. Profit from other operations

	2005	2004
Sales of raw materials	—	27,841
Technology service and consultation fee	15,379	12,678
Others	400	820
	15,779	41,339

Profit from other operations decreased by 61.83%. The decreased mainly reflected decreased of sales of raw materials.

(All amounts in RMB'000 unless otherwise stated)

V. EXPLANATORY NOTES TO MAJOR ITEMS IN THE CONSOLIDATED FINANCIAL STATEMENTS (THE FOLLOWING REPRESENTS GROUP FIGURES UNLESS OTHERWISE STATED) (continued)

35. Finance Expenses

	2005	2004
Interest expenses	175,884	113,661
Less: Interest income	54,870	22,578
Gain/losses on exchange	48,390	16,130
Cash discounts and interest subsidy	59,746	138,508
Bank charges	59,601	39,257
	288,751	284,978

36. Investment income

The Group

	2005	2004
Gain from stock investment	—	12,140
Share of net gain/losses of jointly-controlled entities	(2,968)	650
Share of net gain/losses of associates	(1,716)	—
Gain on transfer of equity investment	1,598	—
Dividends received from investee companies	—	250
Amortization of differences in equity investment	(812)	(3,673)
Provision for impairment of long-term investments	—	(13,036)
Written off of long-term investments	(55,456)	—
	(59,354)	(3,669)

As at the balance sheet date, the Group was not subject to significant restrictions in remitting its investment income.

Investment loss in current year increased by RMB55,685,000, which was mainly due to written off of investment impairment of Zimax Technologies Inc.

The Company

	2005	2004
Share of net gain/losses of subsidiaries	925,160	1,164,640
Share of net gain/losses of associates	(1,698)	—
Share of net gain/losses of jointly-controlled entities	(1,381)	—
Gain/losses on transfer of equity investment	1,598	—
Dividends received from investee companies	—	250
Amortization of differences in equity investment	907	(1,954)
Provision for impairment of long-term investment	—	(13,036)
Written-off of long-term investments	(4,873)	—
	919,713	1,149,900

As at the balance sheet date, the Group was not subject to significant restrictions in remitting its investment income.

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V. EXPLANATORY NOTES TO MAJOR ITEMS IN THE CONSOLIDATED FINANCIAL STATEMENTS (THE FOLLOWING REPRESENTS GROUP FIGURES UNLESS OTHERWISE STATED) (continued)

37. Subsidies income

Item	2005	2004
Refund of VAT on software products*	435,326	345,066
Financial subsidies on essential new products	8,900	20,254
Preferential financial subsidies on new products	3,500	3,052
Subsidies granted on export sales	—	4,631
Others	10,288	5,695
	458,014	378,698

* Refund of VAT on software products represented the refund upon payment of VAT paid 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.

38. Non-operating income

	2005	2004
Gains from disposal of fixed assets	909	164
Income from penalty payment	9,367	5,155
Income from compensation payment	10,000	6,756
Reward income	5,107	—
Others	2,244	5,966
	27,627	18,041

Non-operating income increased by 53.13% mainly as a result of increased income from compensation and Reward income.

39. Non-operating expenses

	2005	2004
Provision for impairment of fixed assets	—	87,003
Provision for impairment of intangible assets	2	20,632
Net loss on written off of assets	7,072	43,785
Input VAT not offset in exports	—	3,447
Donations	2,218	—
Penalties	5,638	—
Others	1,792	5,770
	16,722	160,637

Non-operating expenses decreased by 89.59%. The decrease mainly reflected the decrease of fixed asset impairment provision, intangible asset impairment provision and written off of fixed assets.

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V. EXPLANATORY NOTES TO MAJOR ITEMS IN THE CONSOLIDATED FINANCIAL STATEMENTS (THE FOLLOWING REPRESENTS GROUP FIGURES UNLESS OTHERWISE STATED) (continued)

40. Other cash outflow from operating activities

Other cash outflow from operating activities in the consolidated cash flow statement at 31 December 2005 was RMB3,326,157,000, comprising mainly operating expenses and administrative expenses.

VI. SEGMENT INFORMATION BY INDUSTRY AND REGION

The Group

Items of principal operations	Revenue from principal operations		Costs of sales		Gross profit	
	2005	2004	2005	2004	2005	2004
Communication system construction income	17,016,057	16,540,980	10,208,099	9,119,506	6,807,958	7,421,474
Communication terminal equipment	4,333,082	6,014,967	3,574,985	5,150,790	758,097	864,177
Telecommunications service income	226,781	142,206	161,713	98,810	65,068	43,396
Total	21,575,920	22,698,153	13,944,797	14,369,106	7,631,123	8,329,047

Geographical segments	Revenue from principal operations		Cost of sales		Profits from principal operations	
	2005	2004	2005	2004	2005	2004
Domestic	13,874,309	17,803,600	9,364,085	11,796,644	4,510,224	6,006,956
Overseas	7,701,611	4,894,553	4,580,712	2,572,462	3,120,899	2,322,091
Total	21,575,920	22,698,153	13,944,797	14,369,106	7,631,123	8,329,047

The Company

Items of principal operations	Revenue from principal operations		Costs of sales		Gross profit	
	2005	2004	2005	2004	2005	2004
Communication system construction income	16,408,812	16,486,739	13,175,302	11,831,497	3,233,510	4,655,242
Communication terminal equipment	4,156,240	5,086,206	3,496,520	4,454,322	659,720	631,884
Total	20,565,052	21,572,945	16,671,822	16,285,819	3,893,230	5,287,126

Geographical segments	Revenue from principal operations		Cost of sales		Gross profit	
	2005	2004	2005	2004	2005	2004
Domestic	13,439,004	17,545,832	10,925,688	13,708,115	2,513,316	3,837,717
Overseas	7,126,048	4,027,113	5,746,134	2,577,704	1,379,914	1,449,409
Total	20,565,052	21,572,945	16,671,822	16,285,819	3,893,230	5,287,126

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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	At the beginning of the year RMB'000	Addition in the period RMB'000	Reduction in the period RMB'000	At the end of the year RMB'000
Shenzhen Zhongxingxin Telecommunications Equipment Company, Limited	10,000	—	—	10,000

The amount was RMB10,000,000 at the beginning and the end of the year. No movements were recorded during the year.

3. Movements in shares or equity held by connected parties with controlling relationship:

Name of corporation	At the beginning of the period		Addition in the period		Reduction in the period		At the end of the period	
	Amount	%	Amount	%	Amount	%	Amount	%
Shenzhen Zhongxingxin Telecommunications Equipment Company, Limited	423,222	44.11%	—	—	64,263	6.70%	358,959	37.41%

Changes in the shareholding of the controlling shareholders were attributable to the Group's share reform plan. Please refer to Note V.28 for details of the shareholding structure following the share reform plan.

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 are as follow:

Name of related companies	Relationship with the Company
Shenzhen Zhongxing WXT Equipment Company, Ltd.	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
Shenzhen Lead Communications Company, Limited*	Under the same controlling shareholder as the Company
Beijing Yuanjing Technology Co., Ltd.	Associate
Shenzhen Zhongxing Xindi Telecommunications Equipment Company, Limited	Under the same controlling shareholder as the Company
Xi'an Microelectronics Technology Research Institute	Shareholder of the Company's controlling shareholder
Lishan Microelectronics Research Institute	Shareholder of the Company
Beijing Zhongxingxin Communication Equipment Company, Limited	Subsidiary jointly-controlled by the Company
Beijing Zhongxing Intelligent Transportation Systems Ltd. [#]	Entity in which the Company holds an equity interest
Shenzhen Zhongxing Xinyu FPC Company, Limited	Under the same controlling shareholder as the Company
Shenzhen Gaodonghua Communication Technology Co., Ltd.	Partially holding company of the shareholder of the Company's controlling shareholder
Beijing Xieli Chaoyue Science Technology Co., Ltd.	Controlling 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
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 Lead Communications Company, Limited has been acquired by Shenzhen Changfei Investment Company, Limited, the holding subsidiary of the Company in March 2004, and has been combined in the consolidated financial statements of the Company, rather than as a related company after the acquisition.

[#] Beijing Zhongxing Intelligent Transportation Systems Ltd was no longer considered an associate as the Company no longer exercised significant influence over Beijing Zhongxing Intelligent Transportation Systems Ltd following a share transfer in July 2005 that reduced the Company's effective control over Beijing Zhongxing Intelligent Transportation Systems Ltd to less than 20%.

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VII. RELATIONSHIP WITH CONNECTED PARTIES AND CONNECTED TRANSACTIONS (continued)

5. Major transactions between the Group and related companies during the year are as follow:

(1) Sales of goods to the connected parties:

Item	Names of companies	2005	2004
Sales of goods	Shenzhen Zhongxing Information Technology Co., Ltd.	7,910	3,435
	Shenzhen Zhongxingxin Telecommunications Equipment Company, Limited	545	1
	Beijing Zhongxingxin Communication Equipment Company Limited	3,248	10,904
	Beijing Zhongxing Yuanjing Technology Co., Ltd.	2,815	13,945
	Shenzhen Lead Communications Company, Limited*	—	43,577
	Beijing Zhongxing Intelligent Transportation Systems Ltd.	4,265	16,591
	Xi'an Microelectronics Technology Research Institute	6,478	52,547
	Beijing Xieli Chaoyue Science Technology Co., Ltd.	—	228
	Shenzhen Zhongxing Development Co., Ltd.	—	2,982
	ZTE IC Design Co., Ltd	9,025	—
	Shenzhen Zhongxing WXT Equipment Company, Ltd.	5,233	1,580
	Shenzhen Zhongxing Xindi Telecommunications Equipment Company, Limited	13	—

* The amount involved in related-party transactions between the Company and Shenzhen Lead Communications Company, Limited was the transaction amount before that company was consolidated in the Company in January to March of 2004.

(2) Purchase of raw materials from connected parties:

Item	Names of companies	2005	2004
Purchase of raw materials	Shenzhen Zhongxingxin Telecommunications Equipment Company, Limited	311,970	254,467
	Shenzhen Zhongxing WXT Equipment Company, Ltd.	184,326	107,842
	Shenzhen Zhongxing Xindi Telecommunications Equipment Company, Limited	84,327	145,659
	Shenzhen Zhongxing Information Technology Co., Ltd.	16,163	7,301
	Xi'an Microelectronics Technology Research Institute	7,718	12,103
	Shenzhen Zhongxing Xinyu FPC Company, Limited	41,623	6,686
	Beijing Zhongxingxin Communication Equipment Company Limited	89	266
	Shenzhen Lead Communications Company, Limited*	—	39,747
	Shenzhen Gaodonghua Communication Technology Co., Ltd.	—	12,034
	Chung Hing (Hong Kong) Development Limited	8,166	1,500
	ZTE IC Design Co., Ltd.	36,380	—
	WuXi KaiEr Science and Technology Company, Limited	11,957	—
	Shenzhen Decang Technology Company Limited	5,874	—

* The amount involved in connected transactions between the Company and Shenzhen Lead Communications Company, Limited was the transaction amount before that company was consolidated in the Company in January to March of 2004.

(3) Other major related transaction

Item	2005	2004
Conversion of equities	1,024	—

Notes:

- (1) Sales of goods to connected parties: Goods were sold to connected parties by the Company at the market price during the year.
- (2) Purchase of raw materials from connected parties: Raw materials, parts and ancillary materials were purchased by Company from connected parties at the market price during the year.
- (3) Other major connected transactions: During the year, the Company acquired from Beijing Zhongxingxin Communication Equipment Company Limited a 19% interest in Beijing Zhongxing Intelligent Transportation Systems Ltd at an agreed price.

NOTES TO FINANCIAL STATEMENTS

(Prepared under PRC GAAP)

(All amounts in RMB'000 unless otherwise stated)

VII. RELATIONSHIP WITH CONNECTED PARTIES AND CONNECTED TRANSACTIONS (continued)

6. Amounts due from/to connected parties

Items	Name of connected parties	Amount at the end of the period	Amount at the beginning of the period
Accounts payable	Shenzhen Zhongxingxin Telecommunications Equipment Company, Limited	104,563	51,168
	Shenzhen Zhongxing WXT Equipment Company, Ltd.	65,870	31,325
	Shenzhen Zhongxing Information Technology Co., Ltd.	14,910	3,487
	Shenzhen Zhongxing Xinyu FPC Company, Limited	6,005	2,057
	Shenzhen Zhongxing Xindi Telecommunications Equipment Company, Limited	27,490	17,939
	Shenzhen Gaodonghua Communication Technology Co., Ltd.	1,408	5,046
	Beijing Zhongxingxin Communication Equipment Company Limited	182	93
	Xi'an Microelectronics Technology Research Institute	2,616	3,923
	Chung Hing (Hong Kong) Development Limited	954	—
	ZTE IC Design Co., Ltd	11,067	—
	Shenzhen Decang Technology Company Limited	3,156	—
Other payables	Shenzhen Zhongxingxin Telecommunications Equipment Company, Limited	313	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	—
Notes payables	Shenzhen Zhongxing WXT Equipment Company, Ltd.	3,040	—
	Shenzhen Gaodonghua Communication Technology Co., Ltd.	—	8,448
	Shenzhen Zhongxing Xinyu FPC Company, Limited	3,173	—
	Shenzhen Zhongxing Information Technology Co., Ltd.	401	—
	ZTE IC Design Co., Ltd	775	—
	Shenzhen Decang Technology Company Limited	559	—
Accounts prepaid	Shenzhen Zhongxing WXT Equipment Company, Ltd.	—	613
	Shenzhen Zhongxing Information Technology Co., Ltd.	3,464	2,663
Other receivables	Xi'an Microelectronics Technology Research Institute	—	65
	Lishan Microelectronics Research Institute	—	565
	Shenzhen Zhongxing Information Technology Co., Ltd.	1,038	1,038
	China Precision Machinery Import and Export Shenzhen Company	—	1,394
Trade receivables	Shenzhen Zhongxingxin Telecommunications Equipment Company, Limited	177	169
	Shenzhen Zhongxing WXT Equipment Company, Ltd.	9,053	2,930
	Beijing Zhongxing Yuanjing Technology Co., Ltd.	—	3,187
	Shenzhen Zhongxing Information Technology Co., Ltd.	3,062	1,246
	Beijing Zhongxingxin Communication Equipment Company Limited	2,070	—
	ZTE IC Design Co., Ltd	2,150	—
Advances from customers	Xi'an Microelectronics Technology Research Institute	154	93
	Beijing Zhongxingxin Communication Equipment Company Limited	—	847
	Beijing Zhongxing Yuanjing Technology Co., Ltd.	765	—
	Beijing Zhongxing Intelligent Transportation Systems Ltd.	—	1,082
Dividends payable	Shenzhen Zhongxing WXT Equipment Company, Ltd.	14,837	12,087
	Lishan Microelectronics Research Institute	936	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 are interest-free, unsecured and have no fixed terms of repayment.

NOTES TO FINANCIAL STATEMENTS

(Prepared under PRC GAAP)

(All amounts in RMB'000 unless otherwise stated)

VIII. CONTINGENT EVENTS

1. In November 2005, a Jiangsu Provincial Higher People's 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 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. 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.
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 has 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 has valid defences against the claims brought in the arbitration, the directors currently believe 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 has been made in the financial statements.

3. On 18 August 2005, the Company received a notice of arbitration from a foreign consultant in respect of (i) a claim of consultancy fee of approximately USD90,000 (equivalent to approximately RMB726,000); (ii) a claim of agency fee of approximately USD1,190,314 (equivalent to approximately RMB9,606,000); (iii) a compensation claim of approximately USD50,000 (equivalent to approximately RMB404,000) for harassment and undue delay in honoring of a consultancy agreement.

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 has 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, the subsidiary of the Group in Pakistan has 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 of additional custom duties of approximately Rs.177 million (equivalent to approximately RMB23.9 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. On 5 September 2005, all disputes between the parties relating to this action were referred to Alternate Dispute Resolution Committee ("the Committee") for resolution and 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 custom duties would be in the order of approximately Rs.36 million (equivalent to approximately RMB4.8 million) and have been accrued in the Group's financial statements for the year ended 31 December 2005. 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 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.

5. As at 31 December 2005, the Group had outstanding bank guarantees amounting RMB2,823,760,000.

NOTES TO FINANCIAL STATEMENTS

(Prepared under PRC GAAP)

(All amounts in RMB'000 unless otherwise stated)

IX. COMMITMENTS

	2005	2004
Capital commitments		
Contracted but not provided for	231,561	282,446
Lease commitments	183,425	149,323
Investment commitments	21,065	—
	436,051	431,769

X. POST BALANCE SHEET EVENT

As at the approval date of the financial statements, the Group had no discloseable post balance sheet events.

XI. COMPARATIVE AMOUNTS

Certain comparative amounts have been restated to conform with the current year's presentation. In order to reflect the Group's business more accurately, we have reclassified the opening balances of our financial statements as follows:

The Group	Before reclassification	After reclassification
Inventories	4,643,758	1,871,767
Amount due from customers for contract work	—	2,752,024
Fixed assets — cost	2,725,769	2,785,789
Fixed assets — accumulated depreciation	793,323	830,873
Long-term prepaid expenses	23,785	1,315
Amount due to customers for contract work	—	2,318,731
Advances from customers	2,630,721	292,023
The Company	Before reclassification	After reclassification
Inventories	4,808,259	1,350,130
Amount due from customers for contract work	—	3,414,540
Amount due to customers for contract work	—	2,162,901
Advances from customers	2,455,494	249,004

In order to reflect the financial conditions of construction contracts more accurately, receipts from construction contract work in progress are recorded as amount due from customers for contract work or amount due to customers for contract work. The amount of contract costs incurred to date plus recognised gross profit (loss) of an individual contract work in excess of progress billings is recognised as amount due from customers for contract work; whereas, the amount of progress billings in excess of contract costs incurred to date plus recognised gross profit (loss) of an individual contract work is recognised as amount due to customers for contract work.

XII. APPROVAL OF FINANCIAL STATEMENTS

The financial statements were resolved and approved by the Board of Directors of the Company on 6 April 2006.

APPENDIX

(All amounts in RMB'000 unless otherwise stated)

I 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 AS") and the financial statements prepared under the Hong Kong Financial Reporting Standard are as follow:

	2005		2004	
	Net profit	Net asset	Net profit	Net asset
Under PRC AS	1,194,343	10,125,095	1,008,870	9,174,439
Differences in accounting standards				
Technology grants and research expenses under different accounting standards	106,740	177,182	(24,434)	69,589
Provision for retirement benefits under accounting standards generally accepted in Hong Kong	(1,536)	(30,459)	(1,733)	(28,923)
Recognition of excess over the cost of business combination	9,460	—	—	—
Deferred tax debit	(21,306)	(21,306)	—	—
Adjustments to previous financial statements as a result of changes in accounting estimates	—	—	289,786	—
Others	—	—	—	2,047
Prepared under Hong Kong financial reporting standards	1,287,701	10,250,512	1,272,489	9,217,152

(All amounts in RMB'000 unless otherwise stated)

II Fully diluted and weighted average net return on assets and earnings per share

	Profit for the reporting period	Return on net assets		Earnings per share	
		Fully diluted	Weighted average	Fully diluted	Weighted average
Profit from principal operations	7,525,463	74.33%	78.13%	7.84	7.84
Operating profit	1,092,299	10.79%	11.34%	1.14	1.14
Net profit	1,194,343	11.80%	12.40%	1.24	1.24
Net profit after extraordinary items	1,212,926	11.98%	12.59%	1.26	1.26

Net profits after extraordinary items are listed below:

	2005
Net profit	1,194,343
Add(less):	
Subsidy income	(22,688)
Non-operating income	(27,627)
Non-operating expenses	16,722
Impairment of difference in equity investment	55,455
Income tax effect on extraordinary items	(3,279)
Net profit after extraordinary items	1,212,926

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.

APPENDIX

(All amounts in RMB'000 unless otherwise stated)

III Breakdown of provisions for asset impairment

	Balance at the beginning	Addition during the year	Reduction during the year Other reasons	Balance at year end
I. Provision of bad debt	907,098	705,215	(439,102)	1,173,211
Including: Trade receivables	429,605	217,537	(201,896)	445,246
Other receivables	477,493	487,678	(237,206)	727,965
II. Provision for impairment of inventories	419,773	96,185	—	515,958
Including: Raw materials	86,161	—	—	86,161
Materials under sub-contract processing	—	1,599	—	1,599
Work in progress	—	5,779	—	5,779
Finished goods	333,612	88,807	—	422,419
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	—	—	94,980
Including: buildings	7,708	—	—	7,708
Machinery	1,475	—	—	1,475
Electronic equipment	85,797	—	—	85,797
V. Provision for impairment of intangible assets	26,954	2	—	26,956
Including: land use rights	6,322	—	—	6,322
Software	12,882	2	—	12,884
Operating concession	7,750	—	—	7,750

STATEMENT OF CHANGES IN SHAREHOLDERS' EQUITY

(All amounts in RMB'000 unless otherwise stated)

	2005	2004
I. Share capital		
Balance at the beginning	959,522	667,296
Addition during the year	—	293,610
Including: Transfer from capital reserve	—	—
Transfer from surplus reserve	—	—
Transfer from profit allocation	—	—
Share capital as enlarged by issue of new shares	—	160,151
Bonus share issue	—	133,459
Reduction during the year	—	(1,384)
Balance at year-end	959,522	959,522
II. Capital reserve		
Balance at the beginning	5,491,658	2,106,043
Addition during the year	14,766	3,385,615
Including: share capital premium	—	3,383,411
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	2,204
Others	5,307	—
Reduction during the year	—	—
Including: transfer to share capital	—	—
Balance at year-end	5,506,424	5,491,658
III. Statutory and discretionary surplus reserves		
Balance at the beginning	733,350	410,038
Addition during the year	185,802	323,312
Including: Appropriations from net profit	185,802	323,312
Transfer from statutory public welfare fund	—	—
Reduction during the year	—	—
Including: making up of losses	—	—
Transfer to share capital	—	—
Distribution of cash dividend	—	—
Distribution of scrip dividend	—	—
Balance at year-end	919,152	733,350
Including: Statutory surplus reserve	919,152	733,350

STATEMENT OF CHANGES IN SHAREHOLDERS' EQUITY

(All amounts in RMB'000 unless otherwise stated)

	2005	2004
IV. Statutory public welfare fund		
Balance at the beginning	252,006	214,053
Addition during the year	92,902	37,953
Including: Appropriations from net profit	92,902	37,953
Reduction during the year	—	—
Including: Expenses for acquisition and construction of staff housing	—	—
Other expenses on public welfare	—	—
Balance at year-end	344,908	252,006
V. Undistributed profits at the beginning of year	1,495,431	1,221,165
Net profit for the year	1,194,343	1,008,870
Profit distribution for the year	(518,584)	(734,604)
Undistributed profits at year-end	2,171,190	1,495,431



To the members
ZTE Corporation
(Incorporated in the People's Republic of China with limited liability)

We have audited the financial statements on pages 182 to 255 which have been prepared in accordance with accounting principles generally accepted in Hong Kong.

RESPECTIVE RESPONSIBILITIES OF DIRECTORS AND AUDITORS

The Company's directors are responsible for the preparation of financial statements which give a true and fair view. In preparing financial statements which give a true and fair view, it is fundamental that appropriate accounting policies are selected and applied consistently. It is our responsibility to form an independent opinion, based on our audit, on those financial statements and to report our opinion 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.

BASIS OF OPINION

We conducted our audit in accordance with Hong Kong Standards on Auditing issued by the Hong Kong Institute of Certified Public Accountants. An audit includes an examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements. It also includes an assessment of the significant estimates and judgements made by the directors in the preparation of the financial statements, and of whether the accounting policies are appropriate to the Company's and the Group's circumstances, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance as to whether the financial statements are free from material misstatement. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the financial statements. We believe that our audit provides a reasonable basis for our 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 2005 and of the profit and cash flows of the Group for the year then ended and have been properly prepared in accordance with the disclosure requirements of the Hong Kong Companies Ordinance.

Ernst & Young
Certified Public Accountants
Hong Kong
6 April 2006

CONSOLIDATED INCOME STATEMENT

(Prepared under Hong Kong accounting standards)

Year ended 31 December 2005

	Notes	2005 RMB'000	2004 RMB'000 (Restated)
REVENUE	4	21,575,920	21,220,062
Cost of sales		(14,101,720)	(13,813,530)
Gross profit		7,474,200	7,406,532
Other income and gains	4	681,646	534,129
Research and development costs		(1,959,543)	(2,265,211)
Selling and distribution costs		(3,186,442)	(2,799,630)
Administrative expenses		(1,095,400)	(981,420)
Other operating expenses		(128,605)	(162,352)
Finance costs	6	(175,884)	(140,397)
Share of profits and losses of:			
Jointly-controlled entities		(1,198)	3,105
Associates		(2,969)	32
PROFIT BEFORE TAX	5	1,605,805	1,594,788
Tax	9	(179,851)	(114,954)
PROFIT FOR THE YEAR		1,425,954	1,479,834
Attributable to:			
Equity holders of the parent	10	1,287,701	1,272,489
Minority interests		138,253	207,345
		1,425,954	1,479,834
DIVIDEND			
Proposed final	11	239,880	239,880
EARNINGS PER SHARE ATTRIBUTABLE TO ORDINARY EQUITY HOLDERS OF THE PARENT			
Basic	12	RMB1.34	RMB1.57

CONSOLIDATED BALANCE SHEET

(Prepared under Hong Kong accounting standards)

31 December 2005

	Notes	2005 RMB'000	2004 RMB'000 (Restated)
NON-CURRENT ASSETS			
Property, plant and equipment	14	2,470,965	1,935,131
Prepaid land premiums/land lease payments	15	55,062	53,095
Intangible assets	16	335,835	207,949
Goodwill	17	—	5,684
Investments in jointly-controlled entities	19	6,588	7,786
Investments in associates	20	35,583	8,845
Available-for-sale equity investments/long-term investments	21	43,288	44,347
Long-term trade receivables	24	307,666	88
Factored long-term trade receivables	25	687,765	—
Deferred tax assets	35	59,587	104,681
Total non-current assets		4,002,339	2,367,606
CURRENT ASSETS			
Prepaid land premiums/land lease payments	15	1,418	1,361
Inventories	22	2,240,327	1,725,067
Amount due from customers for contract work	23	4,689,157	2,752,024
Trade and bills receivables	24	4,686,775	5,912,181
Factored trade receivables	25	36,416	—
Prepayments, deposits and other receivables	26	1,188,313	651,301
Loan receivables	27	46,165	—
Pledged bank deposits	28	175,899	88,978
Cash and cash equivalents	28	5,397,233	7,509,245
Total current assets		18,461,703	18,640,157
CURRENT LIABILITIES			
Trade and bills payables	29	6,269,792	4,341,111
Amount due to customers for contract work	23	733,455	2,318,731
Other payables and accruals	30	2,900,137	2,768,159
Interest-bearing bank borrowings	31	599,695	421,695
Bank advances on factored trade receivables	25	36,416	—
Tax payable		114,672	230,719
Dividend payables		163,008	40,921
Total current liabilities		10,817,175	10,121,336
NET CURRENT ASSETS		7,644,528	8,518,821
TOTAL ASSETS LESS CURRENT LIABILITIES		11,646,867	10,886,427

continued/...

CONSOLIDATED BALANCE SHEET (continued)

(Prepared under Hong Kong accounting standards)

31 December 2005

	Notes	2005 RMB'000	2004 RMB'000 (Restated)
NON-CURRENT LIABILITIES			
Interest-bearing bank borrowings	31	80,000	1,025,262
Bank advances on factored long-term trade receivables	25	687,765	—
Provision for retirement benefits	32	30,459	28,923
Other long-term payables	33	127,402	136,710
Total non-current liabilities		925,626	1,190,895
Net assets		10,721,241	9,695,532
EQUITY			
Equity attributable to equity holders of the parent			
Issued capital	36	959,522	959,522
Reserves	37(a)	9,051,110	8,017,750
Proposed final dividend	11	239,880	239,880
		10,250,512	9,217,152
Minority interests		470,729	478,380
Total equity		10,721,241	9,695,532

Hou Weigui
Director

Yin Yimin
Director

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

(Prepared under Hong Kong accounting standards)

Year ended 31 December 2005

	Note	Attributable to equity holders of the parent						Minority interests RMB'000	Total Equity RMB'000
		Issued share capital RMB'000	Capital reserve 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 2004		667,296	2,079,104	720,208	1,043	932,091	200,188	4,599,930	4,826,483
Issue of bonus shares		133,459	—	—	—	(133,459)	—	—	—
Issue of H shares		160,151	3,574,571	—	—	—	—	3,734,722	3,734,722
Conversion of state-owned equity interest shares		(1,384)	(29,475)	—	—	—	—	(30,859)	(30,859)
Share issue expenses		—	(161,685)	—	—	—	—	(161,685)	(161,685)
Exchange realignments		—	—	—	2,743	—	—	2,743	906
Total income and expense for the year recognised directly in equity		—	—	—	2,743	—	—	2,743	906
Net profit for the year		—	—	—	—	1,272,489	—	1,272,489	207,345
Total income and expense for the year		—	—	—	2,743	1,272,489	—	1,275,232	208,251
Final 2003 dividend declared		—	—	—	—	—	(200,188)	(200,188)	—
Transfer from retained profits		—	—	265,148	—	(265,148)	—	—	—
Proposed final 2004 dividend	11	—	—	—	—	(239,880)	239,880	—	—
Capital contributions by minority shareholders		—	—	—	—	—	—	—	39,112
Acquisition of subsidiaries		—	—	—	—	—	—	—	6,921
Dividends paid to minority shareholders		—	—	—	—	—	—	—	(2,457)
At 31 December 2004 and 1 January 2005		959,522	5,462,515	985,356	3,786	1,566,093	239,880	9,217,152	478,380
Exchange realignments and other income recognised directly in equity		—	5,306	—	(19,767)	—	—	(14,461)	(3,111)
Total income and expense for the year recognised directly in equity		—	5,306	—	(19,767)	—	—	(14,461)	(3,111)
Net profit for the year		—	—	—	—	1,287,701	—	1,287,701	138,253
Total income and expense for the year		—	5,306	—	(19,767)	1,287,701	—	1,273,240	135,142
Final 2004 dividend declared		—	—	—	—	—	(239,880)	(239,880)	—
Acquisition of subsidiaries		—	—	—	—	—	—	—	19,115
Disposal of subsidiaries		—	—	—	—	—	—	—	(11,555)
Acquisition of minority interest		—	—	—	—	—	—	—	(9,704)
Dividends declared to minority shareholders		—	—	—	—	—	—	—	(122,087)
Dividends paid to minority shareholders		—	—	—	—	—	—	—	(43,789)
Capital contributions by minority shareholders		—	—	—	—	—	—	—	25,227
Transfer from retained profits		—	38,603	278,704	—	(317,307)	—	—	—
Proposed final 2005 dividend	11	—	—	—	—	(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

* These reserve accounts comprise the consolidated reserves of approximately RMB9,051,110,000 (2004: RMB8,017,750,000) in the consolidated balance sheet.

CONSOLIDATED CASH FLOW STATEMENT

(Prepared under Hong Kong accounting standards)

Year ended 31 December 2005

	Notes	2005 RMB'000	2004 RMB'000 (Restated)
CASH FLOWS FROM OPERATING ACTIVITIES			
Profit before tax		1,605,805	1,594,788
Adjustments for:			
Finance costs	6	175,884	140,397
Share of profits and losses of jointly-controlled entities		1,198	(3,105)
Share of profits and losses of associates		2,969	(32)
Interest income	4	(54,870)	(30,118)
Government grants	4	(139,491)	(68,710)
Depreciation	5	386,859	279,797
Recognition of prepaid land lease payments	15	1,317	1,360
Provision against inventory obsolescence and net realisable value	5	96,185	279,575
Provision for bad and doubtful debts	5	15,642	100,027
Amortisation and impairment of goodwill	5, 17	56,267	17,733
Amortisation of intangible assets	5, 16	82,735	79,846
Impairment of intangible assets	5, 16	—	7,847
Loss on disposal of items of property, plant and equipment	5	6,163	11,654
Loss on retirement and disposal of intangible assets	5	70	19,605
Loss on disposal of interests in subsidiaries	5	2,057	—
Gain on deemed disposal of interests in a subsidiary	4	(3,655)	—
Gain on disposal of short-term investments	4	—	(12,139)
Excess over the cost of business combinations/ negative goodwill recognised	4	(12,236)	(4,770)
Operating profit before working capital changes		2,222,899	2,413,755
(Increase)/decrease in long-term trade receivables		(307,578)	102,868
Increase in inventories		(733,796)	(657,672)
(Increase)/decrease in amount due from customers for contract work		(1,937,133)	900,967
(Increase)/decrease in trade and bills receivables		1,217,673	(757,033)
Increase in prepayments, deposits and other receivables		(526,433)	(171,933)
Increase in loan receivables		(46,165)	—
Increase/(decrease) in trade and bills payables		1,943,636	(168,656)
Decrease in amount due to customers for contract work		(1,585,276)	(452,273)
Increase in other payables and accruals		121,791	464,587
Increase in other long-term payables		—	4,978
Increase in factored trade receivables		(36,416)	—
Increase in factored long-term trade receivables		(687,765)	—
Bank advances on factored trade receivables		724,181	—
Cash generated from operations		369,618	1,679,588

continued/...

CONSOLIDATED CASH FLOW STATEMENT (continued)

(Prepared under Hong Kong accounting standards)

Year ended 31 December 2005

	Notes	2005 RMB'000	2004 RMB'000 (Restated)
CASH FLOWS FROM OPERATING ACTIVITIES			
Cash generated from operations		369,618	1,679,588
Interest received		54,870	30,118
Interest and other finance costs paid		(175,884)	(140,397)
Hong Kong profits tax (paid)/refunded		(6,588)	2,239
PRC taxes paid		(217,663)	(116,863)
Overseas taxes paid		(26,553)	(9,650)
Dividends received from jointly-controlled entities		—	700
Dividends paid		(239,880)	(203,322)
Dividends paid to minority shareholders		(43,789)	(2,457)
Net cash inflow/(outflow) from operating activities		(285,869)	1,239,956
CASH FLOWS FROM INVESTING ACTIVITIES			
Purchase of leasehold land		(3,341)	(414)
Purchases of items of property, plant and equipment		(803,781)	(646,554)
Proceeds from disposal of items of property, plant and equipment		3,727	5,754
Additions to intangible assets		(206,768)	(56,703)
Receipt of government grants		133,999	109,855
Purchases of available-for-sale equity investments/long-term investments		(1,999)	(34,500)
Purchase of short-term investments		—	(82,891)
Proceeds from disposal of short-term investments		—	95,030
Acquisition of associates		(16,307)	(8,513)
Acquisition of subsidiaries	38	(51,449)	(7,602)
Acquisition of minority interests		(3,200)	(2,146)
Disposal of subsidiaries	39	(31,224)	—
(Increase)/decrease in pledged time deposits		(86,921)	8,107
Net cash outflow from investing activities		(1,067,264)	(620,577)

continued/...

CONSOLIDATED CASH FLOW STATEMENT (continued)

(Prepared under Hong Kong accounting standards)

Year ended 31 December 2005

	Notes	2005 RMB'000	2004 RMB'000 (Restated)
CASH FLOWS FROM FINANCING ACTIVITIES			
Net proceeds from issue of H shares		—	3,573,037
Capital contributions by minority shareholders		25,227	39,112
New bank loans		108,695	1,768,029
Repayment of bank loans		(868,967)	(2,065,965)
Net cash inflow/(outflow) from financing activities		(735,045)	3,314,213
NET INCREASE/(DECREASE) IN CASH AND CASH EQUIVALENTS		(2,088,178)	3,933,592
Cash and cash equivalents at beginning of year		7,509,245	3,572,867
Effect of foreign exchange rate changes, net		(23,834)	2,786
CASH AND CASH EQUIVALENTS AT END OF YEAR		5,397,233	7,509,245
ANALYSIS OF BALANCES OF CASH AND CASH EQUIVALENTS			
Cash and bank balances	28	4,178,498	4,775,748
Non-pledged time deposits with original maturity of less than three months when acquired		1,218,735	2,733,497
		5,397,233	7,509,245

BALANCE SHEET

(Prepared under Hong Kong accounting standards)

31 December 2005

	Notes	2005 RMB'000	2004 RMB'000 (Restated)
NON-CURRENT ASSETS			
Property, plant and equipment	14	1,718,547	1,393,004
Prepaid land premiums/land lease payments	15	49,406	49,435
Intangible assets	16	268,427	159,835
Investments in subsidiaries	18	408,868	396,283
Investments in jointly-controlled entities	19	2,500	2,500
Investments in associates	20	24,707	4,013
Available-for-sale equity investments/long-term investments	21	41,288	40,264
Long-term trade receivables	24	327,122	—
Factored long-term trade receivables	25	683,598	—
Deferred tax assets	35	55,113	76,475
Total non-current assets		3,579,576	2,121,809
CURRENT ASSETS			
Prepaid land premiums/land lease payments	15	1,300	1,279
Inventories	22	1,278,092	1,203,430
Amount due from customers for contract work	23	4,440,842	3,414,540
Trade and bills receivables	24	5,690,947	6,256,867
Factored trade receivables	25	5,007	—
Prepayments, deposits and other receivables	26	2,239,947	1,224,398
Pledged bank deposits	28	46,126	44,512
Cash and cash equivalents	28	4,212,810	6,418,653
Total current assets		17,915,071	18,563,679
CURRENT LIABILITIES			
Trade and bills payables	29	8,457,453	6,748,602
Amount due to customers for contract work	23	688,876	2,162,901
Other payables and accruals	30	2,590,981	2,604,125
Interest-bearing bank borrowings	31	500,000	340,344
Bank advances on factored trade receivables	25	5,007	—
Tax payable		63,974	221,647
Dividend payables		928	920
Total current liabilities		12,307,219	12,078,539
NET CURRENT ASSETS		5,607,852	6,485,140
TOTAL ASSETS LESS CURRENT LIABILITIES		9,187,428	8,606,949

continued/...

BALANCE SHEET (continued)

(Prepared under Hong Kong accounting standards)

31 December 2005

	Notes	2005 RMB'000	2004 RMB'000 (Restated)
NON-CURRENT LIABILITIES			
Interest-bearing bank borrowings	31	—	950,000
Bank advances on factored long-term trade receivables	25	683,598	—
Provision for retirement benefits	32	30,459	28,923
Other long-term payables	33	81,111	82,000
Total non-current liabilities		795,168	1,060,923
Net assets		8,392,260	7,546,026
EQUITY			
Issued capital	36	959,522	959,522
Reserves	37(b)	7,192,858	6,346,624
Proposed final dividend	11	239,880	239,880
Total equity		8,392,260	7,546,026

Hou Weigui
Director

Yin Yimin
Director

NOTES TO FINANCIAL STATEMENTS

(Prepared under Hong Kong accounting standards)

31 December 2005

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 parent 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 equity investments, which have been measured at fair value. These financial statements are presented in Renminbi ("RMB") and all values are rounded to the nearest thousand except when otherwise indicated.

Basis of consolidation

The consolidated financial statements include the financial statements of the Company and its subsidiaries for the year ended 31 December 2005. 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 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 in the results and net assets of the Company's subsidiaries.

NOTES TO FINANCIAL STATEMENTS

(Prepared under Hong Kong accounting standards)

31 December 2005

2.2 IMPACT OF NEW AND REVISED HONG KONG FINANCIAL REPORTING STANDARDS

The following new and revised HKFRSs affect the Group and are adopted for the first time for the current year's financial statements:

HKAS 1	Presentation of Financial Statements
HKAS 2	Inventories
HKAS 7	Cash Flow Statements
HKAS 8	Accounting Policies, Changes in Accounting Estimates and Errors
HKAS 10	Events after the Balance Sheet Date
HKAS 11	Construction Contracts
HKAS 12	Income Taxes
HKAS 14	Segment Reporting
HKAS 16	Property, Plant and Equipment
HKAS 17	Leases
HKAS 18	Revenue
HKAS 19	Employee Benefits
HKAS 20	Accounting for Government Grants and Disclosure of Government Assistance
HKAS 21	The Effects of Changes in Foreign Exchange Rates
HKAS 23	Borrowing Costs
HKAS 24	Related Party Disclosures
HKAS 27	Consolidated and Separate Financial Statements
HKAS 28	Investments in Associates
HKAS 31	Interests in Joint Ventures
HKAS 32	Financial Instruments: Disclosure and Presentation
HKAS 33	Earnings per Share
HKAS 36	Impairment of Assets
HKAS 37	Provisions, Contingent Liabilities and Contingent Assets
HKAS 38	Intangible Assets
HKAS 39	Financial Instruments: Recognition and Measurement
HKAS 39 Amendment	Transition and Initial Recognition of Financial Assets and Financial Liabilities
HKFRS 3	Business Combinations
HKAS Int-10	Government Assistance — No Specific Relation to Operating Activities (HKAS 20)
HKAS Int-13	Jointly Controlled Entities — Non-monetary Contributions by Venturers
HKAS Int-15	Operating Leases — Incentives
HKAS Int-21	Income Taxes — Recovery of Revalued Non-Depreciable Assets
HKAS Int-27	Evaluating the Substance of Transactions Involving the Legal Form of a Lease
HKAS Int-29	Disclosure — Service Concession Arrangements

The adoption of HKASs 2, 7, 8, 10, 11, 12, 14, 16, 18, 19, 20, 23, 27, 28, 31, 33, 36, 37, 38, HKFRS 3, HKAS-Int-10, 13, 15, 21, 27 and 29 has had no material impact on the accounting policies of the Group and the Company and the methods of computation in the Group's and the Company's financial statements.

HKAS 1 has affected the presentation of minority interests on the face of the consolidated balance sheet, consolidated income statement, consolidated statement of changes in equity and other disclosures. In addition, in prior periods, the Group's share of tax attributable to associates and jointly-controlled entities was presented as a component of the Group's total tax charge in the consolidated income statement. Upon the adoption of HKAS 1, the Group's share of the post-acquisitions results of associates and jointly-controlled entities is presented net of the Group's share of tax attributable to associates and jointly-controlled entities.

2.2 IMPACT OF NEW AND REVISED HONG KONG FINANCIAL REPORTING STANDARDS (continued)

HKAS 21 had no material impact on the Group. As permitted by the transitional provisions of HKAS 21, goodwill arising in a business combination prior to 1 January 2005 and fair value adjustments arising on that acquisition are deemed to be in the currency of the Company. In respect of acquisition subsequent to 1 January 2005, any goodwill arising on the acquisition of a foreign operation and any fair value adjustments to the carrying amounts of the assets and liabilities are treated as assets and liabilities of the foreign operation and are translated at the closing rate in accordance with HKAS 21.

HKAS 24 has expanded the definition of related parties and affected the Group's related party disclosures.

The impact of adopting the other HKFRSs is summarised as follows:

(a) HKAS 17 — Leases

In prior years, leasehold land and buildings held for own use were stated at cost less accumulated depreciation and any impairment losses.

Upon the adoption of HKAS 17, the Group's leasehold interest in land and buildings is separated into leasehold land and buildings. The Group's leasehold land is classified as an operating lease, because the title of the land is not expected to pass to the Group by the end of the lease term, and is reclassified from property, plant and equipment to prepaid land premiums/land lease payments, while buildings continue to be classified as part of property, plant and equipment. Prepaid land premiums for land lease payments under operating leases are initially stated at cost and subsequently amortised on the straight-line basis over the lease term. When the lease payments cannot be allocated reliably between the land and buildings elements, the entire lease payments are included in the cost of the land and buildings as a finance lease in property, plant and equipment.

This change in accounting policy has had no effect on the consolidated income statement and retained profits. The comparative amounts for the year ended 31 December 2004 in the consolidated balance sheet have been restated to reflect the reclassification of the leasehold land.

(b) HKAS 32 and HKAS 39 — Financial Instruments

(i) *Equity securities*

In prior years, the Group classified its investments in equity securities as long-term investments, which were held for non-trading purposes and were stated at their fair values on an individual basis with gains and losses recognised as movements in the investment revaluation reserve. Upon the adoption of HKAS 39, these securities held by the Group at 1 January 2005 in the amount of RMB44,347,000 are designated as available-for-sale investments under the transitional provisions of HKAS 39 and accordingly are stated at fair value with gains or losses being recognised as a separate component of equity until subsequent derecognition or impairment.

The adoption of HKAS 39 has not resulted in any change in the measurement of these equity securities.

(ii) *Loans and receivables*

In prior years, the Group used general provision to account for the provisions for trade and bills receivables.

Upon the adoption of HKAS 39, the Group has developed a specific doubtful debt provisioning policy based on the customers' credit rating and historical repayment records.

The effects of the above changes are summarised in note 2.4 to the financial statements. In accordance with HKAS 39, comparative amounts have not been restated.

NOTES TO FINANCIAL STATEMENTS

(Prepared under Hong Kong accounting standards)

31 December 2005

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. Unless otherwise stated, these HKFRSs are effective for annual periods beginning on or after 1 January 2006:

HKAS 1 Amendment	Capital Disclosures
HKAS 19 Amendment	Actuarial Gains and Losses, Group Plans and Disclosures
HKAS 21 Amendment	Net investment in a foreign operation
HKAS 39 Amendment	Cash Flow Hedge Accounting of Forecast Intragroup Transactions
HKAS 39 Amendment	The Fair Value Option
HKAS 39 & HKFRS 4 Amendments	Financial Guarantee Contracts
HKFRSs 1 & 6 Amendments	First-time Adoption of Hong Kong Financial Reporting Standards and Exploration for and Evaluation of Mineral Resources
HKFRS 6	Exploration for and Evaluation of Mineral Resources
HKFRS 7	Financial Instruments: Disclosures
HK(IFRIC)-Int 4	Determining whether an Arrangement contains a Lease
HK(IFRIC)-Int 5	Rights to Interests arising from Decommissioning, Restoration and Environmental Rehabilitation Funds
HK(IFRIC)-Int 6	Liabilities arising from Participating in a Specific Market — Waste Electrical and Electronic Equipment
HK(IFRIC)-Int 7	Applying the Restatement Approach Under HKAS 29 Financial Reporting in Hyperinflationary Economies

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 incorporates the disclosure requirements of HKAS 32 relating to financial instruments. This HKFRS shall be applied for annual periods beginning on or after 1 January 2007.

In accordance with the amendments to HKAS 39 regarding financial guarantee contracts, financial guarantee contracts are initially recognised at fair value and are subsequently measured at the higher of (i) the amount determined in accordance with HKAS 37 and (ii) the amount initially recognised, less, when appropriate, cumulative amortisation recognised in accordance with HKAS 18.

The HKAS 19 Amendment, HKAS 39 Amendment regarding cash flow hedge accounting of forecast intragroup transactions, HKFRSs 1 and 6 Amendments, HKFRS 6, HK(IFRIC) — Int 5 and HK(IFRIC) — Int 6 do not apply to the activities of the Group. HK(IFRIC) — Int 6 shall be applied for annual periods beginning on or after 1 December 2005.

Except as stated above, the Group expects that the adoption of the other pronouncements listed above will not have any significant impact on the Group's financial statements in the period of initial application.

2.4 SUMMARY OF THE IMPACT OF CHANGES IN ACCOUNTING POLICIES

(a) Effect on the consolidated balance sheet

At 1 January 2005	Effect of adopting		
	HKAS 17 [#]	HKASs 32 [#] and 39 [*]	
Effect of new policies (Increase/(decrease))	Prepaid land lease payments RMB'000	Change in classification of equity investments RMB'000	Total RMB'000
<u>Assets</u>			
Property, plant and equipment	(54,456)	—	(54,456)
Prepaid land lease payments	54,456	—	54,456
Available-for-sale equity investments	—	44,347	44,347
Long-term investments	—	(44,347)	(44,347)
			—

* Adjustment taken effect prospectively from 1 January 2005

Adjustments/presentation taken effect retrospectively

At 31 December 2005	Effect of adopting			Total
	HKAS 17	HKASs 32 and 39	HKAS 39	
Effect of new policies (Increase/(decrease))	Prepaid land lease payments RMB'000	Change in classification of equity investments RMB'000	Change in accounting estimate for provision of bad debts RMB'000	RMB'000
<u>Assets</u>				
Property, plant and equipment	(56,480)	—	—	(56,480)
Prepaid land lease payments	56,480	—	—	56,480
Trade and bills receivables	—	—	145,920	145,920
Available-for-sale equity investments	—	43,288	—	43,288
Long-term investments	—	(43,288)	—	(43,288)
				145,920

NOTES TO FINANCIAL STATEMENTS

(Prepared under Hong Kong accounting standards)

31 December 2005

2.4 SUMMARY OF THE IMPACT OF CHANGES IN ACCOUNTING POLICIES (continued)

(b) Effect on the consolidated income statement for the years ended 31 December 2005 and 2004

Effect of new policies	Effect of adopting		Total RMB'000
	HKAS 1 Share of post-tax profits and losses of jointly- controlled entities and associates RMB'000	HKAS 39 Change in accounting estimate for provision of bad debts RMB'000	
Year ended 31 December 2005			
Decrease in other operating expenses	—	145,920	145,920
Total increase in profit	—	145,920	145,920
Increase in basic earnings per share	—	0.15	0.15
Year ended 31 December 2004			
Increase/(decrease) in share of profits and losses of jointly-controlled entities	(305)	—	(305)
Decrease in tax	305	—	305
Total increase/(decrease) in profit	—	—	—
Increase/(decrease) in basic earnings per share	—	—	—

2.5 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.

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.

2.5 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Joint ventures (continued)

A joint venture is treated as:

- (a) a subsidiary, if the Group/Company, directly or indirectly, controls more than half of its voting power or issued share capital or controls the composition of its board of directors, 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 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.

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.

NOTES TO FINANCIAL STATEMENTS

(Prepared under Hong Kong accounting standards)

31 December 2005

2.5 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

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.

Excess over the cost of business combinations (*applicable to business combinations for which the agreement date is on or after 1 January 2005*)

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.

2.5 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Impairment of assets

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.

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); or
- (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).

NOTES TO FINANCIAL STATEMENTS

(Prepared under Hong Kong accounting standards)

31 December 2005

2.5 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 machineries 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.

2.5 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 5 years.

Operating concession

Operating concession represents the right to operate a telecommunications company, 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 5 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

Applicable to the year ended 31 December 2004:

The Group classified its equity investments, other than subsidiaries, associates and jointly-controlled entities, as long-term investments.

Long-term investments

Long-term investments are non-trading investments in unlisted equity securities intended to be held on a long-term basis.

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2.5 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Investments and other financial assets (continued)

Applicable to the year ended 31 December 2004 (continued):

Long-term investments (continued)

Unlisted securities are stated at their estimated fair values, on an individual basis. The estimated fair values of unlisted investments are determined by the directors having regard to, inter alia, the prices of the most recent reported sales or purchases of the securities, or comparison of price/earnings ratios and dividend yields of the securities with those of similar listed securities, with allowance made for the lower liquidity of the unlisted securities.

The gains or losses arising from changes in fair value of a security are dealt with as movements in the investment revaluation reserve, until the security is sold, collected, or otherwise disposed of, or until the security is determined to be impaired, when the cumulative gain or loss derived from the security recognised in the investment revaluation reserve, together with the amount of any further impairment, is charged to the income statement in the period in which the impairment arises.

Applicable to the year ended 31 December 2005:

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 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, i.e., the date that the Group commits to purchase 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 classified as held for trading are included in the category "financial assets at fair value through profit or loss". 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 carried at amortised cost using the effective interest method. 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.

2.5 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Investments and other financial assets (continued)

Applicable to the year ended 31 December 2005 (continued):

Available-for-sale financial assets (continued)

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

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.

Impairment of financial assets (applicable to the year ended 31 December 2005)

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 profit or loss.

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.

Assets carried at cost

If there is objective evidence that an impairment loss on an unquoted equity instrument that is not carried at fair value because its fair value cannot be reliably measured 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 discounted at the current market rate of return for a similar financial asset. Impairment losses on these assets are not reversed.

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2.5 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Investments and other financial assets (continued)

Impairment of financial assets (applicable to the year ended 31 December 2005) (continued)

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 profit or loss, is transferred from equity to the income statement. Impairment losses on equity instruments classified as available for sale are not reversed through profit or loss.

Derecognition of financial assets (applicable to the year ended 31 December 2005)

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 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.

Interest-bearing loans and borrowings

All loans and borrowings are initially recognised at the fair value of the consideration received less directly attributable transaction costs.

After initial recognition, interest-bearing loans and borrowings are subsequently measured at amortised cost using the effective interest method.

Gains and losses are recognised in net profit or loss when the liabilities are derecognised as well as through the amortisation process.

Derecognition of financial liabilities (applicable to the year ended 31 December 2005)

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 profit or loss.

2.5 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.

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2.5 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Provisions (continued)

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.

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.

2.5 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Retirement benefits schemes

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 in the PRC provincial and municipal governments 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 schemes

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 plan 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.

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 profit or loss. 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 statements.

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.

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2.5 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

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.

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; and
- (e) dividend income, when the shareholders' right to receive payment has been established.

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.

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 determines whether a sale qualifies as an construction contract and has developed criteria in making that judgement. A construction contract is a contract specifically negotiated for the construction of an asset or a combination of assets that are closely inter-related or interdependent in terms of their design, technology and function on their ultimate purpose or use. Therefore, revenue arising from the telecommunications systems contracts should be accounted for under HKAS 11 using the percentage of completion method.

2.5 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (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 goodwill and property, plant and equipment

The Group determines whether goodwill 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 goodwill 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 goodwill at 31 December 2005 was nil (2004: RMB5,684,000). The carrying amount of property, plant and equipment was approximately RMB2,470,965,000 (2004: RMB1,935,131,000). More details are set out in notes 14 and 17.

Management carries out the impairment review on property, plant and equipment by comparing the lower of carrying amount and recoverable amount of property, plant and equipment.

An impairment loss is recognised when the carrying amount of 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 cashflow of property, plant and equipment.

Goodwill is subject to annual impairment review according to the future economic benefit generated by the acquired entity. Impairment of goodwill is provided whenever the underlying entity is unable to generate the future economic benefit within the entity; not able to benchmark with other companies within the industry; due to the market change; or in any case the Group is unable to assess the future economic benefit of that entity reliably.

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 2005 was approximately RMB2,470,965,000. The Group depreciates the items of property, plant and equipment on the straight-line basis over their estimated useful lives, and after taking into account of their estimated residual value, commencing from the date the items of property, plant and equipment is 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.

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2.5 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Estimation uncertainty (continued)

Income taxes

As at 31 December 2005, a deferred tax asset of approximately RMB59,587,000 has been recognised in the Group's balance sheet. The realisability of the deferred tax asset mainly depends on whether sufficient future profits or taxable temporary differences will be available in the future. Due to good estimation to the profits generated in the future, the directors of the Company consider no material reversal of deferred tax assets may arise, which would be recognised in the income statement for the period in which such a reversal takes place.

3. 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.
- (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.

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3. SEGMENT INFORMATION (continued)

(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 2005 and 2004.

Group

	Wireless communications		Wireline switch and access		Optical and data communications		Handsets		Telecommunications software systems, services and other products		Consolidated	
	2005 RMB'000	2004 RMB'000	2005 RMB'000	2004 RMB'000	2005 RMB'000	2004 RMB'000	2005 RMB'000	2004 RMB'000	2005 RMB'000	2004 RMB'000	2005 RMB'000	2004 RMB'000
Segment revenue:												
Contract revenue from external customers	8,930,836	8,786,407	2,752,570	2,598,588	3,352,980	2,335,273	—	—	1,943,428	1,484,827	16,979,814	15,205,095
Sale of goods and services	—	—	—	—	—	—	4,333,082	6,014,967	263,024	—	4,596,106	6,014,967
Total	8,930,836	8,786,407	2,752,570	2,598,588	3,352,980	2,335,273	4,333,082	6,014,967	2,206,452	1,484,827	21,575,920	21,220,062
Segment results	2,590,240	2,654,012	1,085,112	1,150,138	160,110	258,586	118,165	(64,871)	334,131	609,038	4,287,758	4,606,903
Interest and unallocated gains											681,646	534,129
Unallocated expenses											(3,183,548)	(3,408,984)
Finance costs											(175,884)	(140,397)
Share of profits and losses of:												
Jointly-controlled entities											(1,198)	3,105
Associates											(2,969)	32
Profit before tax											1,605,805	1,594,788
Tax											(179,851)	(114,954)
Profit for the year											1,425,954	1,479,834
Assets and Liabilities												
Segment assets	5,292,995	3,975,515	2,196,473	1,319,962	2,778,123	1,624,418	2,162,194	2,460,313	810,136	740,563	13,239,921	10,120,771
Investments in jointly-controlled entities	—	—	—	—	4,613	4,035	—	—	1,975	3,751	6,588	7,786
Investments in associates	—	—	—	—	—	—	—	—	35,583	8,845	35,583	8,845
Unallocated assets											9,181,950	10,870,361
Total assets											22,464,042	21,007,763
Segment liabilities	860,005	1,486,801	91,578	407,707	204,755	275,238	344,933	248,998	93,207	148,985	1,594,478	2,567,729
Unallocated liabilities											10,148,323	8,744,502
Total liabilities											11,742,801	11,312,231
Other segment information:												
Depreciation and amortisation	123,367	106,452	37,519	22,906	82,886	50,605	105,251	70,939	45,421	30,255	478,496	361,003
Amortisation of goodwill	—	—	—	—	—	—	—	2,958	—	1,738	—	4,696
Capital expenditure	371,525	266,426	112,990	57,329	249,611	126,652	316,966	177,542	136,787	75,722	1,187,879	703,671

(b) Geographical segments

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

Group

	The PRC		Asia (excluding the PRC)		Africa		Others		Consolidated	
	2005 RMB'000	2004 RMB'000	2005 RMB'000	2004 RMB'000	2005 RMB'000	2004 RMB'000	2005 RMB'000	2004 RMB'000	2005 RMB'000	2004 RMB'000
Segment revenue:										
Contract revenue from external customers	10,838,079	10,636,190	3,428,396	2,453,308	2,576,744	1,513,052	136,595	602,545	16,979,814	15,205,095
Sale of goods and services	3,036,230	6,008,332	1,140,259	6,635	258,667	—	160,950	—	4,596,106	6,014,967
Total	13,874,309	16,644,522	4,568,655	2,459,943	2,835,411	1,513,052	297,545	602,545	21,575,920	21,220,062

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4. 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 turnover and other income and gains is as follows:

	Note	2005 RMB'000	2004 RMB'000
Revenue			
Telecommunications systems contracts		16,979,814	15,205,095
Sale of goods and services		4,596,106	6,014,967
		21,575,920	21,220,062
Other income			
Government grants		139,491	68,710
Service fees		15,379	22,968
VAT subsidies, exemptions and refunds#		456,015	395,424
Bank interest income		54,870	30,118
		665,755	517,220
Gains			
Excess over the cost of business combinations /negative goodwill recognised		12,236	4,770
Gain on disposal of short-term investments		—	12,139
Gain on deemed disposal of interests in a subsidiary	39	3,655	—
		15,891	16,909
		681,646	534,129

During the years ended 31 December 2004 and 2005, 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 (深圳市國家稅務局) and Shenzhen Local Tax Bureau (深圳市地方稅務局). In addition, for the years ended 31 December 2004 and 2005, Shenzhen Zhongxing Software Company, Limited ("Zhongxing Software"), being a designated software enterprise, was 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 by the Shenzhen State Tax Bureau (深圳市國家稅務局) and had been received by Zhongxing Software.

5. PROFIT BEFORE TAX

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

	Note	2005 RMB'000	2004 RMB'000 (Restated)
Cost of inventories sold		13,373,519	13,322,040
Depreciation	14	394,444	279,797
Less: Amount capitalised as deferred development costs		(7,585)	—
		386,859	279,797
Amortisation of intangible assets	16	82,735	79,846
Goodwill:			
Amortisation for the year*	17	—	4,696
Impairment arising during the year*	17	56,267	13,037
		56,267	17,733
Impairment of intangible assets	16	—	7,847
Loss on retirement and disposal of intangible assets	16	70	19,605
Provision for bad and doubtful debts*		15,642	100,027
Provision for warranties**	34	225,790	129,930
Provision against inventory obsolescence and net realisable value**		96,185	279,575
Minimum lease payments under operating leases on land and buildings		188,905	109,054
Auditors' remuneration		4,870	4,190
Staff costs (including directors' and supervisors' remuneration — note 7):			
Wages, salaries, bonuses, allowances and welfares		2,601,779	2,892,283
Pension scheme contributions:			
Defined benefits pension scheme — note 32		2,224	2,473
Defined contribution pension scheme		187,081	128,022
		2,791,084	3,022,778
Foreign exchange differences*		48,390	13,334
Loss on disposal of items of property, plant and equipment*		6,163	11,654
Loss on disposal of interests in subsidiaries*		2,057	—

* The amortisation and impairment of goodwill, provision for bad and doubtful debts, foreign exchange differences, loss on disposal of items of property, plant and equipment and loss on disposal of interests in subsidiaries are included in "Other operating expenses" on the face of the consolidated income statement.

** The provision for warranties and provision against inventory obsolescence and net realisable value are included in "Cost of sales" on the face of the consolidated income statement.

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6. FINANCE COSTS

	Group	
	2005 RMB'000	2004 RMB'000
Interest on bank loans wholly repayable within five years	36,042	75,056
Finance costs on trade receivables factored and bills discounted	139,842	65,341
	175,884	140,397

7. DIRECTORS' AND SUPERVISORS' REMUNERATION

Directors' and supervisors' remuneration for the year, disclosed pursuant to the Listing Rules and Section 161 of the Companies Ordinance, are as follows:

	Group	
	2005 RMB'000	2004 RMB'000
Fees	—	—
Other emoluments of executive directors and supervisors:		
Salaries, bonuses, allowances and welfare	3,037	3,073
Performance related bonuses	1,824	5,544
Retirement benefits scheme contribution	32	58
	4,893	8,675

(a) Independent non-executive directors

The salaries, bonuses, allowances and welfare paid to independent non-executive directors during the year were as follows:

	2005 RMB'000	2004 RMB'000
Zhu Wuxiang	60	60
Chen Shaohua	60	60
Tan Zhenhui	25	60
Mi Zhengkun	60	60
Li Jin	60	35
Qiao Wenjun	60	60
	325	335

There were no other emoluments payable to the independent non-executive directors during the year (2004:Nil).

7. 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	Retirement benefits scheme contribution RMB'000	Total remuneration RMB'000
2005					
<i>Executive directors:</i>					
Yin Yimin	—	423	700	8	1,131
Shi Lirong	—	353	420	8	781
He Shiyong	—	387	250	2	639
	—	1,163	1,370	18	2,551
<i>Non-executive directors:</i>					
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
<i>Supervisors:</i>					
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

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7. 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 contribution RMB'000	Total remuneration RMB'000
2004					
<i>Executive directors:</i>					
Yin Yimin	—	394	1,052	10	1,456
Shi Lirong	—	364	1,002	10	1,376
He Shiyong	—	373	1,022	9	1,404
	—	1,131	3,076	29	4,236
<i>Non-executive directors:</i>					
Hou Weigui	—	332	1,000	24	1,356
Li Juping	—	60	—	—	60
Dong Lianbo	—	60	—	—	60
Xie Weiliang	—	60	—	—	60
Zhang Junchao	—	60	—	—	60
Tan Shanyi	—	60	—	—	60
Wang Zongyin	—	60	—	—	60
	—	1,823	4,076	53	5,952
<i>Supervisors:</i>					
Zhang Taifeng	—	332	700	—	1,032
Wang Wangxi	—	242	497	4	743
He Xuemei	—	149	271	1	421
Cao Quansheng	—	48	—	—	48
Li Jinhu	—	48	—	—	48
Li Huanru	—	48	—	—	48
Cui Hongwei	—	48	—	—	48
	—	915	1,468	5	2,388

There was no arrangement under which directors and supervisors waived or agreed to waive any remuneration during the year.

8. FIVE HIGHEST PAID EMPLOYEES

The five highest paid employees during the year included one (2004: Nil) director, details of whose remuneration are set out in note 7 above. Details of the remuneration of the remaining 4 (2004: 5) non-director and non-supervisor, highest paid employees for the year are as follows:

	2005 RMB'000	2004 RMB'000
Salaries, bonuses, allowances and welfare	4,145	833
Performance related bonuses	863	7,289
Retirement benefits scheme contribution	18	—
	5,026	8,122

The number of non-director, non-supervisor, highest paid employees whose remuneration fell within the following bands is as follows:

	Number of employees	
	2005	2004
Nil to RMB1,000,000	—	—
RMB1,000,001 to RMB1,500,000	4	—
RMB1,500,001 to RMB2,000,000	—	5
	4	5

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.

9. TAX

	2005 RMB'000	2004 RMB'000 (Restated)
Group:		
Current — Hong Kong	5,726	5,735
Current — Mainland China		
Charge for the year	34,700	113,651
Overprovision in prior years	—	(52,513)
Current — Overseas	94,331	9,567
Deferred tax (note 35)	45,094	38,514
Total tax charge for the year	179,851	114,954

Hong Kong profits tax has been provided at the rate of 17.5% (2004: 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.

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9. TAX (continued)

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

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

On 31 July 1997, ZTE Kangxun Telecom Company, Limited ("Kangxun"), a major subsidiary of the Company was approved by the Shenzhen Local Tax Bureau to be exempted from corporate income tax for two years and was granted a 50% relief in the three years thereafter starting from the first profitable year which was effective from 1 January 1997 until 31 December 2001. Kangxun was also certified as a high-technology enterprise on 1 August 2001. In December 2001, Kangxun obtained an approval from the Shenzhen Local Tax Bureau to extend the 50% relief from corporate income tax for a further three years effective from 1 January 2002 until 31 December 2004 during which Kangxun was subject to a corporate income tax rate of 7.5%. Kangxun is subject to a corporate income tax rate of 15% commencing from 1 January 2005.

As a designated software enterprise, Zhongxing Software, a major subsidiary of the Company was approved as a new software enterprise and entitled to full exemption from corporate income tax for two years and a 50% relief in the three years thereafter starting from the first profitable year which was effective 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 the three years thereafter starting from the first profitable year which was effective from 1 January 2005 until 31 December 2009. ZTE Mobile is entitled to full exemption from corporate income tax in the current year.

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:

	2005		2004	
	RMB'000	%	RMB'000 (Restated)	%
Profit before tax	1,605,805		1,594,788	
Tax at statutory tax rate	529,916	33.0	526,280	33.0
Lower tax rate for specific provinces or local authority	(289,045)	(18.0)	(287,117)	(18.0)
Expenses not deductible for tax	103,669	6.5	115,735	7.2
Income not subject to tax	(51,602)	(3.2)	(49,213)	(3.1)
Tax holiday	(89,482)	(5.5)	(202,910)	(12.7)
Profits and losses attributable to jointly-controlled entities and associates	625	—	(471)	—
Tax losses utilised from previous years	(5,702)	(0.4)	—	—
Other tax allowances	(41,558)	(2.6)	—	—
Tax losses of subsidiaries	23,030	1.4	12,650	0.8
Tax charge at the Group's effective rate	179,851	11.2	114,954	7.2

9. TAX (continued)

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 (2004: RMB305,000).

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 (2004: Nil).

10. NET PROFIT FROM ORDINARY ACTIVITIES ATTRIBUTABLE TO EQUITY HOLDERS OF THE PARENT

The net profit from ordinary activities attributable to equity holders of the parent for the year ended 31 December 2005 dealt with in the financial statements of the Company, was approximately RMB1,084,317,000 (2004: RMB150,233,000) (note 37(b)).

11. DIVIDEND

	2005 RMB'000	2004 RMB'000
Proposed final — RMB0.25 (2004: RMB0.25) per ordinary share	239,880	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.

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

The calculation of basic earnings per share is based on the net profit for the year attributable to ordinary equity holders of the parent of RMB1,287,701,000 (2004: RMB1,272,489,000) and the weighted average number of 959,521,650 (2004: 810,759,661) ordinary shares in issue during the year.

Diluted earnings per share amounts for the years ended 31 December 2005 and 2004 have not been presented as the Company did not have any dilutive potential ordinary shares during these years.

13. DISTRIBUTION OF PROFIT

In accordance with the PRC Company Law and the Company's articles of association, the Company and its subsidiaries registered in the PRC, except for Sino-foreign joint ventures, are required to appropriate 10% of the net profit after tax (after offsetting any prior years' losses) calculated in accordance with "Accounting Standards for Business Enterprises" and "Accounting System for Business Enterprises" and other related standards (collectively "PRC GAAP") to the statutory surplus reserve (except where the reserve balance has reached 50% of each entity's capital), and 5% to 10% to the statutory public welfare fund and, on an optional basis, the discretionary surplus reserve fund. The statutory surplus reserve can be utilised to offset prior years' losses or to increase capital. However, the balance of the statutory surplus reserve must be maintained at a minimum of 25% of capital after such usages. The statutory public welfare fund can only be utilised for collective benefits to the employees of the respective companies. The above reserves cannot be used for purposes other than those for which they are created and are not distributable as cash dividends. The statutory surplus reserve and statutory public welfare fund were collectively presented as the statutory reserve fund in the financial statements.

The Company can distribute dividends based on the lower of the Company's retained profits determined under PRC GAAP or those under HKASs.

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14. 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 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 (note 38)	—	—	12,345	475	—	12,820
Disposal of subsidiaries (note 39)	—	—	(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

14. PROPERTY, PLANT AND EQUIPMENT (continued)

Group (continued)

	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 (Restated)
31 December 2004						
At 1 January 2004:						
Cost	649,951	46,101	1,416,418	118,228	19,378	2,250,076
Accumulated depreciation and impairment	(51,769)	(31,647)	(551,795)	(41,969)	—	(677,180)
Net carrying amount	598,182	14,454	864,623	76,259	19,378	1,572,896
At 1 January 2004, net of accumulated depreciation and impairment	598,182	14,454	864,623	76,259	19,378	1,572,896
Additions	387	8,952	497,865	32,656	106,694	646,554
Disposals	—	—	(15,725)	(1,684)	—	(17,409)
Acquisition of subsidiaries	—	—	11,921	171	—	12,092
Depreciation provided during the year	(33,631)	(5,866)	(224,532)	(15,768)	—	(279,797)
Transfers	—	4,967	5,531	—	(10,498)	—
Reclassifications	(1,084)	—	(7,973)	9,057	—	—
Exchange realignments	—	—	779	16	—	795
At 31 December 2004, net of accumulated depreciation and impairment	563,854	22,507	1,132,489	100,707	115,574	1,935,131
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

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14. 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 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

14. PROPERTY, PLANT AND EQUIPMENT (continued)

Company (continued)

	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 (Restated)
31 December 2004						
At 1 January 2004:						
Cost	625,068	42,382	1,240,179	109,027	13,672	2,030,328
Accumulated depreciation and impairment	(40,814)	(29,473)	(487,305)	(38,657)	—	(596,249)
Net carrying amount	584,254	12,909	752,874	70,370	13,672	1,434,079
At 1 January 2004, net of accumulated depreciation and impairment	584,254	12,909	752,874	70,370	13,672	1,434,079
Additions	—	170	376,325	25,679	89,396	491,570
Disposals	—	—	(10,661)	(1,684)	—	(12,345)
Transfers from subsidiaries	—	—	10,319	—	—	10,319
Transfers to subsidiaries	—	—	(308,732)	(13,112)	—	(321,844)
Depreciation provided during the year	(32,130)	(4,670)	(160,332)	(11,639)	—	(208,771)
Transfers	—	4,967	—	—	(4,967)	—
Reclassifications	(1,084)	—	(6,660)	7,744	—	—
Exchange realignments	—	—	6	(10)	—	(4)
At 31 December 2004, net of accumulated depreciation and impairment	551,040	13,376	653,139	77,348	98,101	1,393,004
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

As at 31 December 2005, 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 RMB220,000,000, included in the Group's buildings.

Approximately RMB14,000,000 of the Group's construction in progress represented telecommunication equipments. The Group contributed such equipments through a subsidiary for a partnership arrangement with Algerie Telecom in operating a wireless network in Algeria. According to the respective contract, the Group's subsidiary will share certain portion of the profit generated from the wireless network for a period of five years and the ownership of these telecommunication equipments will be retained by the subsidiary during the five-year period, and will be transferred to Algerie Telecom for nil consideration. The equipments were accounted for as construction in progress as at 31 December 2005.

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15. PREPAID LAND PREMIUMS/LAND LEASE PAYMENTS

Group

	2005 RMB'000	2004 RMB'000 (Restated)
Carrying amount at 1 January		
As previously reported	—	—
Effect of adopting HKAS 17 (note 2.2(a))	54,456	55,402
As restated	54,456	55,402
Additions during the year	3,341	414
Recognised during the year	(1,317)	(1,360)
Carrying amount at 31 December	56,480	54,456
Current portion	(1,418)	(1,361)
Non-current portion	55,062	53,095

The leasehold land is held under a medium term lease and is situated in the PRC.

Company

	2005 RMB'000	2004 RMB'000 (Restated)
Carrying amount at 1 January		
As previously reported	—	—
Effect of adopting HKAS 17 (note 2.2(a))	50,714	51,993
As restated	50,714	51,993
Additions during the year	1,241	—
Recognised during the year	(1,249)	(1,279)
Carrying amount at 31 December	50,706	50,714
Current portion	(1,300)	(1,279)
Non-current portion	49,406	49,435

The leasehold land is held under a medium term lease and is situated in the PRC.

As at 31 December 2005, 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.

16. 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 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 (note 38)	47	—	—	—	47
Disposals of subsidiaries (note 39)	—	(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
31 December 2004:					
At 1 January 2004:					
Cost	1,280	162,297	39,840	244,296	447,713
Accumulated amortisation and impairment	(469)	(65,936)	(5,971)	(116,793)	(189,169)
Net carrying amount	811	96,361	33,869	127,503	258,544
Cost at 1 January 2004, net of accumulated amortisation and impairment	811	96,361	33,869	127,503	258,544
Additions	—	48,856	—	7,847	56,703
Retirements and disposals	—	(838)	—	(18,767)	(19,605)
Amortisation provided during the year	(128)	(35,477)	(1,992)	(42,249)	(79,846)
Impairment during the year	—	—	—	(7,847)	(7,847)
At 31 December 2004	683	108,902	31,877	66,487	207,949
At 31 December 2004 and at 1 January 2005:					
Cost	1,280	209,421	39,840	140,039	390,580
Accumulated amortisation and impairment	(597)	(100,519)	(7,963)	(73,552)	(182,631)
Net carrying amount	683	108,902	31,877	66,487	207,949

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16. INTANGIBLE ASSETS (continued)

Company

	Computer software RMB'000	Deferred development costs RMB'000	Total RMB'000
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
31 December 2004:			
At 1 January 2004:			
Cost	144,417	199,387	343,804
Accumulated amortisation and impairment	(61,906)	(79,175)	(141,081)
Net carrying amount	82,511	120,212	202,723
Cost at 1 January 2004, net of accumulated amortisation and impairment	82,511	120,212	202,723
Additions	43,945	—	43,945
Retirements and disposals	(838)	(13,848)	(14,686)
Amortisation provided during the year	(32,270)	(39,877)	(72,147)
At 31 December 2004	93,348	66,487	159,835
At 31 December 2004 and at 1 January 2005:			
Cost	186,631	140,038	326,669
Accumulated amortisation and impairment	(93,283)	(73,551)	(166,834)
Net carrying amount	93,348	66,487	159,835

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17. GOODWILL

	Note	Group RMB'000
31 December 2005		
At 1 January 2005:		
Cost as previously reported		27,030
Effect of adopting HKFRS 3		(21,346)
Cost as restated		5,684
Accumulated amortisation and impairment as previously reported		(21,346)
Effect of adopting HKFRS 3		21,346
Accumulated amortisation and impairment as restated		—
Net carrying amount		5,684
Cost at 1 January 2005, net of accumulated impairment		5,684
Acquisition of a subsidiary	38	50,583
Impairment during the year		(56,267)
Cost and carrying amount at 31 December 2005		—
At 31 December 2005:		
Cost		56,267
Accumulated impairment		(56,267)
Net carrying amount		—
31 December 2004		
At 1 January 2004:		
Cost		24,884
Accumulated amortisation and impairment		(3,613)
Net carrying amount		21,271
Cost at 1 January 2004, net of accumulated amortisation and impairment		21,271
Acquisition of additional interests in a subsidiary		2,146
Amortisation provided for the year		(4,696)
Impairment during the year		(13,037)
At 31 December 2004		5,684
At 31 December 2004:		
Cost		27,030
Accumulated amortisation and impairment		(21,346)
Net carrying amount		5,684

As at 31 December, 2005, the directors reassessed the recoverable amount of goodwill arising on acquisition of subsidiaries. Due to continuous losses made by these subsidiaries, the directors, by discounting the future cash flow generated from the subsidiaries with reference to the average borrowing rate of the Group, considered the goodwill of approximately RMB56,267,000 was fully impaired.

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18. INVESTMENTS IN SUBSIDIARIES

	Company	
	2005 RMB'000	2004 RMB'000
Unlisted shares, at cost	517,218	532,297
Less: Provision for impairment	(108,350)	(136,014)
	408,868	396,283

The Company's trade receivable, other receivable, trade payable and other payable balances with the subsidiaries are disclosed in notes 24, 26, 29 and 30, 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 interests attributable to the Company		Principal activities
			Direct	Indirect	
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	USD7,231,029	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	70	25	Development of telecommunications systems software and provision of related consultancy services
Wuxi Zhongxing Optoelectronics Technologies Company, Limited ("Wuxi Zhongxing") [#] (i) (無錫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) (深圳市中興集成通信有限公司)	The PRC/Mainland China 27 June 2003	RMB55,000,000	75	5	Development, manufacture and sale of information technology products
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

18. INVESTMENTS IN SUBSIDIARIES (continued)

Particulars of the principal subsidiaries are as follows (continued):

Name	Place and date of incorporation/registration and operations	Nominal value of issued ordinary/registered share capital	Percentage of equity interests attributable to the Company		Principal activities
			Direct	Indirect	
ZTE do Brasil Ltd ^{***} (中興通訊(巴西)有限責任公司)	Brazil 7 August 2002	USD200,000 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	USD9,800,000 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	HKD50,000,000 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 system
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") [#] (iii) (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") [#] (iii) (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

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18. INVESTMENTS IN SUBSIDIARIES (continued)

Particulars of the principal subsidiaries are as follows (continued):

Name	Place and date of incorporation/registration and operations	Nominal value of issued ordinary/registered share capital	Percentage of equity interests attributable to the Company		Principal activities
			Direct	Indirect	
Shenzhen Ruide Electronic Industrial Company, Limited [#] (iii) (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) Holdings Ltd (“ZiMax”)	Cayman Islands 13 August 2004	USD5,500,000 Ordinary	100	—	Investment holding
ZiMax Technologies Inc (“ZiMax Tech”)	United States of America 2 June 2005	USD5,379,745 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.

(iii) The Group has unilateral controls over these subsidiaries.

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 particular of excessive length.

19. INVESTMENTS IN JOINTLY-CONTROLLED ENTITIES

	Group		Company	
	2005 RMB'000	2004 RMB'000	2005 RMB'000	2004 RMB'000
Unlisted shares, at cost	—	—	2,500	2,500
Share of net assets	6,588	7,786	—	—
	6,588	7,786	2,500	2,500

19. INVESTMENTS IN JOINTLY-CONTROLLED ENTITIES (continued)

The Company's trade receivable, trade payable and other payable balances with a jointly-controlled entity are disclosed in notes 24, 29 and 30 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	Issued and paid-up capital/ registered capital	Percentage of			Principal activities
				Ownership interest	Voting power	Profit sharing	
Beijing Zhongxing Telecom Ltd. ("Beijing Zhongxing")# (北京中興新通訊設備有限公司)	Corporate	The PRC 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 names of this jointly-controlled entity is directly translated from its Chinese names.

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.

The following table illustrates the summarised financial information of the Group's jointly-controlled entities:

	2005 RMB'000	2004 RMB'000
Share of the jointly-controlled entities' assets and liabilities		
Current assets	6,163	17,406
Non-current assets	2,530	973
Current liabilities	(2,105)	(8,672)
Non-current liabilities	—	—
Minority interests	—	(1,921)
Net assets	6,588	7,786
Share of the jointly-controlled entities' results		
Turnover	4,315	40,168
Other revenue	1,427	283
Total revenue	5,742	40,451
Total expenses	(6,940)	(36,056)
Tax	—	(305)
Minority interests	—	(985)
Profit/(loss) after tax	(1,198)	3,105

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20. INVESTMENTS IN ASSOCIATES

	Group		Company	
	2005 RMB'000	2004 RMB'000	2005 RMB'000	2004 RMB'000
Unlisted shares, at cost	—	—	37,088	4,013
Share of net assets	35,583	8,845	—	—
Provision for impairment	35,583	8,845	37,088	4,013
	—	—	(12,381)	—
	35,583	8,845	24,707	4,013

The Company's trade receivable, trade payable and other payable balances with associates are disclosed in notes 24, 29, 30 to the financial statements, respectively. The amount due from/to the associate is unsecured, interest-free and are repayable on demand.

Particulars of the principal associates are as follows:

Name	Business structure	Place and date of incorporation/registration and operations	Issued and paid-up capital/registered capital	Percentage of ownership interest attributable to the		Principal activities
				Group		
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公司)	Corporate	The PRC 20 March 2000	RMB64,000,000	40		Design, research, development and sale of integrated circuits and related electronic 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 export of related products and technologies
Shenzhen Smart Electronics Ltd. ("Smart") #* (深圳市思瑪特電子有限公司)	Corporate	The PRC 4 July 2005	HKD15,000,000	16.32**		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 of which these associates have significant influence over the board.

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:

	2005 RMB'000	2004 RMB'000
Assets	205,325	34,226
Liabilities	108,392	1,540
Revenues	169,154	15,550
Profit	7,543	107

21. AVAILABLE-FOR-SALE EQUITY INVESTMENTS/LONG-TERM INVESTMENTS

	Group		Company	
	2005 RMB'000	2004 RMB'000	2005 RMB'000	2004 RMB'000
Unlisted equity investments, at fair value	43,288	45,021	41,288	40,264
Provision for impairment	—	(674)	—	—
	43,288	44,347	41,288	40,264

The above investments consist of investments in equity securities which were designated as available-for-sale financial assets on 1 January 2005 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 income statement, are reasonable, and that they are the most appropriate values at the balance sheet date.

22. INVENTORIES

	Group		Company	
	2005 RMB'000	2004 RMB'000	2005 RMB'000	2004 RMB'000
Raw materials	1,248,645	983,326	782,628	633,186
Work in progress	532,923	338,981	287,420	199,289
Finished goods	458,759	402,760	208,044	370,955
	2,240,327	1,725,067	1,278,092	1,203,430

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23. TELECOMMUNICATIONS SYSTEMS CONTRACTS

	Group		Company	
	2005 RMB'000	2004 RMB'000	2005 RMB'000	2004 RMB'000
Amount due from customers for contract work	4,689,157	2,752,024	4,440,842	3,414,540
Amount due to customers for contract work	(733,455)	(2,318,731)	(688,876)	(2,162,901)
	3,955,702	433,293	3,751,966	1,251,639
Contract costs incurred plus recognised profits less recognised losses to date	19,420,235	15,327,336	16,346,089	14,992,094
Less: Progress billings	(15,464,533)	(14,894,043)	(12,594,123)	(13,740,455)
	3,955,702	433,293	3,751,966	1,251,639

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 customer's credit worthiness. The credit terms for major customers are reviewed regularly by senior management. The Group seeks to maintain strict control over its outstanding receivables and has a credit control department to minimise credit risk. Overdue balances are reviewed regularly by senior management. In view of the aforementioned, there is no significant concentration of credit risk. Trade receivables are non-interest-bearing.

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

	Group		Company	
	2005 RMB'000	2004 RMB'000	2005 RMB'000	2004 RMB'000
Within 6 months	3,968,731	4,252,421	4,697,530	4,901,198
7 to 12 months	701,656	1,453,143	840,424	1,116,903
1 to 2 years	313,288	194,940	428,519	193,718
2 to 3 years	10,551	5,609	11,872	43,213
Over 3 years	215	6,156	39,724	1,835
	4,994,441	5,912,269	6,018,069	6,256,867
Current portion of trade and bills receivables	(4,686,775)	(5,912,181)	(5,690,947)	(6,256,867)
Long-term portion	307,666	88	327,122	—

24. TRADE AND BILLS RECEIVABLES/LONG-TERM TRADE RECEIVABLES (continued)

The balances due from subsidiaries, the ultimate holding company, a jointly-controlled entity, associates and related companies included in the above are as follows:

	Group		Company	
	2005 RMB'000	2004 RMB'000	2005 RMB'000	2004 RMB'000
Subsidiaries	—	—	1,661,034	587,821
The ultimate holding company	177	169	8	—
A jointly-controlled entity	2,070	2,354	2,070	2,354
Associates	2,150	4,197	—	4,197
Related companies	13,314	7,151	3,071	3,087
	17,711	13,871	1,666,183	597,459

The maximum outstanding amount due from related companies for the Company and the Group during the year are RMB3,071,000 and RMB13,314,000 respectively.

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.

Included in the year end trade receivable balance of approximately RMB771,876,000 (2004: RMB340,344,000) was pledged to banks as security for bank borrowings (note 31).

25. FACTORED TRADE RECEIVABLES/FACTORED LONG-TERM TRADE RECEIVABLES

At 31 December 2005, the Company and a subsidiary of the Group factored trade receivables of 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	
	2005 RMB'000	2004 RMB'000	2005 RMB'000	2004 RMB'000
Prepayments	154,597	157,518	70,729	57,252
Deposits and other receivables	1,029,214	488,174	1,025,357	557,470
Due from subsidiaries	—	—	1,122,894	602,911
Due from related companies	4,502	5,609	4,502	4,894
Dividend receivable	—	—	16,465	1,871
	1,188,313	651,301	2,239,947	1,224,398

The maximum outstanding amount due from related companies for the Company and the Group during the year are RMB4,502,000 and RMB4,502,000 respectively.

The amounts due from subsidiaries and related companies are unsecured, interest-free and are repayable on demand.

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27. LOAN RECEIVABLES

During the year, the Group granted two loans to its potential customers.

A loan of SEK43,000,000 (equivalent to approximately RMB44,015,000) bears interest at the STIBOR + 3% to 8%, repayable in March 2006 and are secured by certain properties and shares of the customer and the customer's subsidiary and guaranteed by the customer's immediate holding company. Another loan of EUR3,150,000 (equivalent to approximately RMB30,176,000) bears interest at the three months EURIBOR + 1% to 3%, repayable in four installments which will be fully repaid by February 2007 and is secured by the shares of the customer's immediate holding company and guaranteed by the customer's intermediate holding company. Subsequent to the balance sheet date, the SEK loan of approximately SEK15,621,000 (equivalent to approximately RMB15,989,000) and the first installment payment of EURO dollar loan were both overdue in March 2006 and February 2006, respectively, and the respective borrowers are in the process of negotiating with management for a two months deferred payment tenor. The executive directors had taken necessary measures with the potential customers to recover the loans receivable and in view of the securities on hand, are of the opinion that no provision is necessary for these loans receivable.

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.

28. CASH AND CASH EQUIVALENTS AND PLEDGED BANK DEPOSITS

Note	Group		Company	
	2005 RMB'000	2004 RMB'000	2005 RMB'000	2004 RMB'000
Cash and bank balances	4,178,498	4,775,748	3,007,727	3,766,385
Time deposits	1,394,634	2,822,475	1,251,209	2,696,780
	5,573,132	7,598,223	4,258,936	6,463,165
Less: Pledged bank deposits	(175,899)	(88,978)	(46,126)	(44,512)
Cash and cash equivalents	5,397,233	7,509,245	4,212,810	6,418,653

At the balance sheet date, the cash and bank balances of the Group denominated in Renminbi amounted to approximately RMB3,689,593,000 (2004: RMB2,386,274,000). 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.

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 approximates to their fair values.

29. 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	
	2005 RMB'000	2004 RMB'000	2005 RMB'000	2004 RMB'000
Within 6 months	6,049,126	4,180,450	8,418,896	6,688,650
7 to 12 months	142,100	61,260	3,698	25,512
1 to 2 years	45,968	68,391	11,343	5,934
2 to 3 years	5,506	8,200	3,778	4,997
Over 3 years	27,092	22,810	19,738	23,509
	6,269,792	4,341,111	8,457,453	6,748,602

The balances due to the subsidiaries, the ultimate holding company, related companies, associates and a jointly-controlled entity included in the above are as follows:

	Group		Company	
	2005 RMB'000	2004 RMB'000	2005 RMB'000	2004 RMB'000
Subsidiaries	—	—	8,248,272	5,135,686
The ultimate holding company	104,563	51,168	—	—
Related companies	125,867	78,166	2,975	3,426
Associates	15,557	—	—	—
A jointly-controlled entity	182	—	—	—
	246,169	129,334	8,251,247	5,139,112

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.

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30. OTHER PAYABLES AND ACCRUALS

Note	Group		Company	
	2005 RMB'000	2004 RMB'000	2005 RMB'000	2004 RMB'000
Receipts in advance	860,106	310,360	492,673	260,970
Other payables	940,784	958,086	637,286	718,953
Accruals	847,861	1,313,173	562,147	924,997
Provision for warranties 34	248,998	186,227	248,998	186,227
Due to the ultimate holding company	313	313	313	313
Due to subsidiaries	—	—	647,775	512,665
Due to a jointly-controlled entity	1,024	—	1,024	—
Due to associates	765	—	765	—
Due to related companies	286	—	—	—
	2,900,137	2,768,159	2,590,981	2,604,125

The other payables are non-interest-bearing and have an average term of three months. The balances due to the ultimate holding company, subsidiaries, a jointly-controlled entity, associates and related companies are unsecured, interest-free and are repayable on demand.

31. INTEREST-BEARING BANK BORROWINGS

	Effective interest rate (%)	Maturity	Group		Company	
			2005 RMB'000	2004 RMB'000	2005 RMB'000	2004 RMB'000
Current						
Bank loans — Unsecured	5.58–6.138	2006	552,000	60,099	500,000	—
Bank loans — Secured	4.96	2006	47,695	361,596	—	340,344
			599,695	421,695	500,000	340,344
Non-current						
Other loans — Unsecured	3.78–6.21	2007	80,000	1,025,262	—	950,000
			679,695	1,446,957	500,000	1,290,344

31. INTEREST-BEARING BANK BORROWINGS (continued)

	Group		Company	
	2005 RMB'000	2004 RMB'000	2005 RMB'000	2004 RMB'000
Analysed into:				
Bank loans repayable:				
Within one year or on demand	599,695	421,695	500,000	340,344
In the second year	80,000	677,262	—	650,000
In the third to fifth years, inclusive	—	348,000	—	300,000
	679,695	1,446,957	500,000	1,290,344

The Group and the Company's secured bank loans or banking facilities were secured by:

		Group		Company	
	Note	2005 RMB'000	2004 RMB'000	2005 RMB'000	2004 RMB'000
Pledged deposits	28	175,899	88,978	46,126	44,512
Trade receivables		771,876	340,344	688,605	340,344
		947,775	429,322	734,731	384,856

Certain of the Group and Company's unsecured bank loans were guaranteed by:

	Group		Company	
	2005 RMB'000	2004 RMB'000	2005 RMB'000	2004 RMB'000
Other banks or government	580,000	580,000	500,000	500,000

The bank loans are fixed-rate borrowings which carry interest at a rate of 3.78% per annum.

The carrying amounts of the Group's and the Company's borrowings approximate their fair values.

32. 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 2005 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 obligation over the average expected future working lifetime of the active members of the plan.

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32. PROVISION FOR RETIREMENT BENEFITS (continued)

The benefits obligations recognised in the balance sheet are as follows:

Group and Company

	2005 RMB'000	2004 RMB'000
Present value of the obligations	54,577	39,046
Unrecognised actuarial losses	(24,118)	(10,123)
Net liability in the balance sheet	30,459	28,923

Movements in the net liability recognised in the balance sheet during the year are as follows:

	2005 RMB'000	2004 RMB'000
Net liability at beginning of year	28,923	27,190
Benefits expenses recognised in the consolidated income statement	2,224	2,473
Pension payments made	(688)	(740)
Net liability at end of year	30,459	28,923

The principal assumptions used in determining the pension benefits obligations are shown below:

	2005	2004
(a) Discount rate	3.5%	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.		

The benefits expense recognised in the consolidated income statement for the year is as follows:

	2005 RMB'000	2004 RMB'000
Current service cost	—	—
Interest cost on benefits obligations	1,935	1,581
Net actuarial losses recognised in the year	289	892
Benefits expense included in staff costs — note 5	2,224	2,473

33. OTHER LONG-TERM PAYABLES

Other long-term payables represent government grants which are unsecured, interest-free and have no fixed terms of repayment.

34. PROVISION FOR WARRANTIES

	Group		Company	
	2005 RMB'000	2004 RMB'000	2005 RMB'000	2004 RMB'000
At beginning of year	186,227	160,573	186,227	157,819
Additional provisions	225,790	129,930	225,790	129,930
Amounts utilised during the year	(163,019)	(104,276)	(163,019)	(101,522)
At 31 December 2005	248,998	186,227	248,998	186,227

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 would 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.

35. DEFERRED TAX

The movements in deferred tax assets and liabilities during the year are as follows:

	Group		Company	
	2005 RMB'000	2004 RMB'000	2005 RMB'000	2004 RMB'000
Deferred tax assets:				
At beginning of year	104,681	143,195	76,475	90,135
Deferred tax credit to the income statement during the year (note 9)	(45,094)	(38,514)	(21,362)	(13,660)
At end of year	59,587	104,681	55,113	76,475

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35. DEFERRED TAX (continued)

	Group		Company	
	2005 RMB'000	2004 RMB'000	2005 RMB'000	2004 RMB'000
Deferred tax assets:				
Provision against inventories	39,069	53,015	39,069	50,636
Provision for warranties	37,350	33,934	37,350	33,934
Provision for retirement benefits	4,569	4,350	4,569	4,350
Unrealised profit arising on consolidation	4,474	25,827	—	—
Deferred tax liabilities:				
Intangible assets	(26,614)	(9,973)	(26,614)	(9,973)
Government grants	739	(2,472)	739	(2,472)
Deferred tax assets, net	59,587	104,681	55,113	76,475

At 31 December 2004 and 2005, 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.

36. SHARE CAPITAL

	2005 RMB'000	2004 RMB'000
Registered, issued, and fully paid		
State-owned A shares of RMB1.00 each	392,080	462,273
Legal person A shares of RMB1.00 each	29,724	35,044
Individual A shares of RMB1.00 each	377,567	302,054
H shares of RMB1.00 each	160,151	160,151
	959,522	959,522

Pursuant to a resolution at an extraordinary general meeting held on 16 December 2005, the existing individual A share shareholders are compensated by the existing non-tradable share shareholders with 2.5 shares for each 10 shares held, immediately after the conversion of non-tradable shares or state-owned shares to tradable A shares. The total number of shares of the Company remain unchanged after the share reform.

Each of the Company's owners of non-tradable shares undertakes not to transfer or trade the listed shares, which are converted from the original non-tradable shares, held by it within 12 months from the date of shares deemed tradable on the Shenzhen Stock Exchange on 29 December 2005.

Zhongxingxin, the ultimate holding company of the Group, further undertakes 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.

Zhongxingxin further provides 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.

37. 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 page 185 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.

(b) Company

Note	Issued share capital RMB'000	Capital reserve 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 2004	667,296	2,079,104	476,376	1,543	627,278	200,188	4,051,785
Final 2003 dividend declared	—	—	—	—	—	(200,188)	(200,188)
Issue of H shares	160,151	3,574,571	—	—	—	—	3,734,722
Conversion of state-owned equity interest shares	(1,384)	(29,475)	—	—	—	—	(30,859)
Transfer from/(to) retained profits	—	—	174,342	—	(174,342)	—	—
Issue of bonus shares	133,459	—	—	—	(133,459)	—	—
Share issue expenses	—	(161,685)	—	—	—	—	(161,685)
Net profit for the year	—	—	—	—	150,233	—	150,233
Proposed final 2004 dividend	11	—	—	—	(239,880)	239,880	—
Exchange realignments	—	—	—	2,018	—	—	2,018
At 31 December 2004 and 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)	—	—
Net profit for the year	—	—	—	—	1,084,317	—	1,084,317
Proposed final 2005 dividend	11	—	—	—	(239,880)	239,880	—
Exchange realignments and other income recognised directly in equity	—	5,306	—	(3,509)	—	—	1,797
At 31 December 2005	959,522	5,467,821	769,603	52	955,382	239,880	8,392,260

At 31 December 2005, the Company had retained profits of approximately RMB955,382,000 (2004: RMB229,830,000), after the appropriation of proposed final dividend, as determined in accordance with the lower of the amount determined under PRC GAAP or HKASs, available for distribution by way of cash in kind.

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38. BUSINESS COMBINATIONS

In April 2005, ZTEsoft, a subsidiary of the Group, acquired 54% of equity interests in Guangzhou Nanfang Telecom for a cash consideration of approximately RMB8.3 million. Guangzhou Nanfang Telecom is engaged in the development, manufacture and marketing of telecommunications systems software.

In April 2005, Shanxi Zhongxing Telecom Equipment Company, Limited, formerly a 51% owned subsidiary of the Group, was divested and the Group's respective share of its net asset of RMB5.6 million was contributed as capital injection to Xian Jingcheng in exchange for a 34% shareholding of Xian Jingcheng. In November 2005, the Group further acquired 36% equity interest of Xian Jingcheng for cash consideration of approximately RMB5.8 million. Xian Jingcheng is engaged in development, manufacture and marketing of information technology products and the provision of related technical services.

In August 2005, ZIMax, a subsidiary of the Group, acquired 100% of equity interests in ZIMax Tech. ZIMax Tech is engaged in research and development of telecommunications related products. The consideration for the acquisition was approximately RMB43.4 million in cash.

The carrying value of the identifiable assets and liabilities of Guangzhou Nanfang Telecom, Xian Jingcheng and ZIMax Tech, in the opinion of the directors, approximates to their estimated fair value and as at the date of acquisition immediately before the acquisition were as follows:

	Notes	Carrying amount RMB'000
Property, plant and equipment	14	12,820
Intangible assets	16	47
Inventories		17,401
Cash and bank balances		6,065
Trade receivables		34,308
Prepayments and other receivables		24,574
Short-term loan		(3,000)
Trade payables		(5,184)
Accruals and other payables		(46,863)
Minority interests		(19,115)
		<hr/>
		21,053
Goodwill on acquisitions	17	50,583
Excess over the cost of business combinations recognised in the income statement		(8,525)
		<hr/>
		63,111
		<hr/>
Satisfied by:		
Cash		57,514
Interest in a jointly-controlled entity		5,597
		<hr/>
		63,111
		<hr/>

38. BUSINESS COMBINATIONS (continued)

An analysis of the net outflow of cash and cash equivalents in respect of the acquisition of subsidiaries is as follows:

	RMB'000
Cash consideration	(57,514)
Cash and bank balances acquired	6,065
Net outflow of cash and cash equivalents in respect of the acquisition of subsidiaries	(51,449)

Since their acquisition, the aforesaid subsidiaries contributed approximately RMB28 million to the Group's turnover and a loss of approximately RMB42 million to the consolidated profit for the year ended 31 December 2005.

Had the combinations been taken place at the beginning of the year, the revenue of the Group and the profit of the Group for the year would have been approximately RMB21,598 million and approximately RMB1,399 million, respectively.

39. DISPOSAL OF INTERESTS IN SUBSIDIARIES

	Notes	2005 RMB'000	2004 RMB'000
Net assets disposed of:			
Property, plant and equipment	14	6,128	—
Intangible assets	16	3,709	—
Available-for-sale investment		1,582	—
Inventories		11,013	—
Cash and bank balances		31,552	—
Trade receivables		26,399	—
Prepayments and other receivables		5,880	—
Trade payables		(14,833)	—
Short-term loan		(9,990)	—
Accruals and other payables		(35,517)	—
Minority interests		(11,555)	—
		14,368	—
Loss on disposal of interests in subsidiaries		(1,198)	—
Gain on deemed disposal of interests in a subsidiary	4	3,655	—
		16,825	—
Satisfied by:			
Cash		328	—
Reclassification from interests in subsidiaries to interests in associates		10,900	—
Reclassification from interests in subsidiaries to interests in jointly-controlled entities		5,597	—
		16,825	—

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39. DISPOSAL OF INTERESTS IN SUBSIDIARIES (continued)

An analysis of the net inflow of cash and cash equivalents in respect of the disposal of interests in subsidiaries is as follows:

	RMB'000
Cash consideration	328
Cash and bank balances disposed of	<u>(31,552)</u>
Net outflow of cash and cash equivalents in respect of the disposal of interests in subsidiaries	<u>(31,224)</u>

The results of the subsidiaries disposed of in the year ended 31 December 2005 had no significant impact on the Group's consolidated turnover or profit after tax for the year.

40. CONTINGENT LIABILITIES

- (a) At the balance sheet date, contingent liabilities not provided for in the financial statements were as follows:

Group and Company

	2005 RMB'000	2004 RMB'000
Discounted bills	—	440,885
Factored trade receivables	438,490	691,744
Guarantees given to banks in respect of performance bonds	2,823,760	1,626,070
	<u>3,262,250</u>	<u>2,758,699</u>

- (b) On 26 April 2000, the Company approved and declared an one-off share bonus of approximately RMB34 million and RMB30 million to its then employees who had elected to participate in a Deferred Share Bonus Scheme (the "DSBS") with a term of either three years or five years. Pursuant to the DSBS, the total amount of bonus payable to each qualified employee was used to purchase a total of 1,884,250 A shares of the Company during 2001 and these A shares were locked up for a period of either three years or five years under the three years DSBS and five years DSBS until 20 April 2004 and 20 June 2006, respectively. The Company has guaranteed the employees that, upon disposal of these shares in 2004 and 2006, respectively, the disposal price would not be less than approximately RMB18.5 per share, after being adjusted for the Company's bonus issues in 2001, 2003 and 2004.

As at 31 December 2005, a total of 2,600,849 A shares are subject to the guaranteed disposal price.

In the opinion of the directors, any resulting liabilities arising from the guaranteed disposal price under the DSBS would not have material adverse impact on the Group's financial statements. Therefore, no provision in respect of such guarantee has been made in the financial statements.

40. CONTINGENT LIABILITIES (continued)

- (c) On 3 November 2005, a Jiangsu Provincial Higher People's 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 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. 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.
- (d) During the year, the subsidiary of the Group in Pakistan has 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 of additional custom duties of approximately Rs.177 million (equivalent to approximately RMB23.9 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. On 5 September 2005, all disputes between the parties relating to this action were referred to Alternate Dispute Resolution Committee ("the Committee") for resolution and 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 custom duties would be in the order of approximately Rs.36 million (equivalent to approximately RMB4.8 million) and have been accrued in the Group's financial statements for the year ended 31 December 2005. 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 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.

- (e) 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 has 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 has valid defences against the claims brought in the arbitration, the directors currently believe 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 has been made in the financial statements.

- (f) On 18 August 2005, the Company received a notice of arbitration from a foreign consultant in respect of (i) a claim of consultancy fee of approximately USD90,000 (equivalent to approximately RMB726,000); (ii) a claim of agency fee of approximately USD1,190,314 (equivalent to approximately RMB9,606,000); (iii) a compensation claim of approximately USD50,000 (equivalent to approximately RMB404,000) for harassment and undue delay in honoring of a consultancy agreement.

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 has 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.

Save as disclosed above, as at 31 December 2005, the Company and the Group had no material contingent liabilities.

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41. PLEDGE OF ASSETS

Details of the Group's bank loans, which are secured by the assets of the Group, are included in note 31 to the financial statements.

42. OPERATING LEASE ARRANGEMENTS

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 2005, the Group had total future minimum lease payments under non-cancellable operating leases falling due as follows:

	2005 RMB'000	2004 RMB'000
Within one year	97,047	74,350
In the second to fifth years, inclusive	79,109	67,542
After five years	7,269	7,431
	183,425	149,323

43. COMMITMENTS

In addition to the operating lease commitments detailed in note 42 above, the Group had the following commitments at the balance sheet date:

Capital commitments

	2005 RMB'000	2004 RMB'000
Land and buildings:		
Authorised, but not contracted for	—	—
Contracted, but not provided for	231,561	282,446
	231,561	282,446
Investment in an associate:		
Contracted, but not provided for	21,065	—

44. DIFFERENCES IN FINANCIAL STATEMENTS PREPARED UNDER PRC GAAP AND HKASs

Ernst & Young is responsible for the audit of the Group's and the Company's financial statements prepared under 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 those under HKASs are summarised as follows:

	Notes	2005 RMB'000	2004 RMB'000
Net profit			
Net profit from ordinary activities attributable to shareholders under PRC GAAP		1,194,343	1,008,870
Add back/(deduct):			
Accounting standards differences			
Recognition of government grants	(i)	(8,881)	38,630
Recognition of deferred bonuses	(ii)	—	(127,951)
Provision for retirement benefits	(iii)	(1,536)	(1,733)
Deferred development costs	(iv)	115,621	(38,763)
Recognition of excess over the cost of business combinations	(v)	9,460	—
Deferred tax	(vi)	(21,306)	—
Other differences			
Difference in accounting estimates in respect of revenue recognised using the percentage of completion method for telecommunications systems contracts	(vii)	—	(668,042)
Recognition of income tax and deferred tax	(vi)	—	94,881
Difference in accounting estimates in respect of provision for trade receivables, other receivables and prepayments and net realisable value of inventories	(viii)	—	553,402
Consolidation of subsidiaries	(ix)	—	112,653
Estimated useful lives of fixed assets	(x)	—	132,988
Accrual of performance bonuses	(xi)	—	167,554
Profit attributable to equity holders of the parent under HKASs		1,287,701	1,272,489

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44. DIFFERENCES IN FINANCIAL STATEMENTS PREPARED UNDER PRC GAAP AND HKASs (continued)

	Notes	31 December 2005 RMB'000	31 December 2004 RMB'000
Shareholders' equity			
Shareholders' equity under PRC GAAP		10,125,095	9,174,439
Add back /(deduct):			
Accounting standards differences			
Recognition of government grants	(i)	(4,926)	5,149
Provision for retirement benefits	(iii)	(30,459)	(28,923)
Deferred development costs	(iv)	182,108	66,487
Deferred tax	(vi)	(21,306)	—
Equity attributable to equity holders of the parent under HKASs		10,250,512	9,217,152

(i) Government grants

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

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

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

(ii) Recognition of deferred bonuses

Under PRC GAAP, there is no specific standard, regulation or rule for the recognition of deferred bonuses. All the deferred bonuses are expensed as declared irrespective of whether or not the employee has qualified to be entitled to such bonuses.

Under HKASs, the deferred bonuses are recognised when the employee qualifies for the bonuses and the deferred bonuses charged to the income statement over the required service period.

(iii) Provision for retirement benefits

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

44. DIFFERENCES IN FINANCIAL STATEMENTS PREPARED UNDER PRC GAAP AND HKASs (continued)

(iv) 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.

(v) Excess over the cost of business combinations

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

Under HKASs, 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.

(vi) Income tax and deferred tax

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

(vii) Revenue recognition using the percentage of completion method

In the preparation of the financial statements under PRC GAAP for the year ended 31 December 2004, the stage of completion relating to the revenue recognition for telecommunications systems contracts is revised to be estimated by reference to the completion of the physical proportion of the work or the proportion of costs incurred to date to the estimated total cost of the relevant contract.

Subsequent to the change of accounting estimates for the preparation of financial statements under PRC GAAP, there are no differences between the telecommunications systems contracts recorded under PRC GAAP and HKASs.

(viii) Provisions

In the preparation of the financial statements under PRC GAAP for the year ended 31 December 2004, the Group had changed its accounting estimates during the year in respect of the provisions for trade receivables, other receivables and prepayments and net realisable value of inventories.

Subsequent to the change of accounting estimates for the preparation of financial statements under PRC GAAP, there are no differences between the provisions accounted for under PRC GAAP and HKASs.

(ix) Consolidation of subsidiaries

The differences represent historic discrepancies on the carrying values of interests in subsidiaries recorded by the Company under PRC GAAP as compared to the shareholders' equity and current account balances recorded in the financial statements of individual subsidiaries prepared under PRC GAAP or HKASs.

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44. DIFFERENCES IN FINANCIAL STATEMENTS PREPARED UNDER PRC GAAP AND HKASs (continued)

(x) Estimated useful lives of fixed assets

In the preparation of the financial statements under PRC GAAP for the year ended 31 December 2004, the Group had changed its accounting estimates during the year in respect of the useful lives of certain fixed assets.

Subsequent to the change of accounting estimates for the preparation of financial statements under PRC GAAP, there are no differences between the depreciation charged under PRC GAAP and HKASs.

(xi) Accrual of performance bonuses

Performance bonuses were accrued upon approval in the preparation of the financial statements under HKASs. Such performance bonuses were only charged to the income statement upon actual payment in 2004 and included in the financial statements prepared under PRC GAAP for the year ended 31 December 2004.

45. 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:

Name of company	Nature of transaction	Notes	2005 RMB'000	2004 RMB'000 (Restated)
The ultimate holding company				
Zhongxingxin and its subsidiaries, associates and jointly-controlled entities ^a 中興新及其附屬子公司、聯營公司及共同控制企業	Purchase of raw materials	(a)	437,920	446,559
	Sale of finished goods	(b)	558	43,803
Shareholders of the ultimate holding company				
Shenzhen Zhongxing WXT Equipment Company, Ltd and its subsidiaries, associates and jointly-controlled entities ^a 深圳中興維先通設備有限公司及其附屬子公司、聯營公司及共同控制企業	Purchase of raw materials	(a)	184,326	122,375
	Sale of finished goods	(e)	5,233	4,562
Xian Microelectronics Technology Research Institute and its subsidiaries, associates and jointly-controlled entities ^a 西安微電子技術研究所及其附屬子公司、聯營公司及共同控制企業	Purchase of raw materials	(a)	23,881	19,404
	Sale of finished goods	(e)	14,388	35,045
	Corporate guarantee	(d)	—	58,000
Jointly-controlled entities				
Beijing Zhongxing Telecom Ltd 北京中興新通訊設備有限公司	Purchase of raw materials	(a)	89	267
	Sale of finished goods	(b)	3,248	10,904
	Acquisition of a 19% equity interest in ZTE ITS Limited	(c)	1,024	—
ZTE ITS Limited 中興智能交通系統(北京)工程有限公司	Sale of finished goods	(b)	4,265	16,591

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45. RELATED PARTY TRANSACTIONS (continued)

(I) Transactions with related parties (continued)

Name of company	Nature of transaction	Notes	2005 RMB'000	2004 RMB'000 (Restated)
Associates				
Beijing Yuanjing Technology Co., Ltd. [#] 北京中興遠景科技有限公司	Sale of finished goods	(b)	2,815	13,945
ZTEIC Design Co., Ltd. [#] 深圳市中興集成電路設計有限責任公司	Purchase of raw materials	(a)	36,830	—
	Sale of finished goods	(e)	9,025	—
Wuxi Kaier Technology Company Ltd. 無錫凱爾科技有限公司	Purchase of raw materials	(a)	11,957	—
Shenzhen Decang Technology Company Limited [#] 深圳市德倉科技有限公司	Purchase of raw materials	(e)	5,874	—
Entity controlled by key management personnel of the Group				
Chung Hing (Hong Kong) Development Company Limited [#] 中興香港發展有限公司	Purchase of raw materials	(a)	8,166	1,500
Shareholder of a subsidiary				
The Government of the Democratic Republic of Congo	Corporate guarantee	(d)	80,000	80,000

[#] The English names of these companies are directly translated from their Chinese names.

In the opinion of the directors, the above transactions were conducted in the ordinary course of business.

The transactions with related parties for the year ended 31 December 2004 have been restated to exclude the effect of VAT. In the opinion of the directors, such restatement can better reflect the related parties transactions in the financial statement.

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) During the year, Beijing Zhongxing Telecom Limited, the Group's 50% owned jointly-controlled entity, disposed its 70% equity interests 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 70% equity interests in ZTE ITS Limited by Beijing Zhongxing Telecom Limited, ZTE ITS Limited, which was formerly a jointly-controlled entity of the Group, became a 19% owned available-for-sale investment of the Group.
- (d) The guarantees in respect of bank borrowings were 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 related parties.

NOTES TO FINANCIAL STATEMENTS

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45. RELATED PARTY TRANSACTIONS (continued)

(II) Outstanding balance with related parties:

- (i) Details of the Group's trade balances with ultimate holding company, jointly-controlled entities, associates and other related parties as at balance sheet date are disclosed in notes 24 and 29 to the financial statements.
- (ii) Details of the Group's balances of payable and receivable which are not trading nature with ultimate holding company, jointly-controlled entities, associates and other related parties as at balance sheet date are disclosed in notes 26 and 30 to the financial statements.

(III) Compensation of key management personnel of the Group

	2005 RMB'000	2004 RMB'000
Short term employee benefits	4,875	6,716
Post-employment benefits	53	29
Total compensation paid to key management personnel	4,928	6,745

Included in the transactions with Zhongxingxin, the Group's ultimate holding company, and its subsidiaries, associates and jointly-controlled entities, approximately RMB431 million of the transaction constituted continuing connected transactions as defined in Chapter 14A of the Listing Rules.

46. 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 2005, the bank loans of the Group and the Company are all fixed rate debts. 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 USD and RMB and certain portion of the bank loans is denominated in USD. 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.

46. FINANCIAL RISK MANAGEMENT OBJECTIVES AND POLICIES (continued)

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.

47. POST BALANCE SHEET EVENTS

There were no significant events after 31 December 2005.

48. COMPARATIVE AMOUNTS

As further explained in notes 2.2 and 2.4 to the financial statements, due to the adoption of new HKFRSs during the current year, the accounting treatment and presentation of certain items and balances in the financial statements have been revised to comply with the new requirements. Accordingly, certain comparative amounts have been reclassified and restated to conform to the current year's presentation.

49. APPROVAL OF THE FINANCIAL STATEMENTS

The financial statements were approved and authorised for issue by the board of directors on 6 April 2006.

DOCUMENTS AVAILABLE FOR INSPECTION

1. Text of the 2005 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 2005 prepared in accordance with the PRC GAAP and HKAS 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

7 April 2006