CHINA UNICOM LTD
Form 20-F
June 29, 2007

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 20-F

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

OR

þ **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the fiscal year ended December 31, 2006

OR

o **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the transition period from __________ to __________

OR

o **SHELL COMPANY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
Date of event requiring this shell company report __________

Commission file number 1-15028

CHINA UNICOM LIMITED

(Exact Name of Registrant as Specified in Its Charter)

N/A	Hong Kong
(Translation of Registrant s Name Into English)	(Jurisdiction of Incorporation or Organization)

75th Floor, The Center
99 Queen s Road Central
Hong Kong
(Address of Principal Executive Offices)

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

Title of Each Class	Name of Each Exchange On Which Registered
Ordinary shares, par value HK$0.10 per share	New York Stock Exchange, Inc.*

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

Securities registered or to be registered pursuant to Section 12(g) of the Act:
None
(Title of class)

Securities for which there is a reporting obligation pursuant to Section 15(d) of the Act:
None
(Title of Class)

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

As of December 31, 2006, 12,680,989,270 ordinary shares were issued and outstanding.

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

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

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

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

Large Accelerated Filer þ Accelerated Filer o Non-Accelerated Filer o

Indicate by check mark which financial statement item the registrant has elected to follow.

Item 17 o Item 18 þ

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

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Note Regarding Forward-looking Statements

This annual report for the year ended December 31, 2006 contains forward-looking statements that are, by their nature, subject to significant risks and uncertainties. Such forward-looking statements include, without limitation:

- our strategy and future plan,
- our capital expenditure plan,
- our future business condition and financial results,
- our ability to retain existing subscribers and attract new subscribers,
- our ability to improve our existing services and offer and market new services,
- future growth of market demand for our services,
- our abilities to optimize, upgrade and expand our networks and increase network efficiency,
- our ability to leverage our position as an integrated telecommunications operator and expand into new businesses and new markets,
- our ability to upgrade and develop technology applications, and
- future regulatory and other developments in the Chinese telecommunications industry.

These forward-looking statements reflect our current views with respect to future events. Actual results may differ materially from information contained in the forward-looking statements as a result of many factors that may be beyond our control, including, without limitation:

- any changes in the regulatory policies of the Ministry of Information Industry, or MII, the State-owned Assets Supervision and Administration Commission, or SASAC, and other relevant government authorities in the People s Republic of China, or the PRC,
- the PRC government s decision in relation to the technology standards and licenses of third generation mobile telecommunications, or 3G,
- the effects of competition on the demand and price of our telecommunications services,
- any changes in telecommunications and related technology and applications based on such technology, and
- changes in political, economic, legal and social conditions in China including: the PRC government s policies with respect to economic growth, consolidations of and other structural changes in the PRC telecommunications industry, foreign exchange controls, foreign investments in and entry by foreign companies into China s telecommunications market.

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In addition, our future capital expenditure and development plans are dependent on various factors, including, among others:

the availability of adequate financing on acceptable terms,

the adequate and timely supply of equipment when required, and

the adequacy of currently available spectrum and other government-controlled telecommunications resources or availability of additional spectrum and such other telecommunications resources.

Please also see the D. Risk Factors section under Item 3.

Certain Definitions

As used in this annual report, references to we , us , our , the Company and Unicom are to China Unicom Limi Unless the context otherwise requires, these references include all of our subsidiaries. In respect of any time prior to our incorporation, references to we , us , our and Unicom are to the telecommunications businesses in which our predecessors were engaged and which were subsequently assumed by us. All references to Unicom Group are to China United Telecommunications Corporation, our indirect controlling shareholder. Unless the context otherwise requires, these references include all of Unicom Group s subsidiaries, including us and our subsidiaries. Please also see A. History and Development of the Company under Item 4 for our current shareholding structure. For purposes of this annual report, references to PRC and China do not include Hong Kong Special Administrative Region, Macau Special Administrative Region or Taiwan.

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PART I

Item 1. Identity of Directors, Senior Management and Advisers

Not Applicable.

Item 2. Offer Statistics and Expected Timetable

Not Applicable.

Item 3. Key Information

A. Selected Financial Data

The following table presents our selected consolidated income statement data for the years ended December 31, 2002, 2003, 2004, 2005 and 2006 and our selected consolidated balance sheet data as of December 31, 2002, 2003, 2004, 2005 and 2006. The selected consolidated balance sheet data as of December 31, 2005 and 2006 and income statement and cash flow data for the years ended December 31, 2004, 2005 and 2006 have been derived from our audited consolidated financial statements included in this annual report. The selected consolidated balance sheet data as of December 31, 2002, 2003 and 2004 and income statement and cash flow data for the years ended December 31, 2002 and 2003 have been derived from our audited consolidated financial statements that are not included in this annual report.

Our financial statements are prepared in accordance with Hong Kong Financial Reporting Standards and Hong Kong Accounting Standards, or HKFRS. Financial statements prepared in accordance with HKFRS vary in certain material respects from generally accepted accounting principles in the United States, or US GAAP. In accordance with HKFRS, we adopted the purchase method to account for our prior acquisitions from Unicom Group of certain cellular businesses and assets held by Unicom New Century Telecommunications Corporation Limited, or Unicom New Century, Unicom New World Telecommunications Corporation Limited, or Unicom New World, and China Unicom International Limited, or Unicom International. The acquisitions of Unicom New Century, Unicom New World and Unicom International became effective on December 31, 2002, December 31, 2003 and in September 2004, respectively, as described in A. History and Development of the Company under Item 4. Accordingly, our consolidated income statement and, except as otherwise noted, all other HKFRS financial information for the year 2004 presented in this annual report include the operating results of Unicom New Century and Unicom New World for the year ended December 31, 2004 and the operating results of Unicom International from the effective date of the acquisition to December 31, 2004, but our consolidated income statement and all other HKFRS financial information for the year 2003 presented in this annual report do not include the operating results of Unicom New World for the year ended December 31, 2003. Under the purchase method, our consolidated balance sheet as of December 31, 2003 includes the financial position of Unicom New Century and Unicom New World and our consolidated balance sheet as of December 31, 2004 also includes the financial position of Unicom International. In contrast, under US GAAP, these acquisitions would have been accounted for as transfers of entities under common control. The financial statements prepared under US GAAP would have been retroactively restated for all periods presented on a combined basis as if the acquisitions had been in effect since inception, whereby related assets and liabilities of the acquired businesses would have been accounted for at historical cost and the results of operations of the acquired businesses would have been included in the consolidated financial statements for the earliest period presented.

See Note 38 to the consolidated financial statements included in this annual report for a summary of the principal differences between HKFRS and US GAAP in relation to our financial statements.

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	As of or for the year ended December 31					
	2002[(1)]	**2003[(1)(2)]**	**2004[(1)]**	**2005**	**2006**	**2006**
	RMB	**RMB**	**RMB**	**RMB**	**RMB**	**US$[(3)]**
			(in millions, except number of shares and per share data)			
Statement of Income Data:						
HKFRS:						
Revenue (Turnover):						
Cellular Service Business	31,112	57,819	71,887	79,712	86,584	11,095
-GSM Service Business	27,890	41,153	47,509	52,135	59,291	7,598
-CDMA Service Business	3,222	16,667	24,378	27,577	27,293	3,497
Paging Business	2,161	1,403				
Long Distance Business	2,766	2,273	1,848	1,525	1,068	137
Data and Internet Business	2,793	3,437	3,662	3,050	2,375	304
Total service revenue	38,832	64,933	77,397	84,287	90,027	11,536
Sales of telecommunications products	1,411	2,221	1,690	2,762	4,267	547
Total revenue	40,243	67,154	79,087	87,049	94,294	12,083
Costs and expenses	(33,932)	(60,956)	(72,616)	(79,947)	(87,799)	(11,251)
Income before income tax	6,311	6,198	6,471	7,102	6,495	832
Net income	4,649	4,269	4,493	4,931	3,732	478
-Basic net income per share[(4)]	0.37	0.34	0.36	0.39	0.30	0.04
-Number of shares outstanding for basic net income per share (in thousands)[(4)]	12,552,996	12,553,010	12,561,242	12,570,398	12,599,018	12,599,018
-Diluted net income per share[(4)]	0.37	0.34	0.36	0.39	0.30	0.04
-Number of shares outstanding for diluted net income per share (in thousands)[(4)]	12,552,996	12,556,728	12,593,054	12,607,476	12,649,306	12,649,306
-Basic net income per ADS[(5)]	3.69	3.41	3.58	3.92	2.96	0.38
-Number of ADS outstanding for basic net income per ADS (in thousands)[(4)]	1,255,300	1,255,301	1,256,124	1,257,040	1,259,902	1,259,902
-Diluted net income per ADS[(5)]	3.69	3.41	3.57	3.91	2.95	0.38

-Number of ADS outstanding for diluted net income per ADS (in thousands)(4)	1,255,300	1,255,673	1,259,305	1,260,748	1,264,931	1,264,931
US GAAP(6):						
Revenue	50,421	71,980	79,388	87,255	94,500	12,109
Operating income from continuing operations	9,759	10,710	8,185	8,142	9,202	1,179
Net income before discontinued operation, and cumulative effect of change in accounting policy	5,500	6,078	4,713	5,013	6,156	789
Loss from discontinued operation, net of tax	422	1,342				
Cumulative effect of change in accounting policy (transitional adjustment of goodwill impairment upon the adoption of SFAS 142)	42					
Net income	5,036	4,736	4,713	5,013	6,156	789
-Basic net income per share before discontinued operation and cumulative effect of change in accounting policy(4)	0.44	0.48	0.38	0.40	0.49	0.06
-Basic net income per ADS before discontinued operation and cumulative effect of change in accounting policy(5)	4.38	4.84	3.75	3.99	4.89	0.63
-Basic net income per share after discontinued operation and cumulative effect of change in accounting policy(4)	0.40	0.38	0.38	0.40	0.49	0.06
-Basic net income per ADS after discontinued operation and cumulative effect of change in accounting policy(5)	4.01	3.77	3.75	3.99	4.89	0.63

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	As of or for the year ended December 31					
	2002[1]	**2003[1][2]**	**2004[1]**	**2005**	**2006**	**2006**
	RMB	**RMB**	**RMB**	**RMB**	**RMB**	**US$[3]**
			(in millions, except number of shares and per share data)			
Balance sheet Data:						
HKFRS:						
Bank balances and cash	14,433	9,220	4,655	5,472	12,182	1,561
Property, plant and equipment	107,216	117,863	118,492	112,373(7)	111,382	14,272
Total assets	152,095	152,870	149,038	142,630	146,438	18,764
Short-term debt and current portion of other long-term debt	15,330	18,173	20,015	22,035	11,072	1,419
Obligations under finance lease-current portion	17	25	938	421	100	13
Obligations under finance lease-non-current portion	101	100	489	145	10	1
Other long-term debt	37,686	36,213	26,137	11,982	4,139	530
Convertible bonds					10,325	1,323
Shareholders equity	66,572	69,052	72,442	76,287	79,412	10,176
Share capital	1,331	1,331	1,332	1,334	1,344	172
US GAAP[6]:						
Property, plant and equipment	118,787	118,171	118,701	112,549	111,286	14,260
Total assets	164,636	150,477	146,615	139,958	143,718	18,416
Obligations under finance lease-current portion	17	25	938	421	100	13
Obligations under finance lease-non-current portion	101	100	489	145	10	1
Other long-term debt	45,520	36,213	26,137	11,982	4,139	530
Convertible bonds					7,863	1,008
Shareholders equity	64,215	65,946	69,442	73,265	78,733	10,089
Share capital	1,331	1,331	1,332	1,334	1,344	172
Other Financial Data:						
HKFRS:						
Net cash generated from operating activities	13,054	22,565	23,819	30,804	35,451	4,543
Net cash used in investing activities	(5,166)	(19,051)	(18,958)	(16,748)	(17,337)	(2,222)
Net cash used in financing activities	(11,868)	(8,778)	(9,401)	(13,213)	(11,403)	(1,461)
Dividend declared per share	0.10	0.10	0.10	0.11	0.18	0.02

US GAAP[(6)]:						
Net cash generated from operating activities	18,235	25,993	24,510	31,486	35,874	4,597
Net cash used in investing activities	(10,261)	(20,295)	(19,668)	(17,431)	(17,760)	(2,276)
Net cash used in financing activities	(12,773)	(11,397)	(9,440)	(13,213)	(11,403)	(1,461)
Dividend declared per share	0.10	0.10	0.10	0.11	0.18	0.02

(1) The adoption of HKFRS on January 1, 2005 resulted in changes in certain accounting policies which have been reflected in the financial statements either in accordance with the transitional provisions in the applicable accounting standards or, to the extent there are no transitional provisions, applied retrospectively. Accordingly, the comparative financial data prior to January 1, 2005 presented herein was restated, as applicable, in 2005 to conform to the changed accounting policies.

(2) Under HKFRS, the sale of Guoxin Paging

Corporation Ltd., or Guoxin Paging, on December 31, 2003 by us to Unicom Group has been accounted for as a sale of discontinued operation. The difference between the sale proceeds and the carrying amount of net assets of Guoxin Paging as of December 31, 2003 was recorded as a loss on sale of discontinued operation in our consolidated income statement for the year ended December 31, 2003. The operating results of Guoxin Paging from January 1, 2003 to the effective date of the sale of Guoxin Paging were included in our consolidated income statement for the year ended December 31, 2003. Under US GAAP, the sale of Guoxin Paging to Unicom Group is considered a transfer of business between entities under common control and accounted for at historical cost of the net assets transferred, after reduction, if appropriate, for an indicated impairment of value. In addition, under US GAAP, the results of operations of a component or segment of an entity that has been disposed of should be reported in discontinued operations as a separate component of income, separated from continuing operations, in the period in which the disposal occurred and in prior periods. Accordingly, all the operating results of Guoxin Paging have been grouped into and reported in the income statement as Discontinued operation Loss from discontinued operation under US GAAP.

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(3) The translation of RMB into US dollars has been made at the rate of RMB7.8041 to US$1.00, the noon buying rate in New York City for cable transfer in RMB as certified for customs purposes by the Federal Reserve Bank of New York on December 29, 2006. The translations are solely for the convenience of the reader.

(4) See Notes 30 and 38 to the financial statements included in this Form 20-F on how basic and diluted net income per share are calculated under HKFRS and US GAAP, respectively.

(5) Net income per ADS is calculated by multiplying net income per share by 10, which is the number of shares represented by each ADS.

(6) The US GAAP amounts as of and for each of the relevant years ended on December 31, 2006, 2005, 2004, 2003 and 2002 are presented as if the acquisitions of Unicom New Century, Unicom New World and Unicom International had been in existence since the beginning of the earliest period presented.

(7) Certain assets have been reclassified for comparative purpose, see Notes 6 and 36 to our consolidated financial statements included in this Form 20-F for detailed discussions.

Historical Exchange Rates Information

We publish our financial statements in Renminbi, or RMB, the legal tender currency in the PRC. In this annual report, references to US dollars or US$ are to United States dollars and references to Hong Kong dollars , HK dollars or HK$ are to Hong Kong dollars. Solely for the convenience of the reader, this annual report contains translations of certain RMB and Hong Kong dollar amounts into US dollar amounts and vice versa at specified rates. These translations should not be construed as representations that the RMB or Hong Kong dollar amounts actually represent such US dollar amounts or could be converted into US dollar amounts at the rates indicated or at all. Unless otherwise stated, the translations of RMB and Hong Kong dollars into US dollars and vice versa have been made at the rate of RMB7.8041 to US$1.00 and HK$7.7771 to US$1.00, the noon buying rates in New York City for cable transfers payable in RMB or Hong Kong dollars as certified for customs purposes by the Federal Reserve Bank of New York on December 29, 2006.

The noon buying rates on June 27, 2007 were RMB7.6210 to US$1.00 and HK$7.8147 to US$1.00, respectively. The average noon buying rates for 2002, 2003, 2004, 2005 and 2006 were RMB8.2771, RMB8.2772, RMB8.2768, RMB8.1826 and RMB7.9723, respectively, to US$1.00, and HK$7.7996, HK$7.7864, HK$7.7899, HK$7.7755 and HK$7.7681, respectively, to US$1.00, calculated as the average of the noon buying rates on the last day of each month during each applicable year. The following table sets forth the high and low noon buying rates between RMB and the US dollar (in RMB per US dollar) and Hong Kong dollar and the US dollar (in Hong Kong dollar per US dollar) for each month during the previous six months:

Period	**High**	**Low**	**High**	**Low**
	(RMB per US$1.00)		**(HK$ per US$1.00)**	
December 2006	7.8350	7.8041	7.7787	7.7665
January 2007	7.8127	7.7705	7.8112	7.7797
February 2007	7.7632	7.7410	7.8141	7.8041
March 2007	7.7454	7.7232	7.8177	7.8093
April 2007	7.7345	7.7090	7.8212	7.8095
May 2007	7.7065	7.6463	7.8236	7.8044
June 2007 (through June 27, 2007)	7.6680	7.6175	7.8188	7.8062

B. Capitalization and Indebtedness

Not applicable.

C. Reasons for the Offer and Use of Proceeds

Not applicable.

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D. Risk Factors

Risks Relating to Our Business

Our cellular businesses face competition from China Mobile Limited, or China Mobile, China Telecommunications Corporation, or China Telecom, and China Network Communications Group Corporation, or China Netcom. Such competition may intensify and result in slower subscriber growth, lower tariffs and higher customer acquisition costs for us, which would materially adversely affect our financial condition, results of operations and growth prospects.

Our cellular businesses face intense competition from China Mobile. China Mobile is the largest cellular operator in China and has competitive advantages over us in areas such as customer base, financial resources and brand recognition. We have been experiencing intense competition from China Mobile in our cellular service areas, and such competition may continue and even intensify. In particular, continued price competition between China Mobile and us, such as increased offerings of package service plans with calling-party-pays features and/or decreased roaming charges, may accelerate the decline of the average revenue per user per month, or ARPU, of our cellular services, and adversely affect our profitability. Moreover, China Mobile has announced its intention to launch 3G cellular services in the future, which could further intensify the competition with our cellular businesses.

Our cellular services also compete with the local wireless telecommunications services offered by China Telecom and China Netcom in their respective service areas, known as Little Smart services, which are based on their fixed line networks and primarily utilize the personal handy-phone system, or PHS, technology. Little Smart services are offered as extensions of fixed line services and, with such features as calling-party-pays arrangements, carry significantly lower tariffs than cellular services. Currently these services have attracted over 90 million users in China and their subscriber base is continuing to grow. In addition, both China Telecom and China Netcom have announced their intention to develop 3G cellular services in the future, which would impose a more direct competition with our cellular business.

Increased competition from China Mobile, China Telecom and China Netcom could lead to slower subscriber growth, lower traffic volume of our cellular services, continued price pressure and higher customer acquisition costs, which may materially adversely affect our financial condition, results of operations and growth prospects.

Our CDMA services may remain in a relatively disadvantageous market position as compared to GSM services in China.

We are the only cellular operator offering CDMA services in China. The majority of cellular subscribers in China today are subscribers to services based on the global system for mobile communications, or GSM. As of December 31, 2006, we had approximately 36.5 million CDMA subscribers, while there were over 400 million cellular subscribers in China as of December 31, 2006. CDMA cellular services compete with GSM services for cellular subscribers, who may be reluctant to switch to CDMA cellular services because of the need to obtain a new CDMA handset and a new phone number. CDMA services are also perceived to have limitations in international roaming due to the lack of CDMA networks in many countries. In addition, CDMA handsets are generally more expensive than GSM handsets and are not compatible with GSM networks. As a result of the smaller subscriber base, the overall size of the supply chain for CDMA cellular services in China is significantly smaller than the supply chain for GSM cellular services.

Whether our CDMA services can gain a more favorable market position will continue to be subject to a number of uncertainties, including, among others:

- whether we can effectively retain our existing subscribers and attract sufficient new CDMA cellular subscribers;
- whether we can effectively maintain and/or improve the ARPU of our CDMA;
- whether we can effectively utilize our CDMA marketing expenses to accelerate the revenue growth of our CDMA business;
- whether we can generate more revenues from value-added services by capitalizing on the technological advantages of CDMA 1X wireless data services; and
- whether we can enhance the market image of our CDMA services among cellular users in China.

Any of these uncertainties may adversely affect the growth and profitability of our CDMA cellular services and consequently our financial condition and results of operation.

Our CDMA and GSM businesses compete with each other in certain areas, which may adversely affect the growth and profitability of these businesses.

To implement differentiated and dedicated management of our CDMA and GSM businesses, we recently segregated the sales and marketing functions of these two businesses, which may require (i) more delineated allocation of resources in personnel, management, finance and information technology, among others and (ii) more management coordination at both headquarter and branch levels. However, we may not be able to achieve favorable results from the implementation of our segregation of the sales and marketing functions of our CDMA and GSM businesses. In addition, the competition between the two businesses for our internal resources as well as external cellular subscribers may not lead to overall better results of our operations. If we cannot coordinate the development of our CDMA and GSM services effectively, or obtain adequate resources for both our GSM and CDMA cellular services, the growth and profitability of these businesses and our financial condition, results of operations and growth prospects may be adversely affected.

Failure to continually optimize, expand and upgrade our networks and infrastructure or changes in telecommunications technology and technological standards could adversely affect our competitive position and hinder our growth.

The growth of our businesses depends on whether we are able to continue to optimize and expand the coverage and capacity of our networks, to upgrade the technology and to improve the quality of our networks in a timely and effective manner. We also need to continue to improve the quality of our existing networks in order to enhance our telecommunications services.

In addition, the telecommunications industry in China and elsewhere in the world is subject to rapid and significant changes in technology and technological standards, including the technology migration to 3G. Such changes may render our networks and systems inadequate or obsolete. As a result of such changes, we may need to make significant changes and upgrades to our existing networks and infrastructure or construct new networks and infrastructure, which may require substantial capital expenditures and other resources.

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Our ability to expand and upgrade our networks and infrastructure is subject to a number of uncertainties, including our ability to achieve the following on a timely basis and on acceptable terms:

obtain adequate financing;

obtain relevant government licenses, permits and approvals;

manage the technology migration in an effective manner;

obtain adequate network equipment and software;

retain experienced management and technical personnel;

obtain sufficient spectrum frequencies, network numbers and other telecommunications resources controlled by the PRC government;

gain access to the sites for network construction or upgrade; and

enter into interconnection and other arrangements with other operators.

If we are not able to timely and effectively overcome these uncertainties and other difficulties we may encounter in expanding and upgrading our networks and infrastructure, our competitive position, financial condition, results of operations and growth prospects may be adversely affected.

The CDMA handset promotional packages have increased our costs and expenses and may adversely affect our profitability.

In order to accelerate the development of our CDMA business and subscriber growth, we have offered CDMA handset promotional packages. Under those arrangements, CDMA handsets were provided to subscribers for their use at no additional cost to them during the specified contract periods as long as such subscribers agreed to incur a minimum amount of service fees during the contract period. The maximum contract period is two years. The cost of the handsets provided to subscribers under these contractual arrangements, treated as deferred customer acquisition costs, was deferred, to the extent recoverable, and amortized over the contractual period during which we expect to receive the minimum contract revenue. Therefore, these promotional packages tend to increase our costs and expenses.

While we have significantly reduced the use of such CDMA handset promotional packages in recent years, the carrying amount of the deferred customer acquisition costs has been gradually reduced but remained sizeable. For the year ended December 31, 2006, amortization of such deferred customer acquisition costs was approximately RMB4.21 billion and the carrying amount of such costs amounted to RMB2.10 billion as of December 31, 2006. As a result, while the use of these CDMA promotional packages has accelerated the growth of our CDMA business, it may adversely affect the profitability of our CDMA business and our financial condition and results of operations.

In addition, upon expiration of the contract period of these CDMA handset promotional packages, some subscribers did not renew their contracts and switched to cheaper service plan packages or subscribed to our competitors cellular services, which contributed to the decrease of ARPU and the increase of the churn rate of our CDMA business in 2006. Such effects, if they continue, may adversely affect the profitability of our CDMA business and our financial condition and results of operations.

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In order to control the costs of our CDMA promotional packages, we adopted a policy to centralize the purchases of CDMA handsets since 2005. This centralized purchasing policy has resulted in our maintaining inventory of CDMA handsets that is subject to the risk of inventory obsolescence. As of December 31, 2006, we maintained an inventory of CDMA handsets of RMB1.35 billion.

If we are unable to fund our capital expenditure and debt service requirements, our financial condition and growth prospects will be adversely affected.

We continue to have a significant level of capital expenditure and debt service requirements. We plan to spend approximately RMB26.00 billion for capital expenditure in 2007, an increase of 20.6% from 2006. As of December 31, 2006, the sum of our long-term and short-term interest bearing debt exceeded the amount of our cash, cash equivalents and short-term bank deposits by RMB13.27 billion. See Liquidity and Capital Resources under Item 5. We cannot assure you that we will be able to obtain future financing on a timely basis and on acceptable terms, and our failure to do so may adversely affect our financial condition, competitive position and growth prospects. Our ability to obtain acceptable financing at any time may depend on a number of factors, including, among others:

- our financial condition and results of operations;
- our creditworthiness and relationship with lenders;
- the condition of the economy and the telecommunications industry in China;
- conditions in relevant financial markets in China and elsewhere in the world; and
- our ability to obtain any required government approvals for our financings.

Our long distance, data and Internet businesses remain small compared to China Telecom or China Netcom, and competition from China Telecom, China Netcom and other telecommunications service providers may adversely affect our profitability and growth in these businesses.

The fixed line operators of China Telecom and China Netcom currently hold the strongest market position in the public switched long distance telephony, or PSTN, and data services markets in their respective service areas. They are also the leading providers of Internet protocol telephony, or IP telephony, and Internet access services in China. China Telecom and China Netcom have competitive advantages over us in areas such as customer base, financial resources, fixed network coverage and last-mile access. Our IP telephony services also compete with other service providers including China Satellite Communication, or China SatCom, and China Railway Communications Co. Ltd., or China Railcom. In 2006, intense competition continued to contribute to the decreases in average realized tariff rates for long distance services and in revenue from our long distance business. In addition, our lack of licenses to operate local telephony networks has continued to hinder the growth of our long distance, data and Internet businesses. Competition from China Telecom, China Netcom and other service providers may continue to adversely affect the profitability and growth of our long distance, data and Internet businesses and, to a lesser extent, our overall financial condition and results of operations.

Our churn rates and doubtful debt ratio may increase.

The monthly average churn rate of our GSM and CDMA cellular services increased from 2.41% in 2005 to 2.44% in 2006 and from 1.49% in 2005 to 1.57% in 2006, respectively.

The reasons for such increases include, among others, competition from other service providers, the increase in the proportion of cost-sensitive subscribers among new subscribers and discontinuance of some contractual subscribers upon expiration of their contract period under CDMA handset promotional packages. Increased churn rates of our GSM and CDMA services may adversely affect our market share and increase our costs of additional customer acquisitions and bad debt, which would adversely affect our financial condition, results of operations and growth prospects.

China is still in the process of developing an effective credit reporting system, and with intense competition in the cellular telecommunications market, our doubtful debt ratio for cellular services, calculated as the amount of doubtful debt provided during the year divided by revenue from our cellular services, may increase in the future. Our doubtful debt ratio of our GSM and CDMA cellular businesses was at 1.7% as of December 31, 2006. If such ratio increases in the future, our financial condition and results of operations could be adversely affected.

Obstacles in interconnection with networks of other telecommunications operators could jeopardize our operations.

The effective provision of our cellular, long distance telephony and other services requires the interconnection between our networks and those of Unicom Group, and the networks of China Telecom, China Netcom, China Mobile and other telecommunications operators. Any obstacles in existing interconnection arrangements or any significant change of their terms, as a result of natural events, accidents, or for regulatory, technological, competitive or other reasons, could lead to temporary service disruptions and increased costs that can seriously jeopardize our operations and adversely affect our profitability and growth. Difficulties in the execution of new interconnection arrangements on a timely basis and on acceptable terms, including the inability to promptly establish additional interconnection links or increase interconnection bandwidths as required, could also adversely affect our financial condition, results of operation and growth prospects.

Our controlling shareholder, Unicom Group, can exert influence on us and cause us to make decisions that may not always be in the best interests of our other shareholders.

Unicom Group indirectly controls an aggregate of 76.59% of our issued share capital as of May 31, 2007. As our controlling shareholder, it is able to influence our major business decisions through its control of our board of directors. All of our executive directors and executive officers also serve as directors or executive officers of Unicom Group. In addition, our operations depend on a number of services provided by Unicom Group. For example, Unicom Group leases to us, on an exclusive basis, capacity on the CDMA network located in our cellular service areas, provides us with access to international gateways, supplies us with subscriber identity module cards, or SIM cards, and calling cards and provides equipment procurement services and customer services to us. Unicom Group and we also provide a number of services to each other, including interconnection and roaming services, sales agency and collection services and provision of premises. See A. History and Development of the Company ¾ Our Relationship with Unicom Group under Item 4 of this annual report. The interests of Unicom Group and our interests in these transactions may differ and Unicom Group may cause us to make decisions that conflict with the interests of our other shareholders.

The internal reorganization of Unicom Group for the A Share offering has created a two-step voting mechanism that will require the approval of the minority shareholders of both our Company and the A Share Company for significant connected transactions between us and Unicom Group.

In October 2002, Unicom Group completed an internal reorganization of its shareholding in our company and the initial public offering in China of its newly established subsidiary, China United Telecommunications Corporation Limited, or the A Share Company. As part of this restructuring, a portion of Unicom Group s indirect shareholding in our company was transferred to the A Share Company, whose

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business is limited to indirectly holding the equity interest of our company without any other direct business operations. A voting mechanism was established to allow public shareholders of the A Share Company to indirectly participate in our shareholders meetings and a two-step voting mechanism was established for the approval of connected transactions. See A. History and Development of the Company ¾ Further Restructuring of Unicom Group and Initial Public Offering of the A Share Company in 2002 under Item 4 below. As a result, significant connected transactions between us or our subsidiaries and Unicom Group or its subsidiaries will require the separate approval of the independent minority shareholders both of our company and of the A Share Company. Connected transactions approved by our independent minority shareholders nevertheless cannot proceed if they are not approved by the independent minority shareholders of the A Share Company. This adds another necessary step of approval process for those transactions.

Investor confidence and the market prices of our shares and ADSs may be materially and adversely impacted if we are or our independent registered public accounting firm is unable to conclude that our internal control over financial reporting is effective in future years as required by Section 404 of the Sarbanes-Oxley Act of 2002.

We are a public company in the United States that is subject to the Sarbanes-Oxley Act of 2002. Pursuant to the requirements of Section 404 of the Sarbanes-Oxley Act of 2002, we include in this annual report a report of management on our internal control over financial reporting and an attestation report of our independent registered public accounting firm on management s assessment of the effectiveness of our internal control over financial reporting.

As of December 31, 2006, our management conducted an assessment of the effectiveness of our internal control over financial reporting and concluded that our internal control over financial reporting as of December 31, 2006 was effective. Our management s assessment has been audited by PricewaterhouseCoopers, an independent registered public accounting firm, which expresses unqualified opinions on our management s assessment and on the effectiveness of our internal control over financial reporting as of December 31, 2006. However, we cannot assure you that, in the future, our management will continue to conclude that our internal control over financial reporting is effective. Even if our management concludes that our internal control over financial reporting is effective for future periods, our independent registered public accounting firm may disagree. If our independent registered public accounting firm is not satisfied with our internal control over financial reporting or the level at which our controls are documented, designed, operated, reviewed or evaluated, or if the independent registered public accounting firm interprets the relevant requirements, rules or regulations differently from us, then it may issue an adverse opinion. Any of these possible outcomes in the future could result in an adverse reaction in the financial marketplace due to a loss of investor confidence in the reliability of our consolidated financial statements, which could materially and adversely affect the market prices of our shares and ADSs.

We may incur increased costs as a result of being a public company.

As a public company listed on the New York Stock Exchange and The Stock Exchange of Hong Kong Limited, we incur a higher level of accounting, legal and other expenses than many private companies. In addition, the Sarbanes-Oxley Act of 2002, as well as new rules subsequently implemented by the Securities and Exchange Commission, or the SEC, and the New York Stock Exchange, have required changes in corporate governance and internal control practices of public companies. We expect these new rules and regulations to increase our legal and financial compliance costs and to make certain corporate activities more time-consuming and costly. For example, as a result of increased compliance work in light of the implementation of Section 404 of the Sarbanes-Oxley Act of 2002, our audit fees increased 110% from US$7.35 million in 2005 to US$15.42 million in 2006.

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The unrealized gain or loss on changes in fair value of the derivative component of our zero coupon convertible bonds and the dilution effect resulting from the conversion of such convertible bonds may adversely affect our share price.

On July 5, 2006, we issued zero coupon convertible bonds due July 5, 2009, with an aggregate principal amount of US$1 billion. The holder of the convertible bonds has an option to convert the bonds into our ordinary shares at a conversion price of HK$8.63 (approximately US$1.11) per share, subject to certain adjustments. According to HKFRS, the conversion option is separately carried as derivative liability at fair value on our balance sheet and any change in such fair value will be charged or credited to our statement of income for the period in which the change occurs. Due to the substantial change in our share price from HK$6.95 as of July 5, 2006, the issue date of the convertible bonds, to HK$11.40 as of December 31, 2006, the fair value of the conversion option in respect of the convertible bonds increased significantly and resulted in an unrealized loss of RMB2.40 billion (approximately US$307 million) on changes in fair value of derivative component of the convertible bonds. Although such unrealized losses do not have any effect on our cash flow or other aspects of our operations, they had a negative impact on our net income for the year 2006, causing a 24.3% decrease from 2005. Fluctuations in our share price, which are beyond our control, could cause unrealized loss or gain again in the future, which may significantly impact our net income. If such unrealized loss or gain reoccurs, we cannot assure you that it will not cause any negative impact on the market price of our shares or ADSs.

In addition, pursuant to the subscription agreement of the convertible bonds, the holder of the convertible bonds may choose to convert such bonds into our common shares, starting from July 5, 2007. Assuming full conversion of the bonds at the initial conversion price of HK$8.63 (US$1.11) per share, the bonds would be convertible into 899,745,075 ordinary shares, representing approximately 6.67% of our enlarged issued and outstanding share capital as of June 20, 2006. If the holder of the convertible bonds chooses to convert a portion or all of the convertible bonds, such conversion may dilute our net income per share, which in turn could have negative impact on the market price of our Shares or ADSs.

Risks Relating to the Telecommunications Industry in China

Regulatory or policy changes relating to the PRC telecommunications industry or any future industry restructuring may materially adversely affect our financial condition, results of operations and growth prospects.

The PRC government continues to regulate many aspects of the telecommunications industry in China. Potential changes in regulations and policies and their implementation could lead to significant changes in the overall industry environment. These changes may include, among others, new regulatory decisions or measures relating to issuance of 3G licenses or selection of 3G technology standards, calling-party-pays arrangements, roaming charges or other tariff adjustments, fulfillment of telecommunications service providers universal service obligations and the associated expenses, usage of numbers or frequency resources and the associated fees, or standards and mechanisms of interconnection settlement, and could substantially affect our financial condition, results of operations and growth prospects. For example, if the PRC government decides to grant 3G licenses to one or more of our competitors but not to us, or deregulates or reduces state tariff rates applicable to some of our services, our results of operations and financial condition may be materially and adversely affected. In addition, MII has recently encouraged the gradual implementation of calling-party-pays billing arrangements and the reduction of roaming charges by wireless telecommunications operators in the PRC. We cannot predict whether such regulatory moves will result in changes in regulations and official policies, and we cannot assure you that any such regulatory moves, if implemented, will not adversely affect our financial condition, results of operations and growth prospects.

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Moreover, the PRC government has in the past restructured the telecommunications industry through a number of initiatives that were rolled out in stages and may initiate further industry restructuring in the future. Any form of potential restructuring of the PRC telecommunications industry may significantly affect the overall business environment and the operations of telecommunications operators in China, including us. We cannot predict the timing for, and any implications and effect of, any future restructuring of the PRC telecommunications industry, or give any assurance that we will not be materially adversely affected by any such industry restructuring. Recently, there have been some media reports indicating that our CDMA and/or GSM businesses may be transferred to other PRC telecommunications operator(s) as a result of a contemplated industry restructuring. We are not aware of any agreements or arrangements in this regard, and we have been unable to confirm with the relevant PRC regulators whether this or any other particular form of industry restructuring is being contemplated. If any such restructuring is carried out at a time or in terms that are not in the interest of our Company or different from market expectations, the value of our Company and the market prices of our ADSs and shares could be materially and adversely affected.

Issuance of additional telecommunications service licenses, including 3G licenses, may further intensify competition in the PRC telecommunications industry and materially adversely affect our financial condition, results of operations and growth prospects.

Since the mid-1990s, the PRC government has taken various measures, including licensing more providers of telecommunications services, to encourage competition in the telecommunications industry. Currently, the Chinese telecommunications market has six basic telecommunications service providers China Telecom, China Mobile, China Netcom, China Satcom, China Railcom, and our Company and thousands of value-added service providers. In addition, the government may grant additional telecommunications service licenses in the future, including 3G licenses.

Although the MII recently announced three 3G technology standards in the PRC, which include the standard known as CDMA2000 that has been utilized by our CDMA cellular business, to date, the PRC government has not publicly announced its official decisions on the definitive timing of the grant of the 3G licenses, the number of 3G licenses to be granted or the selection criteria for telecommunications operators to be granted with 3G licenses. The issuance of 3G licenses may significantly change the overall competition environment of the wireless telecommunications industry and further intensify the competition among telecommunications service providers in China. While we, together with certain other telecommunications service providers, have participated in the 3G trial test and study programs sponsored by the MII and have been preparing for developing 3G business by upgrading our networks and services, we cannot assure you that the PRC government will grant us the requisite approvals and 3G license(s) in a timely or favorable manner, or at all. We cannot predict the 3G technology standards that may be selected by the PRC government for the 3G license(s) that may be granted to us. Even if we are granted one or more 3G licenses, we cannot assure you that we will successfully manage the technology migration to 3G and 3G operations and effectively compete with other cellular services provider(s).

After its accession to the World Trade Organization, or WTO, in December 2001, China promulgated the Administrative Regulations on Telecommunications Companies with Foreign Investment, implementing its commitments to the WTO. Those commitments include the gradual reduction of foreign ownership restrictions in the telecommunications industry and the step-by-step opening of the telecommunications market in China to foreign operators. As of the end of 2006, there was no longer any geographic restriction for foreign telecommunications service provider to provide mobile voice and data telecommunications services in China. See B. Business Overview Regulatory and Related Matters Entry into the Industry under Item 4. When the PRC government grants licenses to additional telecommunications service providers in the future, licensees may include foreign-invested operators. Such foreign-invested operators entering into China s telecommunications market may have competitive advantages over us in areas such as financial resources, network management and technical expertise.

Increased competition in China s telecommunications services industry could impede the growth of our businesses, further increase competition for skilled and experienced employees, result in or exacerbate price competition and increase our customer acquisition costs and other costs and expenses, and thereby adversely affect our results of operations, financial condition and growth prospects.

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The telecommunications industry in China may not sustain its pace of rapid growth, which may adversely affect the growth and profitability of our business.

The telecommunications industry in China has experienced rapid growth in the last several years, especially in the cellular communications sector. The total number of cellular subscribers in China increased from 43.3 million at the end of 1999 to 461.1 million by December 31, 2006. Cellular penetration increased from 3.5% to over 35% nationwide during the same period. The growth in cellular subscribers has been slowing down as cellular penetration continues to increase in our cellular service areas. In addition, ARPU for the cellular communications market in China continues to decline. For example, ARPU of our CDMA subscribers declined from RMB75.1 in 2005 to RMB65.9 in 2006. Any slowdown in the growth in China s telecommunications industry may adversely affect the growth and profitability of our business.

The PRC government may require us, along with other telecommunications service providers in China, to provide universal services with specified obligations, and we may not be compensated adequately for providing such services.

Under the Telecommunications Regulations promulgated by the State Council, telecommunications service providers in China are required to fulfill universal service obligations in accordance with relevant regulations to be promulgated by the PRC government authorities, and the MII has the authority to delineate the scope of universal service obligations. The MII, together with government finance and pricing authorities, is also responsible for formulating administrative rules relating to the establishment of a universal service fund and compensation schemes for universal services.

While specific universal services obligations are not yet clear, we believe that such services may include mandatory provision of basic telecommunications services in less economically developed areas in China and mandatory contribution to a universal service fund. In addition, as part of the transitional measures prior to the formalization of a universal service obligation framework, the MII has required major telecommunications service providers in China, including Unicom Group, to participate in a project to provide telephone services in thousands of remote villages in China. In participating in such project, Unicom Group, with our assistance, undertook the universal service obligation to extend telecommunications service coverage to a total of more than 5,700 administrative-level villages from 2004 to 2006 primarily through its CDMA and satellite transmission networks. See B. Business Overview Regulatory and Related Matters Universal Services under Item 4.

We cannot predict whether the PRC government will specifically require us to undertake universal service obligations in the future. To the extent we are required to do so, it is currently uncertain whether we will be adequately or timely compensated by the government or by the universal service fund. We cannot assure you that we will be able to realize an adequate return on investments for expanding networks to, and providing telecommunications services in, those less economically developed areas due to potentially higher capital expenditure requirements, lower usage by customers and lack of flexibility in setting our tariffs. We also cannot predict whether we will be required to make contribution to the universal service fund. Any of these events may adversely affect our financial condition and results of operations.

Actual or perceived health risks associated with the use of mobile devices could impair our ability to retain and attract customers, reduce cellular service usage or result in litigation.

Concerns have been expressed in some countries that the electromagnetic signals emitted by wireless telephone handsets and base stations may pose health risks at exposure levels below existing guideline levels, and interfere with the operation of electronic equipment. In addition, cellular operators have been subject to lawsuits alleging various health consequences as a result of cellular handset usage or proximity to base stations or seeking protective or remedial measures. While we are not aware that such health risks have been substantiated, there can be no assurance that the actual, or perceived, risks associated with the transmission of electromagnetic signals will not impair our ability to retain customers and attract new customers, reduce cellular service usage or result in litigation.

Risks Relating to Doing Business in China

Our operations may be adversely affected by changes in China s economic, political and social conditions.

Substantially all of our business operations are conducted in China and substantially all of our revenues are derived from our operations in China. Accordingly, our business, financial condition, results of operations and prospects are affected to a significant degree by economic, political and social conditions in China. The PRC economy differs from the economies of most developed countries in many respects, including with respect to the amount of government involvement, level of development, growth rate, control of foreign exchange and allocation of resources. While the PRC economy has experienced significant growth in the past three decades, growth has been uneven across different regions and among various economic sectors. The PRC government has implemented various measures to encourage economic development and guide the allocation of resources. Some of these measures benefit the overall PRC economy, but may also have a negative effect on us. For example, our financial condition and results of operations may be adversely affected by government control over capital investments. In recent years, the PRC government has implemented certain measures to manage the pace of economic growth. These measures may cause a decrease in the level of economic activity in China, including a decline in individual spending activities, which in turn could adversely affect our financial condition and results of operations.

If the PRC government revises the current regulations that allow a foreign investment enterprise to pay foreign exchange in current account transactions, our operating subsidiary s ability to satisfy their foreign exchange obligations and to pay dividends to us in foreign currencies may be restricted.

The ability of our wholly-owned operating subsidiary, China Unicom Corporation Limited, or CUCL, to satisfy its foreign exchange obligations and to pay dividends to us depends on existing and future foreign exchange regulations in China. The Renminbi is currently convertible by foreign-invested enterprises in China to settle transactions under the current account, which include trade and service related foreign exchange transactions and payments of dividends and interest on foreign loans. Renminbi currently cannot be freely converted without regulatory approval for transactions under the capital account, which includes outbound foreign investment and principal payments on foreign loans. CUCL, which holds substantially all of our assets and through which we conduct substantially all of our business, is a foreign-invested enterprise in China. This status allows it to purchase foreign exchange at designated foreign exchange banks for settlement of current account transactions without the approval of the State Administration for Foreign Exchange. However, there is no assurance that the relevant PRC government authorities will not in the future impose any limitation on the ability of foreign-invested enterprises to purchase foreign exchange to satisfy their foreign exchange obligations or to pay dividends. In that event, CUCL s ability to satisfy its foreign exchange obligations and to pay dividends to us in foreign currencies may be restricted.

Fluctuations in the value of the Renminbi could adversely affect the prices of our shares and ADSs as well as our profitability.

Substantially all of our revenues and costs and expenses are denominated in Renminbi, while a portion of our borrowings, equipment purchases and other capital expenditures are denominated in foreign currencies. On July 21, 2005, the PRC government changed its decade-old policy of pegging the value of Renminbi to that of U.S. dollar. Under the new policy, the Renminbi is permitted to fluctuate within a narrow and managed band against a basket of certain foreign currencies determined by the People s Bank of China. As of December 29, 2006, the Renminbi has appreciated approximately 5.71% in value against the U.S. dollar since July 21, 2005. On May 19, 2007, the People s Bank of China announced a policy to expand the maximum daily floating range of RMB trading prices against the U.S. dollar in the inter-bank spot foreign exchange market from 0.3% to 0.5%. With increased floating range of the Renminbi s value against foreign currencies, the Renminbi may appreciate or depreciate significantly in value against the U.S. dollar or other foreign currencies in the long term, depending on the fluctuation of the basket of currencies against which it is currently valued, or it may be permitted to enter into a full float, which may also result in a significant appreciation or depreciation of the Renminbi against the U.S. dollar or other foreign currencies in the future. Increased fluctuations of the Renminbi could adversely affect the value in foreign currency terms of cash flow generated from our operations or any dividends payable on our shares and ADSs, and therefore the price of our shares and ADSs. Any future Renminbi devaluations could also increase our equipment importation costs or lead to significant fluctuations in the exposure of our foreign-currency-denominated liabilities, thereby adversely affecting our profitability.

Uncertainties in the PRC legal system could limit the legal protections available to us and to foreign investors.

Our wholly-owned operating subsidiary, CUCL, is organized under the laws of PRC and is generally subject to laws and regulations applicable to foreign-invested enterprises in China. The Chinese legal system is a civil law system based on written statutes. Unlike common law systems, it is a system in which decided legal cases may be cited for reference but have limited precedential value. Since 1979, the PRC government has promulgated laws and regulations dealing with economic matters such as foreign investment, corporate organization and governance, commerce, property, taxation and trade. However, because these laws and regulations are relatively new, and because of the relatively limited volume of published cases and their non-binding nature, interpretation and/or enforcement of these laws and regulations involves uncertainties. Therefore, the PRC legal system may not afford the same legal protection available to investors in the United States or elsewhere.

Item 4. Information on the Company

A. History and Development of the Company

Historical Industry Restructuring

Since 1993, the PRC government has implemented a number of measures to restructure and introduce competition in the telecommunications industry. Prior to July 1994, China Telecom was the sole provider of telecommunications services in China. In July 1994, Unicom Group was established in accordance with the State Council s approval to introduce orderly competition in the telecommunications industry. Since then, the PRC government has approved Jitong Network Communications Company Limited, or Jitong, and China Netcom Corporation Ltd., or CNCL, to provide IP telephony, Internet and data services. It has also approved China Railcom to provide most telecommunications services other than cellular services.

In 1999, the State Council approved a plan to restructure the former China Telecom along four business lines: fixed line, cellular, paging and satellite communications. As a result of the restructuring, China Telecom retained the fixed line, data and Internet businesses, while China Mobile assumed the cellular business previously operated by China Telecom. In 2002, the PRC government further separated China Telecom into two companies, with the southern company retaining the name of China Telecom and

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assets and businesses in 21 provinces in southern and western China and the northern company retaining assets and businesses in 10 provinces in northern China and merging with CNCL and Jitong to form China Netcom. As a result of the PRC government s efforts to introduce competition in the telecommunications industry, there is currently more than one service provider in most of the sectors within the telecommunications industry. See B. Business Overview ¾ Competition below.

History of Unicom Group

Since its establishment in July 1994, Unicom Group has developed a nationwide cellular network using GSM technology, a nationwide cellular network using CDMA technology and a nationwide long distance telephony network. In May 1997, the State Council granted approval to Unicom Group to provide data services. The MII licensed Unicom Group to begin to provide Internet services in July 1999 and IP telephony services on a trial basis in 12 cities in April 1999 and on a nationwide basis in March 2000.

Unicom Group offers local telephony services in Sichuan Province and the municipalities of Chongqing and Tianjin. It also offers satellite transmission services through its subsidiary, China United Telecommunications Satellite Communication Co. Ltd., or Unisat.

The Restructuring of Unicom Group and Our Initial Public Offering in 2000

We are a company limited by shares incorporated under the Companies Ordinance of Hong Kong on February 8, 2000. Our registered office and principal executive offices are located at 75th Floor, The Center, 99 Queen s Road Central, Hong Kong (telephone number: 852-2126-2018).

Under a reorganization agreement, dated April 21, 2000, between Unicom Group and CUCL, Unicom Group transferred to CUCL certain of its assets, rights and liabilities in preparation for our initial public offering, or IPO. Under an equity transfer agreement, dated April 21, 2000, among us, Unicom Group, China Unicom (Hong Kong) Group Limited and China Unicom (BVI) Limited, or Unicom BVI, Unicom Group transferred to us its 100% equity interest in CUCL, which became our wholly-owned operating subsidiary in China. In return, we issued 9,725 million shares to Unicom BVI, then an indirectly controlled subsidiary of Unicom Group.

In June 2000, we successfully completed our IPO, raising approximately US$5.65 billion. Upon completion of our IPO, our shares became listed and traded on The Stock Exchange of Hong Kong Limited and ADSs representing our shares became listed and traded on the New York Stock Exchange.

Further Restructuring of Unicom Group and Initial Public Offering of the A Share Company in 2002

After our IPO, Unicom BVI, which was a wholly-owned subsidiary of China Unicom (Hong Kong) Group Limited, or Unicom HK, a wholly-owned subsidiary of Unicom Group, directly held 77.47% of our outstanding shares. In October 2002, Unicom Group completed an internal restructuring of its shareholding in our company. Unicom HK transferred the total issued capital of Unicom BVI held by it to Unicom Group and Unicom BVI became a direct wholly-owned subsidiary of Unicom Group. Unicom Group then transferred 51% of its equity interest in Unicom BVI to the A Share Company, a newly established holding company and subsidiary of Unicom Group. The A Share Company s business is limited to indirectly holding the equity interest of our company without any other direct business operations.

Following the restructuring, the A Share Company successfully completed its IPO in the PRC and the listing of its ordinary shares on the Shanghai Stock Exchange, or A Shares. After the IPO of the A Share

Company, the A Share Company transferred all of its net offering proceeds to Unicom Group in return for an additional 22.84% equity interest in Unicom BVI.

In accordance with the articles of association of the A Share Company and Unicom BVI, before Unicom BVI votes on certain proposals at our shareholders meeting, the A Share Company must first convene a shareholders meeting to consider the same proposals in order to direct Unicom BVI to vote the shares in our company indirectly held by the A Share Company through Unicom BVI. Unicom Group can similarly direct the voting in respect of its direct equity interest in Unicom BVI. This mechanism for voting is designed to allow public shareholders of the A Share Company to indirectly participate in our shareholders meeting.

The voting mechanism described above, however, will not apply to the approval process for any connected transactions between us or our subsidiaries and Unicom Group or its subsidiaries, on which Unicom BVI will not be permitted to vote under the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited, or the HKSE Listing Rules. Instead, our significant connected transactions would require the separate approvals of the public shareholders both of our company and of the A Share Company. According to the two-step voting arrangements we and the A Share Company have established, each connected transaction between us or our subsidiaries and Unicom Group or its subsidiaries will consist of an initial agreement and a further agreement. The initial agreement would be entered into by Unicom Group or its subsidiaries (excluding the A Share Company and its subsidiaries) on the one hand and the A Share Company or Unicom BVI on the other hand. This agreement would contain the following terms:

- the closing of the initial agreement would be subject to the (i) successful transfer of all rights and obligations of the A Share Company or Unicom BVI under the initial agreement to us or our subsidiaries, and (ii) the approval of the further agreement by our independent shareholders, and

- Unicom Group or its subsidiaries (excluding the A Share Company and its subsidiaries) would agree and acknowledge that all rights and obligations under the initial agreement can be transferred to us or our subsidiaries without any further consent requirements.

The initial agreement will constitute a connected transaction of the A Share Company and, if certain thresholds are met, will require the approval of the public or independent shareholders of the A Share Company under the rules of the Shanghai Stock Exchange. The further agreement would be entered into by the A Share Company or Unicom BVI on the one hand and us or our subsidiaries on the other hand, and would provide for the transfer of all rights and obligations of the A Share Company or Unicom BVI on the one hand under the initial agreement to us or our subsidiaries on the other hand. The further agreement will constitute a connected transaction of our company and, if certain thresholds are met, will require the approval of our public or independent shareholders under the HKSE Listing Rules. We expect, to the extent the nature of a particular connected transaction allows, the two-step voting arrangements to apply as described above. However, there may be circumstances where the nature of the connected transaction requires the application of the two-step voting arrangements to be adjusted. This may arise where we or our subsidiaries are the providers, rather than recipients, of certain services. In this event, the two-step voting arrangements will need to be adjusted so that the process as described above is effectively reversed, such that the initial agreement is entered into by us or our subsidiaries rather than Unicom Group or its subsidiaries (excluding the A Share Company and its subsidiaries) with the A Share Company or Unicom BVI. Unicom Group or its subsidiaries (excluding the A Share Company and its subsidiaries), rather than us or our subsidiaries, will be party to the further agreement. The arrangements (including the conditions) will apply correspondingly. This two-step structure will be applied in all future connected transactions between us and Unicom Group and will effectively require the separate approvals of the public or independent shareholders both of our company and of the A Share Company for such connected transactions.

Acquisitions of Unicom New Century and Unicom New World and the Sale of Guoxin Paging

On December 31, 2002, in accordance with the two-step approach outlined above, we successfully completed the acquisition from Unicom Group of Unicom New Century, which holds cellular telecommunications businesses (including GSM assets and businesses and CDMA businesses) in the following nine provinces, autonomous regions and municipalities in China: Jilin, Heilongjiang, Jiangxi, Henan, Shaanxi and Sichuan provinces, Guangxi Zhuang Autonomous Region, Xinjiang Uygur Autonomous Region and Chongqing municipality. The total purchase price was HK$4,523,181,304, payable in cash.

On December 31, 2003, we successfully completed the acquisition from Unicom Group of Unicom New World, which holds cellular telecommunications businesses (including GSM assets and businesses and CDMA businesses) in the following nine provinces and autonomous regions in China: Shanxi, Hunan, Hainan, Yunnan, Gansu and Qinghai provinces and Inner Mongolia, Ningxia Hui and Xizang Zang autonomous regions. The total purchase price was HK$3,014,886,000, payable in cash. On the same date, we also completed the sale of the entire equity interests of Guoxin Paging to Unicom Group for a total sale price of HK$2,590,917,656, and such proceeds were applied to our general working capital.

As a result of the acquisitions of Unicom New Century and Unicom New World, CUCL extended its cellular businesses to all provinces, autonomous regions and municipalities in China except Guizhou province.

Mergers of Unicom New Century and Unicom New World into CUCL

On July 30, 2004, Unicom New Century was merged into CUCL and legally dissolved upon the completion of such merger. On September 1, 2005, Unicom New World was merged into CUCL and legally dissolved upon the completion of such merger.

Acquisition of China Unicom International Limited

In September 2004, we acquired from Unicom Group of Unicom International, a limited liability company established in Hong Kong engaging in voice wholesale business, telephone cards business, line leasing services, managed bandwidth services and mobile virtual network services. Unicom International s wholly-owned US subsidiary, China Unicom USA Corporation, or Unicom USA, carries a wholesale business of voice traffic between the United States and mainland China. The total purchase price was HK$37,465,996, payable in cash.

Establishment of Unicom Macau and the Launch of CDMA Services in Macau

On October 15, 2004, we established China Unicom (Macau) Company Limited, or Unicom Macau, in Macau. In March 2005, Unicom Macau was granted, through a bidding process, a CDMA license with a term up to June 5, 2013, which allows Unicom Macau to provide roaming services and, subject to the Macau government s further approval, provide CDMA cellular services to local CDMA users in Macau after the first year of its operation. In October 2005, Unicom Macau completed the construction of a CDMA network in Macau and launched CDMA roaming services. On August 14, 2006, Unicom Macau obtained approval from the Macau government to provide CDMA cellular services to local users in Macau. Unicom Macau also received a 3G license on the basis of CDMA2000 technology standard on October 24, 2006 to operate a CDMA2000 network in Macau. Pursuant to the terms of the 3G license,

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Unicom Macau is required to launch the 3G operations within a year from the date of the issuance of such license.

Incorporation of Unicom Huasheng

On July 1, 2005, CUCL and Unicom Xingye Science and Technology Trade Co., or Unicom Xingye, a subsidiary of Unicom Group, incorporated Unicom Huasheng. Unicom Huasheng, currently a 99.5%-owned subsidiary of CUCL, is principally engaged in sales of handsets and telecommunications equipment and provision of technical services for us.

Share Segregation Reform of the A Share Company

On May 11, 2006, the relevant shareholders of the A Share Company approved a proposal by all the holders of the non-tradable shares of the A Share Company, including Unicom Group, to convert their non-tradable shares into shares that are listed and tradable on the Shanghai Stock Exchange. This proposal was made pursuant to and in compliance with the PRC regulations in respect of share segregation reform of companies listed in the PRC. In connection with the conversion of all non-tradable shares into tradable shares, holders of the non-tradable shares of the A Share Company transferred to each holder of tradable shares 2.8 non-tradable shares for every ten tradable shares held by such holder as of May 17, 2006. The tradable shares converted from non-tradable shares are subject to certain lock-up restrictions as required by the relevant PRC regulations. As a result of the implementation of this proposal, Unicom Group s ownership interest in the A Share Company decreased from 69.32% to 60.74%.

On May 31, 2007, Unicom Group increased its ownership interest in the A Share Company from 60.74% to 61.74% by subscribing for 212,081,265 additional shares of the A Share Company. Pursuant to the lock-up commitment made by Unicom Group, such newly subscribed shares as well as the 1,059,829,820 shares of the A Share Company held by Unicom Group will not be freely tradable until November 16, 2007. The A Share Company in turn held 82.10% of the total equity interest in Unicom BVI, with the remaining 17.90% held directly by Unicom Group. Unicom BVI held 76.59% of our outstanding shares and Unicom Group remains our ultimate controlling shareholder. See also the chart below for the current shareholding structure of our company.

Set forth below is our shareholding structure and subsidiaries as of May 31, 2007.

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Our Relationship with Unicom Group

Unicom Group continues to own and manage the international gateways that provide international connections to our long distance network. Unicom Group also continues to operate the following telecommunications networks:

its cellular networks in Guizhou province,

its local telephony networks in Sichuan Province and Chongqing and Tianjin municipalities, and

the satellite transmission networks operated through Unisat.

In March 2007, Unicom Group obtained approvals from the MII and discontinued the operations of its paging business through Unicom Paging and Guoxin Paging.

Unicom Group holds the licenses required for our telecommunications businesses and we derive our rights to operate our businesses from our status as a subsidiary of Unicom Group. Under the respective reorganization agreements entered into by CUCL, Unicom New Century and Unicom New World with Unicom Group referred to above, Unicom Group undertook to hold and maintain all licenses received from the MII in connection with our businesses solely for our benefit during the term of the licenses and at no cost to us. In addition, Unicom Group undertook to take all actions necessary to obtain and maintain for our benefit such governmental licenses or approvals as we shall require to continue to operate our businesses. Unicom Group also agreed not to engage in any business which competes with our businesses except for the then-existing competing businesses of Unicom Group and to grant us a right of first refusal in relation to any government authorization, license or permit, or other business opportunity to develop any new telecommunications technology, product or service. Finally, Unicom Group also gave us an undertaking not to seek an overseas listing for any of its businesses or the businesses of its subsidiaries in which we are engaged or may engage in the future, except through us.

In connection with the restructuring of Unicom Group and the acquisitions of Unicom New Century, Unicom New World and Unicom International, we entered into a number of agreements with Unicom Group pursuant to the two-step process described in Further Restructuring of Unicom Group and the Initial Public Offering of A Shares above. These include arrangements for interconnection and roaming services between the telecommunications networks owned by us and Unicom Group and for the provision or sharing of telecommunications and ancillary services and facilities between us and Unicom Group. Unicom Group also retains its interests in its other subsidiaries that provide ancillary services to us, including the procurement of telecommunications equipment and the supply of SIM cards and calling cards. In October 2006, we entered into several new agreements with Unicom Group to replace the existing arrangements. See B. Related Party Transactions under Item 7 for a detailed description of our agreements with Unicom Group.

Unicom Group has constructed nationwide cellular networks based on CDMA IX technology. We entered into lease agreements with Unicom Group to lease a portion of the network capacity and began to offer CDMA cellular services on an exclusive basis in our cellular service areas in early 2002. In October 2006, we entered into a new CDMA lease agreement, effective January 1, 2007, with Unicom Group in respect of the CDMA networks. Unicom Group only operates its CDMA networks in Guizhou province, which is outside of our cellular service areas. We also have an option to acquire the CDMA networks from Unicom Group. See B. Related Party Transactions ¾ Leasing of CDMA Network Capacity under Item 7.

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Capital Expenditures and Divestitures

See Liquidity and Capital Resources ¾ Capital Expenditures under Item 5 for information concerning our principal capital expenditures for the previous three years and those planned for 2007. We have not undertaken any significant divestitures.

B. Business Overview

General

We are an integrated telecommunications operator in China, offering a comprehensive range of telecommunications services, including cellular, international and domestic long distance, data and Internet services based on our advanced, uniform nationwide network system. We offer nation-wide cellular communications services based on both GSM and CDMA technologies in China. We and China Mobile are currently the two cellular service providers in China.

We had a total of 105.87 million GSM cellular subscribers as of December 31, 2006, representing an 11.4% increase from 95.07 million subscribers as of December 31, 2005. Our GSM cellular business accounted for 62.9% of our total revenue in the year ended December 31, 2006. We had approximately 36.49 million CDMA cellular subscribers as of December 31, 2006, representing an 11.5% increase from 32.72 million subscribers as of December 31, 2005. Our CDMA Cellular business contributed 33.5% of our total revenue in the year ended December 31, 2006. At the end of 2006, our market share in terms of the number of subscribers in our cellular service areas was 31.3%, declining from 34.5% at the end of 2005.

We also provide long distance, data and Internet services in China. These businesses currently represent a relatively small portion of our overall business. Our long distance, data and Internet businesses collectively accounted for 3.7% of our total revenue in 2006, compared to 5.3% in 2005. Outgoing public switched and IP telephony long distance calls totaled 11.23 billion and 13.13 billion minutes, respectively, in 2006, compared to 10.48 billion and 14.73 billion minutes, respectively, in 2005. Incoming international long distance calls (including incoming calls from Hong Kong, Macau and Taiwan) totaled 2.61 billion minutes in 2006, a slight increase from 2.59 billion minutes in 2005. We had 1.254 million broadband Internet access subscribers at the end of 2006.

Recent Developments

As of March 31, 2007, the total number of our GSM subscribers has increased to 109.16 million, including 56.16 million post-paid subscribers and 53.00 million pre-paid subscribers. As of March 31, 2007, we also had a total of 37.72 million subscribers to our CDMA services. For the three months ended March 31, 2007, average minutes of usage, or MOU, per subscriber per month for GSM and CDMA services in our combined service areas were 237.2 minutes and 257.4 minutes, respectively. ARPU for GSM services in our combined service areas was RMB46.8 for the three months ended March 31, 2007. ARPU for CDMA services in our combined service areas was RMB58.6 for the three months ended March 31, 2007. For the three months ended March 31, 2007, outgoing public switched and IP telephony long distance calls totaled 2.64 billion minutes and 2.98 billion minutes, respectively.

Cellular Services

Our cellular business is our largest business, with our GSM and CDMA businesses together having contributed 96.3% of our total revenue in 2006.

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We offer both GSM and CDMA cellular services. We also offer GSM international roaming services in conjunction with 260 operators in 170 countries and regions and CDMA international roaming services in conjunction with 22 operators in 16 countries and regions.

In 2004, we began to offer GSM and CDMA dual mode cellular handset service under the brand name Worldwind. In April 2005, we launched Worldwind dual-mode card service based on the dual mode handset service. In 2006, we introduced the dual-standby technology into our Worldwind services and now offer dual-mode, dual-standby services under the brand name Worldwind.

In October 2005, we successfully launched our CDMA network in Macau to provide roaming services for all CDMA users in Macau. In 2006, we obtained approval from the Macau government to provide CDMA services to local users in Macau and also received a 3G license to operate a CDMA 2000 network in Macau.

We also offer a broad range of value-added services, or VAS, to our cellular subscribers, including short message services, or SMS, personalized ring-back tone services, CDMA 1X wireless data services and GSM wireless data services, under the integrated business brand of uni , which represents various wireless VAS we offer for our cellular subscribers. The proportion of our total cellular service revenue generated from VAS increased significantly from 15.2% in 2005 to 19.5% in 2006.

GSM Cellular Services

Our GSM cellular networks reach all cities, county centers, major towns, major highways and railways in our cellular service areas. We continue to selectively deploy GSM systems that operate in the 1800 MHz frequency band in high-density population and high call volume centers to supplement our GSM networks operating in the 900 MHz frequency band. In 2006, we continued to focus on optimizing the operational efficiency and stability of our GSM networks, and will continue to improve our GSM networks to support the development of our various cellular services. In particular, we started to upgrade our GSM networks to launch general packet radio service, or GPRS, services since 2005. We have upgraded our GSM networks in 65 major cities to be able to offer GPRS services as of the end of 2006. On May 17, 2007, we launched the commercial operation of GPRS services in 70 cities on a trial basis. We plan to continue and expand our GPRS upgrade to additional cities in 2007.

Post-paid Services and Pre-paid Services

We offer two main categories of GSM cellular services: post-paid and pre-paid services that target different consumer segments. Generally, we promote our pre-paid services to migrant population and temporary residents as well as mass market subscribers and target our post-paid services at consumers who have relatively high usage of telecommunications services.

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Subscribers and Usage

The following table sets forth selected historical information about our GSM cellular operations and our subscriber base for the periods indicated.

	CUCL (4) and Unicom New World, as of or for the year ended December 31,	CUCL(5) as of or for the year ended December 31,		CUCL(5) as of or for the three months ended March 31,
	2004	2005	2006	2007
Number of subscribers (in thousands)	84,267	95,072	105,873	109,158
Post-paid	42,844	48,166	54,267	56,158
Pre-paid	41,423	46,906	51,606	53,000
Estimated market share in our service areas(1)	26.8%	25.6%	23.3%	23.0%
Average minutes of usage per subscriber per month(2)	188.9	202.2	237.2	237.2
Average revenue per subscriber per month (in RMB)(3)	49.4	48.5	49.2	46.8
SMS Volume (in billions)	32.39	39.51	58.89	17.28

(1) Market share in a given area is determined by dividing the number of our GSM subscribers in the area by the total number of cellular subscribers in the area. *Source*: Ministry of Information Industry.

(2) Average minutes of usage per subscriber per month is calculated by dividing the total minutes of usage during the

period by the average number of our GSM subscribers during the period, and dividing the result by the number of months in the relevant period.

(3) Average revenue per subscriber per month, or ARPU, is calculated by dividing the sum of GSM cellular services revenue during the relevant period by the average number of our GSM subscribers during the period, and dividing the result by the number of months in the period.

(4) Includes Unicom New Century, which merged into CUCL on July 30, 2004.

(5) Includes Unicom New Century and Unicom New World, which merged into CUCL on July 30, 2004 and

September 1,
2005,
respectively.

Subscriber Increase: As of December 31, 2006, our total number of GSM subscribers increased from 95.07 million as of December 31, 2005 to 105.87 million, including 54.27 million post-paid subscribers and 51.61 million pre-paid subscribers. We believe that this growth was attributable to a number of factors, including, among others, (i) continued growth of the Chinese cellular telecommunications market, driven by economic growth and reduction in the cost of cellular handsets and services, (ii) our sales and marketing efforts in retaining existing subscribers and expanding our subscriber base, (iii) relatively competitive pricing of our services and (iv) quality of our customer service. However, our share of the cellular market in terms of total cellular subscribers in our GSM cellular service areas was 23.3% as of December 31, 2006, as compared with 25.6% as of December 31, 2005.

MOU and ARPU: MOU and ARPU of our GSM services were 286.05 billion minutes and RMB49.2, respectively, in 2006. The average MOU per subscriber per month was 237.2 minutes in 2006, an increase of 35.0 minutes from 202.2 minutes in 2005. The increase in MOU was attributable to increased competition with our competitor, which resulted in the provision of more call minutes in the package service plans offered to subscribers. The decreasing effective tariffs as a result of such competition also encouraged higher usage among subscribers. ARPU of our GSM services increased slightly from RMB48.5 in 2005 to RMB49.2 in 2006, which was attributable to higher penetration rate of VAS services based on GSM networks.

Churn Rate: In 2006, the monthly average churn rate for our GSM services slightly increased from 2.41% in 2005 to 2.44% primarily as a result of intensified competition and the fact that a larger portion of our new GSM subscribers are low- to mid-end subscribers. Our calculation of churn rate reflects those subscribers who switch to services of other operators and those whose services we terminate as a result of account inactivity or payment delinquency. If competition continues to intensify, our churn rate from subscribers voluntarily discontinuing our services may further increase in the future.

Payment Delinquency: Payment delinquency increased in 2006. As of December 31, 2006, the doubtful debt ratio for our GSM cellular services, calculated as the amount of doubtful debt provided in 2006 divided by revenue from GSM cellular services, is 1.9%, higher than the 1.7% at the end of 2005 due to the fact that a larger portion of our new GSM subscribers are low- to mid- end subscribers. In some of our cellular service areas we require our post-paid subscribers to deposit service charges and maintain a certain level of account balances with us or with commercial banks that collect service fees for us. We classify the creditworthiness of our subscribers into various levels and have adopted other credit control measures. We also closely manage payment delinquencies through confirmation of customer address and other registration information, expansion of collection channels, advance notification of inadequate deposits, close monitoring of call patterns and account balances and prompt termination of services.

Tariffs

Generally the categories of tariffs we charge our cellular subscribers include, among others, basic monthly fees, usage charges, roaming charges, long-distance call charges and charges for value-added services.

The cellular tariffs are set forth by the MII and tariff adjustments are subject to regulation by various government authorities, including the MII, the National Development and Reform Commission and the relevant provincial price regulatory authorities. The following table summarizes the present State-guidance tariff rates for post-paid and pre-paid cellular services:

	Post-paid Services RMB	**Pre-paid Services RMB**
Basic monthly fee	50	0
Local usage charge (per minute)	0.4	0.6
Domestic roaming charge (per minute)	0.6	0.8

Source: MII.

Intense competition in our cellular service areas has resulted in tariff discounts and service promotions offered by both us and our main competitor from time to time, which may lower effective tariffs. These discounts and promotions have taken many forms, including promotional tariff rates, free call minutes, reduced roaming charges, off-peak discounts or discounts for high-usage subscribers and package service plans with fixed monthly fees. See D. Risk Factors Risks Relating to the Telecommunications Industry in China Regulatory or policy changes relating to the PRC telecommunications industry or any future industry restructuring may materially adversely affect our financial condition, results of operations and growth prospects under Item 3.

We have introduced a number of package service plans. Under these plans, subscribers typically pay a fixed monthly fee for a specified number of call minutes. The plans vary in the level of the fixed monthly fee, the number of specified call minutes and the tariff rates for call minutes in excess of the specified call minutes. The terms of these plans also vary depending on the local markets and generally offer some price discounts to similar plans of our main competitor. We have also introduced in selected cities promotional plans for certain qualified subscribers, which allow such subscribers to receive incoming calls without incurring per-minute usage charges in exchange for a fixed monthly fee.

In 1997, the PRC government granted us preferential treatment by allowing us to reduce our tariffs by up to 10% below the State-guidance tariff rates. In the past, this preferential treatment has helped us capture a significant number of cellular subscribers by allowing us to market our cellular services at discounted rates. As we and our main competitor introduced various package service plans and other

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promotional programs, the tariff structure has become more complex. While we continue to maintain tariff levels that are generally lower than those of our main competitor, the more complex tariff structure has, to some extent, made our price advantages less obvious to subscribers compared to previous tariff schemes that were largely based on simple per-minute charges. Beginning in 2005, as we continued to offer package service plans in our service areas, we have significantly reduced the variety of such plans and stopped offering service plans that were not profitable. We also further centralized the package service planning to provincial-level branches and higher.

Beginning in 2006, the MII has stepped up its efforts to encourage wireless telecommunications operators to offer tariff packages featuring calling-party-pays billing arrangements. In light of such policy move, in early 2007, we have started to offer package service plans with calling-party-pays billing arrangements in selected service areas such as Beijing and Guangdong. Depending on the regulatory and business competitive environment, the service areas in which we offer package service plans with calling-party-pays features may further expand.

CDMA Cellular Services

Our controlling shareholder, Unicom Group, currently has the exclusive license to offer CDMA cellular services in China. It has constructed a CDMA network with comprehensive nationwide coverage through its wholly-owned subsidiary, Unicom New Horizon Mobile Telecommunications Company Limited, or Unicom New Horizon. We have leased CDMA network capacity from Unicom Group and offer CDMA cellular services and CDMA 1X wireless data services.

As of 2006, Unicom Group s total CDMA network capacity amounted to approximately 84 million subscribers. This level of capacity provides sufficient room for the growth of our CDMA subscriber base and ensured our CDMA nationwide network coverage and telecommunications quality, including both outdoor and indoor coverage, as well as the data-processing capacity of our CDMA 1X services.

Our Lease of CDMA Networks from Unicom Group

After the acquisitions of Unicom New Century and Unicom New Horizon, we entered into a consolidated lease agreement, or the 2005 CDMA Lease, with Unicom Group and Unicom New Horizon on March 24, 2005 to replace the three then existing lease agreements, or the Old CDMA Leases, between Unicom Group and Unicom Horizon on the one hand, and CUCL, Unicom New Century and Unicom New World, respectively, on the other hand. On October 26, 2006, we entered into a further updated lease agreement, or the 2006 CDMA Lease, with Unicom Group and Unicom Horizon, to replace the 2005 Lease Agreement. See B. Related Party Transactions ¾ Leasing of CDMA Network Capacity under Item 7.

The 2006 CDMA Lease has an initial term of one year commencing from January 1, 2007. We may extend the 2006 CDMA Lease for another year until December 31, 2008 by giving no less than 180 days prior written notice to Unicom New Horizon on or before December 31, 2007. We currently intend to extend the 2006 CDMA Lease to December 31, 2008. The lease fee for each year of 2007 and 2008 will be (i) 31% of the audited service revenue generated in that year by our CDMA business or (ii) 30% of the audited service revenue generated in that year by our CDMA business, if the audited income before taxation of our CDMA business for the relevant year is less than the audited income before taxation of our CDMA business for 2006. The term of the 2006 CDMA Lease may be renewed for additional terms at our option, with the length of such renewed terms and lease fee to be agreed upon.

We lease all constructed CDMA network capacity from Unicom Group and operate these CDMA networks in our cellular service areas on an exclusive basis and receive all revenue generated from the

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operation. We may terminate the lease arrangements upon giving at least 180 days prior written notice to Unicom Group.

In addition to leasing network capacity, we also have the option, exercisable at any time during the lease period and for an additional year thereafter, to purchase the CDMA network in our cellular service areas. The acquisition price will be negotiated between Unicom New Horizon and us. It will be based on the appraisal value of the CDMA network determined by an independent appraiser in accordance with applicable PRC laws and regulations and take into account the then prevailing market conditions and other factors. However, the purchase price will not exceed an amount which would, taking into account all lease fee payments made by us to Unicom New Horizon and lease fee discounts as a result of any delay of delivery, enable Unicom New Horizon to recover its total network construction costs, together with an internal rate of return of 8%. The exercise of the purchase option will be subject to the relevant laws, regulations and the HKSE Listing Rules, including approvals of our minority shareholders for connected transactions. See B. Related Party Transactions Leasing of CDMA Network Capacity under Item 7 for a more detailed description of the New CDMA Lease.

Services

The CDMA services we offer include basic voice and value-added services such as call forwarding and voicemail, caller identity display, SMS services and CDMA 1X wireless data services. Like our GSM services, our CDMA services also offer both post-paid and pre-paid services.

In August 2004 and April 2005, we launched CDMA and GSM dual-mode cellular handset and card services, respectively, under the brand name Worldwind. In 2006, we further integrated dual-standby technology into our services to launch the dual-mode, dual-standby services. Worldwind dual-mode, dual-standby services, which are available to our subscribers who use either a dual-mode, dual-standby handset or a dual-mode, dual-standby user card, have the following features:

- users can switch between GSM and CDMA networks in China, thereby offering wireless coverage in areas of the country covered by only one of these networks;

- when roaming in areas outside of China, users can use the cellular services of local operators, whether they are GSM or CDMA, who signed roaming agreements with us; and

- our GSM users who sign up for Worldwind can continue to use the basic GSM services, while enjoying the additional benefits of the CDMA 1X services.

Subscriber Base

The following table sets forth selected historical information about our CDMA cellular operations and our subscriber base for the periods indicated.

	CUCL(4) and Unicom New World, as of or for the year ended December 31,	**CUCL(5) as of or for the year ended December 31,**		**CUCL(5) as of or for the three months ended March 31,**
	2004	**2005**	**2006**	**2007**
Number of subscribers (in thousands)	27,815	32,723	36,493	37,724
Post-paid	25,824	30,010	33,454	34,605
Pre-paid	1,991	2,713	3,039	3,119
Estimated market share in our service areas(1)	8.8%	8.8%	8.0%	8.0%
Average minutes of usage per subscriber per month(2)	292.3	276.9	274.7	257.4

Average revenue per subscriber per month (in RMB)(3)	85.3	75.1	65.9	58.6
SMS Volume (in billions)	11.83	15.02	16.78	4.52

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(1) Market share in a given area is determined by dividing the number of our CDMA subscribers in the area by the total number of cellular subscribers in the area. *Source*: Ministry of Information Industry.

(2) Average minutes of usage per subscriber per month is calculated by dividing the total minutes of usage during the period by the average number of our CDMA subscribers during the period, and dividing the result by the number of months in the relevant period.

(3) Average revenue per subscriber per month, or ARPU, is calculated by dividing the sum of CDMA cellular services revenue during the relevant

period by the average number of our CDMA subscribers during the period, and dividing the result by the number of months in the period.

(4) Includes Unicom New Century, which merged into CUCL on July 30, 2004.

(5) Includes Unicom New Century and Unicom New World, which merged into CUCL on July 30, 2004 and September 1, 2005, respectively.

As of December 31, 2006, our total CDMA subscriber base reached 36.49 million, representing an increase of 11.5% from 32.72 million subscribers at December 31, 2005. Among the total CDMA subscribers, post-paid subscribers increased by 11.5% from 30.01 million as of December 31, 2005 to 33.45 million as of December 31, 2006, while pre-paid subscribers increased by 12.0% from 2.71 million as of December 31, 2005 to 3.04 million as of December 31, 2006. We believe the growth in our CDMA subscriber base was primarily attributable to:

- increased brand awareness and our distribution and marketing efforts, including our adoption of an effective subsidizing policy that (i) offers various forms of subsidies such as free minutes and free trials of VAS services and (ii) ties the subsidies to subscribers ARPU;

- decreased retail sale prices of and the availability of more varieties of CDMA handsets as a result of our centralized purchasing policy;

- the launching and promotion of our Worldwind dual-mode, dual-standby services, which ensures our subscribers wider coverage based on both of our networks and additional benefits of the CDMA 1X wireless data services;

- the competitiveness of our network coverage and quality; and

- the advantages of the CDMA technology, including the lower radio transmitting power of CDMA handsets as compared to GSM handsets, better voice quality and enhanced security.

MOU, ARPU and Churn Rate

In 2006, total MOU for our CDMA services was 113.85 billion minutes, an increase of 11.9% from 101.75 billion minutes in 2005, and ARPU for our CDMA services was RMB65.9, a decrease from RMB75.1 in 2005. Average MOU per subscriber per month for our CDMA services was 274.7 minutes, 15.8% higher than the average MOU of 237.2 minutes for GSM services, while our RMB65.9 CDMA ARPU was 33.9% higher than the RMB49.2 ARPU for our GSM subscribers. The reasons for the increase in MOU for our CDMA services in 2006 are similar to the reasons for similar trends in GSM services. See B. Business Overview Cellular Services GSM Cellular Services MOU and ARPU under this Item 4. The decrease in ARPU for our CDMA services in 2006 was attributed to intensified market competition and regional promotional activities that led to a decline in effective tariffs, as well as non-renewal by some contractual subscribers upon the expiration of their previous handset subsidy packages.

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The monthly average churn rate for our CDMA services is calculated in the same way as the churn rate for our GSM services and was 1.57% in 2006, slightly higher than 1.49% in 2005, but is significantly lower than the churn rate for our GSM services.

Payment Delinquency

As of December 31, 2006, the doubtful debt ratio for our CDMA cellular services, calculated as the amount of provision for doubtful debt divided by revenue from CDMA cellular services, stood at 1.7%. In 2006, we continued to take various measures to control payment delinquency for our CDMA services, which measures are similar to the ones taken to control payment delinquency for our GSM services. See B. Business Overview Cellular Services GSM Cellular Services Payment Delinquency under this Item 4.

Tariffs and Promotion

The tariff rates for our CDMA services are generally the State-guidance rates for cellular services without the 10% discount we are permitted to adopt for GSM services. However, we have adopted other promotional programs. Generally we charge our CDMA subscribers the following categories of tariffs: basic monthly fees, local usage charges, roaming charges, long-distance call charges and VAS service charges.

To accelerate the growth in our CDMA subscriber base, we have been offering CDMA handset promotion packages since the second half of 2002, providing discounts towards our customers CDMA handset purchase prices on the basis of their committed minimum amount of monthly service fees. Due to the high cost of the handset promotional packages, and in light of the improved coverage of our CDMA network and the growing number of CDMA 1X functions, we have significantly reduced the use of such promotion packages since 2005, and concentrated instead on alternative promotional programs to develop our CDMA services. We offer differentiated services with various combinations of voice and VAS services to effectively target various market sectors. Moreover, we established a subsidiary, Unicom Huasheng, in 2005 to centralize the purchases and distribution of CDMA handsets to control the costs of our CDMA promotion packages.

See D. Risk Factors ¾ Risks Relating to Our Business ¾ Our CDMA services may not succeed in gaining a broader market acceptance in China. under Item 3.

Value-added Services

By leveraging our integrated telecommunications operations and advanced network system, we offer a broad range of value-added cellular services under a uniform business brand of uni , including SMS, personalized ring-back tone services, wireless internet services and other wireless information services. Our value-added services have achieved rapid growth in recent years.

The volume of our SMS continued to increase rapidly in 2006. A total of 75.68 billion short messages were transmitted by our GSM and CDMA subscribers in 2006, an increase of 38.8% over 2005. Our SMS services mainly include the following: SMS transmission and receipt through handsets, service provider-assisted SMS, business SMS platform, voice SMS and other information services. We continue to promote the use of SMS as a convenient and cost effective method of business and personal communication. The SMS platforms of our GSM and CDMA networks are interconnected with each other. Our SMS platforms are also interconnected with the SMS platforms of China Mobile s GSM network, China Telecom s Little Smart network, and China Netcom s Little Smart network.

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We market our personalized ring-back tone service under the brand name Cool Ringtong. This new value-added service has maintained a high growth rate since its introduction. As of December 31, 2006, we had a total number of 35.88 million subscribers to our Cool Ringtong service, representing 25.2% of our total cellular subscriber base from December 31, 2005.

We offer nationwide GSM wireless data services under the service brand of Uni-Info . The Uni-Info services are based on a nationwide wireless information services platform and offer a variety of services including games, downloads and other entertainment services, information and notification services, personal information management and transactions services. We have upgraded our GSM networks in 65 major cities to be able to offer GPRS services as of December 31, 2006. On May 17, 2007, we launched the commercial operation of GPRS services in 70 cities on a trial basis. We plan to continue and expand our GPRS upgrade to additional cities in 2007.

We also offer CDMA 1X wireless value-added services under the uniform business brand of uni , with individual services offered under various sub-brands, including U-Info , U-Net , U-Mail , U-Magic , U-Map and Uni-Web. we continued to focus our efforts in promoting CDMA 1X wireless value-added services in three areas: (1) increasing market penetration, (2) easing the handset supply bottleneck by centralizing the purchase and distribution of CDMA handsets and (3) offering new services and service contents to activate more market demand. By the end of 2006, we had 20.04 million subscribers to CDMA 1X wireless value-added service, representing a substantial increase of 33.2% over 2005.

In 2006, in order to further develop our value-added services, we continued to implement a brand-centric development strategy and adopted the following measures:

- through the improvement of the value-added services, more staff training, advertising and promotions, trial programs and our various other efforts, we strengthened marketing efforts for our value-added services under the uniform business brand of uni ;

- we improved the content of our value-added services, through strengthening service support of and cooperation with content providers and service providers, in order to increase the appeal of these services;

- we improved the quality of our value-added services by strengthening certain customer protection measures, such as requiring service providers to obtain re-confirmation from the subscribers before they activate the service and to provide subscribers trial periods before the service provider starts to charge for the service;

- we actively developed value-added services specifically catering to the youth and campus markets to increase the market share of our U-Power services;

- we targeted mid- to high-end subscribers by emphasizing the technological advantages of dual-mode, dual-standby services to facilitate the development of our Worldwind CDMA and GSM dual mode services and our CDMA 1X data services;

- through cooperation with partners in specific industries, we launched applications such as SAIC Enforcement Horizon , Maritime Horizon , Agriculture Horizon and Police Horizon to extend corporate and industry applications to institutional and industrial customers in markets such as maritime and agriculture. For example, we recently introduced the SAIC Enforcement Horizon application, which aims to offer tailored wireless services to law enforcement personnel of the State Administration of Industries

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and Commerce. We also expanded the application of our CDMA 1X data services in certain industries by providing information solutions to small- and medium-sized enterprises; and

we introduced push mail mobile email services, which allows our subscribers to send and receive emails and view multimedia attachments via a mobile device, such as a handset.

We have designed and implemented a fee structure under which we earn transmission fees from the use of our GSM and CDMA value-added services and charge a certain percentage of information service fees for the billing and collection services we provide to content providers and service providers.

Strategic Cooperation

On June 20, 2006, we entered into a strategic alliance framework agreement with SK Telecom Co., Ltd., or SKT, a mobile telecommunications service provider in Korea. Pursuant to this agreement, we and SKT agreed to cooperate on the further development of CDMA cellular communication services in China. We have identified SKT as our sole and exclusive partner in relation to our CDMA cellular communication business operations for a maximum period of 18 months in the PRC in the areas of CDMA handsets, value-added services and related business platforms, marketing, information technology infrastructure and network technologies. Detailed terms of our business cooperation with SKT are expected to be negotiated in the future and set forth in definitive legal agreements to be entered into by SKT and us. We and SKT have jointly established a designated team to further explore and implement the aforementioned business cooperation initiatives. In addition, pursuant to this agreement, if SKT and/or any of its affiliates, individually or collectively, hold more than 5% of our issued share capital, SKT will be entitled to nominate a representative to our board of directors. SKT has undertaken to cause such director to resign if it and/or its affiliates, individually or collectively, hold no more than 5% of our issued share capital for a period of three months.

Long Distance, Data and Internet Services

We offer international and domestic long distance services in China based on both the PSTN standard and the IP telephony standard. We leverage our ability to integrate our long distance services with a broad range of services to target different customer segments. For example, we have developed a nationwide video-conferencing network that reaches hundreds of cities. In addition to long distance services, we also offer data and Internet services throughout China. Our long distance, data and Internet services are supported by our advanced, unified nationwide network system.

The following table sets forth the total number of outgoing call minutes for our long distance services, leased bandwidth of our data services and number of dedicated access subscribers of Internet services for the periods indicated.

	As of or for the year ended December 31,		
	2004	**2005**	**2006**
Public switched telephony (in billions of minutes):			
Domestic	9.94	10.33	11.07
International	0.16	0.15	0.16
Total	10.10	10.48	11.23
IP telephony (in billion of minutes):			
Domestic	13.81	14.60	13.02
International	0.14	0.13	0.11
Total	13.95	14.73	13.13

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	As of or for the year ended December 31,		
	2004	2005	2006
Data Services			
Bandwidth leased to customers (2Mbps)	9,007	8,706	7,428
Internet Services			
Dedicated access subscribers	61,569	38,000	31,350

Public Switched Telephony Services

We offer PSTN services to business and residential customers who register their telephone numbers with us. They can access our services by dialing a prefix of 193. We also distribute pre-paid long distance calling cards that purchasers can use to access our services by dialing a prefix of 193300. For some corporate and government customers, we also offer our public switched long distance services over dedicated lines, frequently as part of our integrated offerings of long distance and data services.

The following table sets forth selected information about our PSTN services for the periods indicated.

	As of or for the year ended on December 31,		
	2004	2005	2006
Number of cities reached	332	333	333
Minutes of outgoing long distance calls (in billions)	10.10	10.48	11.23
Market share of outgoing long distance call minutes (1)	13.6%	11.57%	11.55%
Minutes of incoming international calls (in billions)	2.47	2.34	2.39

(1) *Source*: MII. In calculating market share, the total minutes of outgoing long distance calls include ours and those of the incumbent operators.

Starting from October 2005, the PRC government regulates the tariff rates for PSTN services by setting the maximum tariff rates. The following table sets forth our present tariff rates (including rates applicable to domestic and international long distance calls made by our cellular subscribers):

	Maximum Tariff Rates RMB per six seconds	Preferential Rates RMB per six seconds
Public switched Domestic Long Distance:	0.06	0.03
Public switched International Long Distance:		
To Hong Kong, Taiwan and Macau	0.18	0.15
To all other international destinations	0.72	0.38

Since 2001, we adjusted the discount rates set forth in the table above as follows:

RMB0.04 per six seconds every day from 8pm to 10pm;

RMB0.03 per six seconds every day from 10pm to 7am of the following day; and

RMB0.04 per six seconds on public holidays and weekends from 7am to 8pm.

Settlement of outgoing and incoming international calls with international operators is conducted through negotiated contracts with such individual international operators, which contracts must be approved by the MII.

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IP Telephony Services

We offer domestic and international long distance IP telephony services through interconnection of our IP network with the Internet and other telecommunications networks based on a manageable IP network configuration to enhance service quality. The following table sets forth selected information about our IP telephony services for the periods indicated.

	As of or for the year ended December 31,		
	2004	**2005**	**2006**
Number of cities reached	341	341	343
Minutes of outgoing IP telephony calls (in billions)	13.95	14.73	13.13
Minutes of incoming international calls (in billions)	0.28	0.25	0.22

In February 2001, the PRC government ceased regulatory control of tariffs for IP telephony long distance calls and allowed operators to set their own rates. The following table sets forth our present tariff rates for our IP telephony services (including rates applicable to IP long distance calls made by our cellular subscribers):

	Our Tariff Rates (RMB)
IP Telephony Domestic Long Distance	0.30 per minute
IP Telephony International Long Distance	
To Hong Kong, Taiwan and Macau	1.50 per minute
To U.S. and Canada	2.40 per minute
To other international destinations	3.60 per minute

Effective September 1, 2001, we adjusted our tariff rates for our IP telephony services for calls to 14 countries, including India, to RMB4.60 per minute.

Data Services

We presently provide data services in 328 cities in China. We target high volume users of integrated voice, data and video communications and offer them data services as part of our integrated offerings of long distance, data and Internet services. Our target customer groups are government offices, financial institutions, multinational or multi-regional corporations, large- and medium-sized enterprises in China, and Internet service providers and Internet content providers that provide telecommunications services. As of December 31, 2006, the total leased bandwidth of our ATM and FR data services was 7,428 x 2 Mbps.

Our data service offerings mainly consist of broadband, managed data services, including:

Frame relay, or FR, services, which provide high speed and cost effective data communications services linking remote business sites using FR technology;

Asynchronous transfer mode, or ATM, services, which employ ATM technology and are able to handle high bandwidth, integrated voice, video, data and Internet traffic; and

Broadband video-conferencing and video-telephony services, which are provided under the brand name of Uni-Video. These services currently include video-conferencing, video-telephony, video conference room leasing and video public telephony services. These services are based on our existing unified data network platform. Two or more users can use our services by connecting to the Internet or our video network through video-conferencing terminals or computer terminals.

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The following table sets forth selected information about our data services for the periods indicated.

	As of December 31,		
	2004	2005	2006
Number of cities reached	328	328	328
Bandwidth leased to customers	9,007	8,706	7,428

We provide data services through an advanced, unified nationwide network system, the backbone of which is our advanced nationwide fiber optic transmission network. This network is the second largest fiber optic transmission network in China. We have also built metropolitan area networks in many cities throughout China. These networks provide local transmission capacity for our different services. See Networks Transmission Network below.

We believe that our ability to offer integrated access to customers premises is important to the success of our data services. We continue to build integrated access networks linking major office buildings to our networks in major cities. See ¾ Networks ¾ Long Distance, Data and Internet Networks below.

Our charges for ATM and FR services include one-time, up-front charges for installation materials (currently RMB500 per circuit or port for ATM services and RMB300 per circuit or port for FR services) and testing (currently RMB500 per circuit or port for ATM services and RMB300 per circuit or port for FR services), a monthly port fee and a monthly circuit fee. Our tariff charges are generally offered at a 10% discount from the State-guidance tariffs.

The following table sets forth our tariff rates for monthly port fees for FR data services of selected bandwidths.

FR Services Port Fee (RMB per month)

Bandwidth (bps)	Port Fee
64k	260
128k	300
256k	400
384k	450
512k	500
768k	650
1M	750
2M	1,000

The following table sets forth our tariff rates for monthly permanent virtual circuit (PVC) fees for FR data services of selected bandwidths and selected distance categories.

FR Services PVC Fee (RMB per month)

Bandwidth	Local (intra-district)	Local (inter-district)	Domestic long distance	Hong Kong, Macau & Taiwan	International long distance (Asia)	International long distance (outside of Asia)
8kbps	290	440	990	1,550	8,800	9,400
16kbps	390	540	1,190	1,800	10,000	10,500
32kbps	450	650	1,300	2,000	11,500	11,500
48kbps	500	750	1,500	2,300	13,000	13,500
64kbps	550	800	1,700	2,600	14,500	14,600
128kbps	700	1,000	2,100	3,400	18,000	18,400
256kbps	800	1,150	2,200	3,500	19,000	19,600
384kbps	850	1,350	2,300	3,800	20,000	20,500
516kbps	1,000	1,450	2,500	4,100	22,300	23,100
768kbps	1,150	1,600	2,700	4,600	25,800	26,550
1Mbps	1,250	2,000	3,000	5,200	28,900	30,050

2Mbps	1,500	2,200	4,000	7,000	39,000	39,000

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The following table sets forth our tariff rates for monthly port fees for ATM services of selected bandwidth.

ATM Services Port Fee (RMB per month)

Bandwidth	Port Fee
256K	400
512K	500
1M	750
2M	1,000
4M	2,000
6M	3,000
8M	4,000
10M	5,000
12M	6,000
34M	7,000
45M	8,000
100M	9,000
155M	10,000

The following table sets forth our tariff rates for monthly circuit fees for ATM data services of selected bandwidths and selected distance categories.

ATM Services Circuit Fee (RMB per month)

Bandwidth	Local (intra-district)	Local (inter-district)	Domestic long distance	Hong Kong, Macau & Taiwan	International long distance (Asia)	International long distance (outside of Asia)
256Kbps	800	1,150	2,200	3,500	19,000	19,600
512Kbps	1,000	1,450	2,500	4,100	22,300	23,100
1Mbps	1,250	2,000	3,000	5,200	28,900	30,050
2Mbps	1,500	2,200	4,000	8,000	39,000	39,000
4Mbps	2,000	3,000	6,000	12,900	72,200	72,200
6Mbps	2,500	5,500	9,000	19,800	105,400	105,400
8Mbps	3,500	8,500	12,000	26,700	138,700	138,700
10Mbps	5,000	11,500	15,500	30,600	157,800	157,800
15Mbps	7,000	15,000	22,000	40,000	205,000	205,000
20Mbps	7,500	17,500	29,000	49,000	252,300	252,300
25Mbps	8,000	21,000	36,000	59,000	300,000	300,000
30Mbps	9,000	24,000	42,000	69,000	348,500	348,500
40Mbps	10,000	29,000	52,000	88,500	416,000	416,000
50Mbps	10,500	32,000	60,000	108,200	486,600	486,600
60Mbps	11,000	33,000	68,000	122,600	567,900	567,900
70Mbps	11,500	35,000	76,000	137,000	649,100	649,100
80Mbps	12,000	36,000	84,000	151,300	730,400	730,400
90Mbps	12,500	37,000	92,000	165,700	811,600	811,600
100Mbps	13,000	37,500	100,000	180,100	892,900	892,900
110Mbps	13,500	38,000	107,500	187,300	933,500	933,500
130Mbps	13,800	38,500	122,500	201,600	1,014,800	1,014,800
155Mbps	14,500	39,000	130,000	216,000	1,096,000	1,096,000

Effective April 2003, we began charging our corporate customers fees for our Uni-Video services based on package service plans, including up-front charges for testing, a monthly fee and usage charges. Retail customers of our Uni-Video services purchase re-chargeable cards to pay for such services.

Internet Services

The Internet services we offer include:

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Dedicated Internet Access. We offer business customers high speed Internet access through dedicated lines. As of December 31, 2006, we had a total of 31,350 subscribers for dedicated Internet access. We package this service with voice and data services to provide integrated communications solutions to our business customers and cooperate with cable operators and real estate developers to offer broadband access to residential customers.

IDC Services. We have built Internet data centers, or IDCs, in selected cities including Shanghai, Beijing, Guangzhou and certain provincial capitals, and provide server hosting, server rental, virtual servers and other IDC services to commercial customers and virtual IDC operators.

Ruyi Mailbox Services. This service allows our cellular subscribers to use their cellular phone numbers as e-mail addresses. As of December 31, 2006, the number of Ruyi Mailbox subscribers was approximately 12.22 million.

Other Internet Services. Other Internet services we offer include international Internet Protocol-Virtual Private Network (or IP-VPN), Virtual Private Data Network (or VPDN), Virtual Internet Service Provider (or VISP), Uninet international roaming and corporate e-mail services.

The following table sets forth selected historical information about our dedicated Internet access service operations and our subscriber base for the periods indicated.

	As of December 31,		
	2004	**2005**	**2006**
Number of cities reached by our dedicated Internet access services	327	334	334
Number of subscribers of dedicated Internet access services	61,569	38,000	31,350

Our tariff charges for dedicated Internet access include a network usage fee, an account set-up fee and a fixed telecommunications fee. Network usage fee is calculated based on monthly service plans. The account set-up fee is RMB100. The fixed telecommunications charge is based on the relevant tariff for the particular type and bandwidth of leased lines used to access the Internet. The following table summarizes the monthly network usage fees for selected bandwidths denoted as R.

Bandwidth	**Standard network usage fees (RMB per month)**
R≤64Kbps	2,700-3,600
64Kbps<R≤128Kbps	3,600-4,900
128Kbps<R≤256Kbps	4,800-6,600
384Kbps <R≤512Kbps	8,500-12,000
1024Kbps<R≤2Mbps	18,000-27,000
8Mbps <R≤10Mbps	59,400-70,000
20Mbps<R≤34Mbps	165,900-195,200
34Mbps <R≤45Mbps	210,000-250,000
45Mbps<R≤100Mbps	428,400-504,000
100Mbps<R≤155Mbps	664,100-781,200

Our provincial and local branches are permitted to make tariff decisions within the range set forth above. For customers who lease a high number of dedicated access lines, we provide discounts of up to 20% of the tariffs set forth in the table above.

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We charge a monthly usage fee for our Ruyi Mailbox services, which is currently RMB6 per month. We do not charge for SMS notifications of e-mail receipt. Other e-mail functions performed through SMS are charged based on the SMS tariff rates for our uni-Info services.

Leased Line Services

We lease transmission lines to large business customers and other telecommunications operators. Our leased line services provide customers with dedicated digital links directly connecting customer sites. As of December 31, 2006, we had a total leased bandwidth of an equivalent of 50,391 x2 Mbps circuits.

Leased line tariffs are primarily based on the bandwidths of the lines leased and the distance of transmission. The following table sets forth State tariff rates for monthly fees of selected types and bandwidths of leased lines and selected distance categories:

	State Tariff Rates (RMB per month)		
	Local (intra-district)	**Local (inter-district)**	**Long distance**
Digital Line (2 Mbps)	2,000	4,000	6,000
Digital Line (34 Mbps)	16,000	31,000	47,000
Digital Line (155 Mbps)	44,000	88,000	132,000

Source: MII.

Similar to PSTN service operators, we can adopt tariffs that are different from the above State tariff rates as long as we do not offer services at tariff rates below cost. We generally offer our leased line services at a 10% discount to the State-guidance tariff rates and market these services to institutional customers through our own dedicated teams and our sales agents.

Sale and Lease of Other Network Elements

We have substantially completed the construction of our nationwide transmission network. See ¾ Networks ¾ Transmission Network below. We have started to offer some network elements such as optic fibers or fiber channels for lease to other telecommunications operators or corporate customers.

Interconnection and Roaming Arrangements

Interconnection

Interconnection refers to various arrangements that permit the connection of our telecommunications networks to other networks. Our cellular and long distance networks interconnect with Unicom Group s cellular networks. Under current arrangements, settlement between Unicom Group and us is based on an internal settlement standard that takes into account either the internal costs of the relevant networks or the government standard applicable between third-party operators, whichever is the more favorable to us.

Unicom Group s cellular networks, our cellular networks and our long distance networks interconnect with the fixed telephone networks of China Telecom, China Netcom and China Railcom. Unicom Group s cellular networks and our cellular networks also interconnect with China Mobile s cellular networks. Our Internet network interconnects with the Internet networks of China Telecom and China Netcom. Although we continue to encounter some difficulties in the execution of our interconnection arrangement with other operators in limited service areas, the situation has been significantly improved since 2004 due to improved regulatory supervision by the PRC government in this area.

In October 2003, the MII issued regulations relating to settlement between telecommunications networks. These new regulations contain provisions regarding revenue sharing methods and settlement mechanisms for interconnection arrangements between other operators and us. These interconnection arrangements under the new regulations are described in ¾ Regulatory and Related Matters ¾ Interconnection Arrangements below.

Unicom Group entered into interconnection arrangements with China Telecom, China Netcom and China Mobile with the following agreements, which equally apply to us:

Framework interconnection and settlement agreement between Unicom Group and the former China Telecom, dated September 30, 2001, the rights and obligations of which were divided and continued after the former China Telecom was split into China Telecom and China Netcom pursuant to an agreement among Unicom Group, China Telecom and China Netcom, dated April 23, 2003. These interconnection and settlement agreements with China Telecom and China Netcom were superseded by the interconnection and settlement agreement between Unicom Group and China Telecom, dated March 29, 2004 and the interconnection and settlement agreement between Unicom Group and China Netcom, dated April 2, 2004. The 2004 agreements contained more detailed provisions relating to interconnection quality, pursuant to new MII directives in this area.

Interconnection and settlement agreements between Unicom Group and China Mobile relating to the interconnection between Unicom Group s GSM and CDMA cellular networks and China Mobile s GSM cellular networks, both dated November 14, 2001, which were subsequently amended and supplemented by the respective parties on December 31, 2003.

Interconnection and settlement agreement between Unicom Group and China Mobile regarding the interconnection of point-to-point short messaging services, dated April 1, 2002.

Interconnection and settlement agreement between Unicom Group and China Mobile regarding the interconnection between China Mobile s GSM cellular networks and Unicom s telecommunications networks, including its local fixed line telephony networks, cellular networks, domestic long distance telephony networks, international telephony networks and IP telephony network, and the interconnection between China Mobile s international gateways and IP telephony network and Unicom Group s cellular networks and local fixed line telephony networks, dated December 31, 2003.

Agreement between Unicom Group and China Mobile regarding the mutual provision of open service platforms, dated November 5, 2003.

Agreement between Unicom Group and China Mobile regarding the mutual provision of open multimedia messaging service and interconnection and settlement business, dated April 6, 2007.

Unicom Group has also entered into the following interconnection arrangements, which equally apply to us:

Interconnection and settlement agreements between Unicom Group and China Railcom relating to the interconnection of Unicom Group s cellular networks and local fixed line telephony networks and China Railcom s local fixed line telephony networks, domestic

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long distance networks and IP telephony networks, dated January 25, 2002 and April 9, 2002.

Supplemental agreements between Unicom Group and China Railcom, which allow each party to offer its domestic and international long distance telephony services and IP telephony services to the cellular or fixed line telephony service subscribers of the other party, dated April 23, 2003.

Interconnection and settlement agreement between Unicom Group and China Satcom relating to the interconnection between Unicom Group s networks and China Satcom s Global Star satellite mobile communications network, dated September 27, 2003.

Framework interconnection and settlement agreement between Unicom Group and China Satcom relating to the interconnection between Unicom Group s cellular networks and China Satcom s IP telephony networks, dated September 24, 2003.

Interconnection agreement among major Internet operators, including Unicom Group, and three national Internet switching centers relating to the interconnection of Internet backbone networks, dated December 20, 2001.

Interconnection and settlement agreement between Unicom Group and China Telecom relating to the provision of point-to-point SMS services between Unicom Group s and China Telecom s networks, dated October 10, 2004.

Interconnection and settlement agreement between Unicom Group and China Netcom relating to the provision of point-to-point SMS services between Unicom Group s and China Netcom s networks, dated October 11, 2004.

For all interconnection services, we are required to pay the interconnection fees regardless of our ability or inability to collect the tariff from our subscribers. The fixed line operators are required to pay interconnection fees regardless of their ability or inability to collect the tariff from their subscribers, except for the interconnection by fixed line subscribers calling our subscribers in the same region where no interconnection fee will be charged. Interconnection charges are accrued on a monthly basis based on the actual call volume and applicable tariff rate. See B. Related Party Transactions Provision of Ongoing Telecommunications and Ancillary Services and Premises Interconnection Arrangements under Item 7 below for the interconnection and settlement arrangements between Unicom Group and us.

Roaming

As of December 31, 2006, our cellular subscribers can roam on cellular networks in Europe, North America and other Asian countries and regions through Unicom Group s international roaming agreements with 260 GSM operators in 170 countries and regions and 22 CDMA operators in 16 countries and regions. Unicom Group has also agreed to arrange for us to participate in its future international roaming arrangements.

A cellular subscriber using roaming services is charged at our roaming usage rate for both incoming and outgoing calls, plus applicable long distance tariffs. Under our roaming agreement with Unicom Group, our subscribers who roam on Unicom Group s networks are charged for each call made or received. We collect this tariff, retain RMB0.20 and pay the remaining amount to Unicom Group. On the other hand, when Unicom Group s subscribers roam on our networks, Unicom Group collects the roaming tariff, retains only RMB0.04 and pays us the remaining amount.

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In early 2007, MII officials publicly indicated that the MII may evaluate the existing policy that caps the roaming fees a wireless telecommunications operator may charge its subscribers with a view to further reducing roaming charges for wireless services. We do not know if or when such a regulatory move may be implemented. See D. Risk Factors Risks Relating to the Telecommunications Industry in China Regulatory or policy changes relating to the PRC telecommunications industry or any future industry restructuring may materially adversely affect our financial condition, results of operations and growth prospects. under Item 3.

The following table is a summary of roaming settlement between Unicom Group and us:

For our subscribers roaming on Unicom Group s networks	Roaming Tariff	Paid to Unicom Group	Retained by Us
GSM pre-paid users (RMB/minute)	0.60	0.40	0.20
GSM post-paid users (RMB/minute)	0.60	0.40	0.20
CDMA users (RMB/minute)	0.60	0.40	0.20

For Unicom Group s subscribers roaming on our networks	Roaming Tariff	Paid to Us	Retained by Unicom Group
GSM pre-paid users (RMB/minute)	0.60	0.56	0.04
GSM post-paid users (RMB/minute)	0.60	0.56	0.04
CDMA users (RMB/minute)	0.60	0.56	0.04

With respect to international roaming, we settle roaming revenue with international operators through Unicom Group in accordance with roaming agreements between Unicom Group and each of the international operators.

See B. Related Party Transactions Provision of Ongoing Telecommunications and Ancillary Services and Premises Roaming Arrangements under Item 7 below for further information regarding the roaming arrangements between Unicom Group and us.

Networks

We operate an advanced network system to support our integrated operations. The backbone of the system is a nationwide fiber optic transmission network, which serves as the common platform for our cellular, long distance, data and Internet networks. In addition, we continue to develop management and network support systems to enhance the quality and reliability of our networks and improve our customer service and operating efficiency. We generally utilize a centralized network planning and equipment selection process, which ensures uniform nationwide design and network compatibility.

Transmission Network

We own and operate an advanced nationwide fiber optic transmission network (except for the Xizang Autonomous Region, in which we lease capacity from other operators). As of December 31, 2006, our fiber optic transmission network reached 346 cities with a total cable length of approximately 863,000 kilometers, of which fiber optic backbone transmission network accounted for approximately 125,000 kilometers.

Our fiber optic transmission network is designed for broadband capacity with superior security and reliability, which supports our integrated telecommunications services and allows us to lease capacity to other telecommunications operators and corporate customers. The network deploys:

synchronous digital hierarchy, or SDH, architecture with protective two- or four-fiber rings, a self-healing system that allows for instantaneous rerouting, automatically protects service circuits and minimizes down time in the event of a fiber cut or equipment malfunction;

dense wave division multiplexing, or DWDM, technology, a means of increasing transmission capacity by transmitting signals over multiple wavelengths through a single fiber; and

a digital cross connection, or DXC, system, a specialized high-speed data channel exchange and connection system that effectively manages the routing and channeling of our services.

Our SDH fiber rings have transmission bandwidths of 2.5 Gb/s in most routes and 10 Gb/s for the fiber ring that covers the eastern and southern coastal areas of China. We deploy mainly transmission equipment and technology supplied by Siemens, Nortel, Lucent, Alcatel, Huawei, ZTE and other vendors.

Concurrently with the construction and expansion of our domestic backbone transmission network, we also seek to expand our international bandwidth. Through our participation in the Asia Pacific Cable Network No. 2 Project (APCN 2), a trans-pacific submarine cable project that connects major countries and regions in eastern Asia and southeastern Asia and links them to North America through Japan, and our membership in the US-Japan Sub-marine Cable Organization, we are linked with 11 operators in Japan, U.S., South Korea, Singapore and Taiwan with 155x62 Mbps capacity. In December 2006, we also participated in the construction of the trans-pacific submarine cable (TPE), a high-speed submarine cable that will connect eastern Asia and North America. The construction of TPE is expected to be completed in 2008 and we will have an initial transmission capacity of 50 Gbps upon completion. We also lease 3669 Mbps of international broadband transmission capacity. We have also opened transmission lines on land with the main operators in Hong Kong and Macau, with 30Gbps and 2.5Gbps of transmission capacity, respectively. In addition, we have established several fiber-optic interconnections with China s neighboring countries such as Vietnam, Mongolia and Russia, with transmission capacity ranging from 622Mbps to 10Gbps.

As of March 31, 2007, our metropolitan area networks cover 346 cities throughout China, with a total length of approximately 783,000 km. These networks provide a unified, high-speed local transmission platform for our cellular, data and Internet services.

Cellular Networks

A cellular network generally consists of:

cell sites, which are physical locations, each equipped with a base station that houses transmitters, receivers and other equipment used to communicate through radio channels with subscribers cellular handsets within the range of a cell;

base station controllers, which connect to, and control, the base stations;

mobile switching centers, which control the base station controllers and the routing of telephone calls; and

transmission lines, which link the mobile switching centers, base station controllers, base stations and the public switched telephone network.

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We own most of the GSM cellular transmission network at the local and provincial level. We lease a portion of our inter-provincial transmission capacity for our GSM cellular networks as well as the CDMA cellular transmission network. We also use our own backbone fiber optic transmission network to provide transmission capacity for our cellular networks. We continue to focus on the management and operation of our cellular networks.

GSM Cellular Networks. The following table sets forth selected information regarding our GSM cellular networks in our service areas as of the dates indicated.

	As of December 31,		
	2004	**2005**	**2006**
Network subscriber capacity (in thousands of subscribers)	84,552	89,461	105,464
Base stations	81,819	94,444	122,205
Base station controllers	1,653	1,781	2,020
Mobile switching centers	477	502	502

Currently our GSM cellular network mainly operates at 900 MHz. We have deployed GSM technology that operates at 1800 MHz in some major metropolitan areas to supplement the capacity of our existing cellular network. We have the right to use 6 x 2 MHz of spectrum in the 900 MHz frequency band and 10 x 2 MHz in the 1800 MHz frequency band for our GSM network.

Our cellular networks are supported by an advanced SS7 signaling system, which fosters efficient use of network capacity, reduces call set up time and enhances transmission capabilities. We have also installed intelligent networks that enable us to provide pre-paid services and a wide range of call features and value-added services.

As of December 31, 2006, we have upgraded our GSM networks in 65 major China cities to be able to offer GPRS services. On May 17, 2007, we launched the commercial operation of GPRS services in 70 cities on a trial basis. We plan to continue and expand our GPRS upgrade to additional cities in 2007.

CDMA Cellular Network. By the end of 2006, Unicom Group completed the construction of a comprehensive CDMA network, with an aggregate network capacity of approximately 84 million subscribers and nationwide coverage. We lease CDMA network capacity in our cellular service areas to operate Unicom Group s network in those areas on an exclusive basis. We have the right to use 10x2 MHz of spectrum in the 800 MHz frequency band for our CDMA services.

Long Distance, Data and Internet Networks

By the end of 2006, our PSTN network reached 334 cities, while the coverage of our Internet networks, including our IP telephony networks, included over 341 cities throughout China.

Long Distance Network. Our long distance network is supported by a nationwide billing system and an intelligent network, which allows us to provide multiple services. Our cellular subscribers can access these services directly through our cellular networks, but our other customers typically access our long distance telephony, IP telephony and Internet services through the public switched telephone networks of China Telecom and China Netcom. As of December 31, 2006, the total network capacity for our IP telephony services reached 20,038 E1. E1 is the European format for digital transmission and carries signals at 2Mbps.

Data and Internet Networks. Our broadband data and Internet networks utilize a unified IP and ATM design, which is particularly suited for real-time, multimedia applications such as video and voice.

ATM switches perform high-speed switching of voice and data traffic and minimize time delay and congestion. They can also prioritize applications that least tolerate time delay, such as telephony and video, over less time-sensitive applications such as e-mails and file transfer. As of December 31, 2006, the international and domestic interconnection bandwidths have reached 3.8 Gbps and 17.8 Gbps, respectively.

Internet Network. Our Internet network, branded as Uninet , is also centrally designed and has a nationwide uniform architecture. It is supported by a nationwide, advanced billing system that facilitates roaming access and delivery of virtual ISP services and other value added services.

Broadband Video Network. Our broadband video network utilizes the H.323 technological standard and two-tier network structure. H.323 is a widely used multi-media conferencing protocol approved by the International Telecommunications Union. As of December 31, 2006, it can provide video conference and video telephone services and currently reaches over 300 cities nationwide as well as the United States and Hong Kong.

Integrated Access Networks. We believe that the key to the success of our data services is our ability to offer integrated access to customers premises. We are building integrated access networks in many cities throughout China. We focus the construction of our access networks on linking major office buildings to our metropolitan area transmission networks. We rely mainly on fiber optic cables to link office buildings to our networks and have offered narrow-band wireless access at the 3.5 GHz frequency band in approximately 3 municipalities, 18 provincial capitals and 14 provinces.

Integrated Management and Network Support Systems

We have developed various management and network support systems to support and manage our various networks. We have established, in each province, municipality or autonomous region, an integrated billing and settlement system that supports the billing and settlement services of our cellular, data and long distance businesses. We have also developed a management support system (MSS) that supports our business support system (BSS) and enterprise resource planning systems (ERP). We have integrated the billing and settlement system and business management system at our headquarters to manage our businesses.

Marketing, Sales and Distribution

We centrally plan our nationwide marketing and sales strategies, but the implementation of these strategies is carried out at the provincial level by operating branches tailored to their specific markets. In 2006, we further implemented our brand-centric marketing strategy and established a comprehensive branding structure, with an equal focus on existing subscriber retention and subscriber base expansion.

Sales and Marketing

We focus on developing a strong brand image of Connecting you freely that conveys our strengths in high quality services, comprehensive network coverage, integrated solution offerings, advanced technology and customer focus. We market all of our services under the China Unicom brand name. In 2006, we continued to implement the customer-oriented branding system focusing on four customer brands Worldwind , U-Power , Ruyi Tong and Unicc Horizon. We consolidated our products, tariff structure and channel resources to offer distinctive customized service packages under these four customer brands that are targeted to different market segments. We emphasized the technological advantages of dual-mode, dual-standby of Worldwind CDMA and GSM dual mode services, our premier customer brand for offering high quality and differentiated services to mid- to high-end individual CDMA and GSM cellular customers. We actively developed the youth and campus markets to increase the market share of our U-Power. We expended significant efforts in marketing the Ruyi Tong service, which is targeted to offer mainstream cellular services to individual customers in the mass market, including potential new subscribers in the rural areas. We actively developed institutional and industrial customers by providing integrated telecommunications solutions to government, small- and medium-sized enterprises and customers in industries such as agriculture, finance and capital markets. In addition to the four customer brands, we offer two business brands, uni and Unicom Commerce , which are used to market our value-added services to cellular subscribers and long-distance, data and Internet services to primarily institutional customers, respectively.

Our marketing strategy utilizes our image as an integrated telecommunications service provider and leverages our comprehensive services and nationwide sales and distribution network. By using direct sales forces and sales agents and active market analysis and through sales channels such as service centers, sales outlets and large-scale chain stores, our marketing strategy can be targeted at different customer segments and adjusted timely in accordance with the demands of different markets. In addition, we also seek to enter into strategic alliances in order to further expand the breadth and depth of our marketing and sales efforts. In September 2004, we entered into a wireless Internet joint marketing agreement with Intel, HP, IBM, Lenovo and Digital China to develop the industry value chain for our U-Net services based on the CDMA 1X network. In June 2005, the Unicom Group and the Lenovo Group entered into an agreement on the cooperation of Lenovo s notebook computers and our U-Net business to expand our U-Net business. In December 2005, the Unicom Group entered into a full and exclusive strategic partnership with the Chinese Table Tennis Association to leverage the popularity of table tennis in China to enhance our brand recognition. In July 2006, we entered into a strategic cooperation agreement with SKT, pursuant to which we and SKT agreed to cooperate on the further development of CDMA cellular communication services in China in the areas of CDMA VAS and marketing, among others. In December 2006, we signed a memorandum of understanding with Toyota Motor (China) Investment Co., Ltd. to engage in joint research and development of vehicle global positioning systems based on our CDMA 1X technology. We expect these cooperative arrangements will enhance our marketing ability and promote our brand recognition and our marketing in China.

Moreover, we seek to formulate effective marketing strategies through customer relations management and analysis of customer segmentation, customer demand and consumption trends.

Customer Segmentation: We have two main categories of customers: (i) institutional customers, comprised of mainly corporate, industry and government customers, and (ii) individual customers. We have set up dedicated sales and service departments for institutional customers, both at our headquarters and at our provincial and local branches. We focus on promoting our integrated and customized solutions to these institutional customers. For individual customers, we conduct our sales through our own service centers and the retail outlets of independent sales agents.

Cellular services: In order to better coordinate our sales and marketing efforts in our cellular service provisions, in 2007 we separated our sales and marketing personnel and activities for our CDMA services from those for our GSM services. As a result, the sales and marketing department of our headquarters and our provincial-level branches have been separated into two independent departments for GSM and CDMA businesses respectively. By establishing a dedicated sales and marketing team for each cellular service segment, we aim to implement more competitive and focused sales and marketing strategies in a cost-effective way. In addition, a new department a comprehensive sales and marketing department was established at our headquarters to supervise and coordinate the sales and marketing activities of the GSM and CDMA business and formulate company-wide policies and strategies in respect of sales and marketing of our cellular services and products. See D. Risk Factors Risks Relating to Our Business Our CDMA and GSM businesses compete with each other in certain areas, which may adversely affect the growth and profitability of these businesses. under Item 3.

We promote our CDMA services by leveraging our abundant CDMA network resources and the technological advantage of CDMA 1X to provide differentiated services targeted at different market segments, including tailoring different service packages for different consumer groups. In 2006, we focused on optimizing the correlation between handset subsidies and the revenue generated by the related subscribers. We centralized our purchasing of CDMA handsets to lower the entry barrier of our CDMA services caused by high handset prices and to make our CDMA services more attractive and affordable to the mass market. We have also coordinated the sourcing of certain models of CDMA handsets with SKT to accelerate the commercial launch of new models of CDMA handsets. In addition, by offering a one-stop solution for customers, based on the integrated service capacity of CDMA 1X network technology, we actively pursued integrated services marketing to promote our CDMA 1X services.

We also continued to expand the subscriber base for our GSM voice and value-added services. Our marketing strategies for GSM services focused on the continued development of voice and SMS services and the rapid expansion of VAS. We also plan to leverage our newly upgraded GPRS networks in major Chinese cities to promote GPRS VAS services. Furthermore, we plan to capitalize on VAS and the release of new network number resources to develop high-end GSM service to enhance the profitability and image of our GSM business.

For our wireless VAS business, we focused on increasing the penetration rate of SMS, Cool Ringtone and wireless data services to achieve higher ARPU for our VAS business. In addition, we also plan to expand our market share in newer services such as mobile music, instant message and stock information download.

Recognizing the importance and the needs of our institutional customers and utilizing our advantages of being an integrated telecommunications operator, we formulated marketing strategies for our cellular services that were tailored to our institutional customers. In 2006, we continued to emphasize the development of advanced and customized industrial applications for our institutional customers. By offering industrial solutions, our business extended from the provision of basic telecommunications services to comprehensive value-added information services. For example, we expanded the CDMA IX-based applications for corporate and industrial customers in specific industries such as maritime. We introduced Agriculture Horizon , an integrated agriculture-related information service specifically targeting rural populations, based on our development of Tianfu Agriculture Information Net , an integrated agriculture information platform supported by our cellular, data and Internet network resources and information resources, which we launched in 2005. We recently introduced the SAIC Enforcement Horizon application which aims to offer tailored wireless services to law enforcement personnel of the State Administration of Industries and Commerce.

Long distance, data and Internet services: In 2006, we continued to focus on institutional customers, including financial institutions, large corporations, multi-national corporations, government entities and Internet service providers and Internet content providers, in order to provide them with customized one-stop solutions. We fully launched Unicom Commerce to offer integrated telecommunications services specifically designed to cater to institutional customers needs. Our marketing efforts with respect to retail customers were focused on promoting profitable services and products.

Service Bundling and Cross-Marketing: A key element of our sales and distribution strategy is to promote our strengths as a provider of a comprehensive range of integrated services. This strategy is implemented by our service centers, independent sales agents and direct sales forces, which distribute and support our various product offerings. For example, we cross-sell our long distance, data and Internet services to our cellular subscribers, as well as bundle wireless data service with voice services. In addition, based on the specific demands of our industry and institutional clients, we provide customized

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communications solutions by bundling VPN, IP telephony, Uni-Video broadband video-telephony and U-Net services under the brand Unicom Commerce.

Distribution

We have a diversified distribution network comprising of self-owned sales outlets, agent/distributor sales outlets and direct sales forces. We distribute our services to our individual customers through our self-owned sales outlets as well as other retail outlets. We distribute our services to large customers through our direct sales forces and agents. We have developed a nationwide distribution network of service centers and sales outlets, of which only a small portion are owned by us and the rest are owned by independent agents or distributors. As a part of the segregation of the sales and marketing functions for our GSM and CDMA businesses, we are in the process of reorganizing our existing distribution system into two distinctive distribution systems for each of our GSM and CDMA businesses. As of December 31, 2006, we had a total of approximately 220,000 sales outlets, of which over 7,775 were self-owned. These service centers and retail outlets distribute our cellular, long distance, data and Internet services and provide post-sales services such as service inquiry, customer complaint and collections.

We generally aim to maintain a flat distribution structure, but utilize a multi-level distribution system in some service areas, in which our top-level distributors further distribute to lower level distributors and sales agents. In 2006, we further reduced the levels of such distribution system to control distribution costs. We are also in the process of setting up direct distribution centers to further flatten the distribution structure in some areas. We have also established direct sales and customer service teams to conduct one-on-one sales to high-usage institutional customers. These direct sales and customer service teams focus is to promote our cellular, domestic and international long distance, data and Internet services as integrated telecommunications services in order to provide differentiated and comprehensive solutions for our customers. In 2006, we actively pursued cooperation opportunities with third-party distribution channels to optimize our overall distribution system. In addition, we enhanced control and evaluation of third-party distribution channels by strengthening the assessment of potential customer contributions.

Customer Service

We provide specialized, differentiated and one-stop services to our customers, based on the customer service resources of Unicom Group. In 2006, we developed a tiered customer service system based on our service brands, and launched a uniform service brand of Unicom 10010 to consolidate all customer service resources and unify the service standards and processing procedures adopted in our outlets, customer service centers, customer clubs and other customer service channels. Our customer service centers in each service area can be accessed by our customers by dialing a nationwide hotline number 10010. Our customer service system is a nationwide platform with regional centers, providing customer services for all of our businesses. This system is based on the customer service centers, and also relies on other systems, including operations, billing, account management and network management. This integrated system allows us to provide personalized and diversified services through customer service representatives or automated systems, including service inquiry, billing inquiry, response to customer complaints and suggestions, service initiation and termination, payment reminder services, emergency and club membership services, to different types of customers on a 24-hour basis. Our customers can access our customer services through various means, including telephone calls, faxes, e-mails and SMSs. To better serve our customers, we provide such value-added services as 10011 bill inquiry hotline, 101901 bill inquiry express line, 13010199999 international roaming service free hotline, bill payment through commercial banks, free copies of detailed statements, Internet account inquiry and a rechargeable card for all of our services. To better meet market demand, we continue to innovate in our customer services, in order to provide more pro-active, comprehensive and targeted customer services. We also continue to promote customer loyalty through our nationwide club member reward program.

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To enhance customer satisfaction, we have launched a series of customer service campaigns such as Reliable Network with Sincere Services. Our headquarters and regional centers have set up hotlines for customer complaints. We also implemented a customer service responsibility system to require all levels of our branches to resolve customers problems within a prescribed period of time. Such a system has helped us to improve service quality and enhance our customer satisfaction.

In addition, we also analyze our customer segments in detail, and tailor our services to the requirements of different customer segments. While we are focused on retention of our individual customers, we pay regular visits and provide one-on-one personalized services to our institutional customers and VIP customers and, through customer clubs , provide high-quality and differentiated services for high-net-worth individual customers and important institutional customers. For mass-market customers, we offer standardized services that aim at enhancing customer experience.

We emphasize customer service and customer relations management and have taken various measures to improve customer satisfaction. Such measures include establishing and improving the customer service network, standardizing the content, manner and criteria of service and improving training of customer service representatives. We established our customer service workflow using a consistent set of standards in order to timely resolve problems for our customers. We have also strengthened our analysis and research of customer consumption behavior, consumption cycle and satisfaction levels in order to understand their consumption pattern and influence their consumption trend.

Billing and Collection

We are able to leverage our strengths as an integrated service provider to offer integrated billing and collection services to our institutional and individual customers. We also integrate the billing systems for different services and distribute unified recharge cards that can be used to recharge various pre-paid services, including pre-paid cellular services, long distance telephony services and Internet dial-up services. Our billing system can distinguish between customers based on the marketing method and service package plans applicable to each customer. These additional functions would allow us to analyze customer data in more detail, thereby improving our ability to analyze the age of our accounts and control bad debts. The following table sets forth our billing and collection methods for each of our business segments:

Business Segment	Billing	Collection
Post-paid GSM and CDMA services	Centralized at the provincial level and generally by monthly billing.	Subscribers may pre-deposit their service charges with us or commercial banks or China Post that collect payment for us, make payment in person at our service centers or branches of China Post, or through commercial banks.
Pre-paid GSM and CDMA services	Centralized on our nationwide intelligent network	Subscribers can purchase and/or re-charge pre-paid cards through various channels. They can also re-charge cards by telephone.
PSTN long distance telephony services	Settlement through centralized system at our headquarters with billing handled at the provincial branch level	Subscribers mainly go to our service centers, commercial banks and branches of China Post for payment.
IP telephony services	Settlement through centralized system at our headquarters with billing for 17910 business carried	Subscribers mainly go to our service centers, commercial banks and branches of China Post for payment.

Business Segment	Billing	Collection
Uni-Video services	out by our headquarters and 17911 by our provincial branches Centralized at our headquarters except that our Guangdong provincial branch is in charge of the billing of pre-paid subscribers to our video-telephony services in Guangdong Province.	Our corporate customers can pay either at the local service centers in the locations of the branches of such customer or at one local service center designated by the customer.
Internet services	Centralized at the provincial level. Billing methods include monthly billing, volume-based billing and billing according to contractual provisions.	Subscribers may go to our service centers, commercial banks, and branches of China Post or use the Internet for payment.
Unicom s Internet Plaza	Customers of the Internet cafes either pay by membership or pay hourly rates.	N/A
Leased lines	Monthly billing in accordance with contractual provisions	Customers mainly pay at our service centers or at commercial banks.

Bad Debt Controls

Cellular Services. Post-paid subscribers must register with us before they can begin using our cellular services. Customer registration allows us to better manage customer credit. If subscribers do not pay their bills on time, we charge a late fee and will either call or send SMSs to the delinquent subscribers to remind them to pay. We generally suspend a post-paid subscriber s account if the account is more than 30 days overdue and terminate the account if it is overdue for more than three months after that. When an account is terminated, we will seek other remedies to collect the overdue payment, including personal visits to the subscriber to collect payments or taking legal action. At the same time, we encourage our subscribers to pre-deposit service charges with us, to be deducted against charges incurred in the future, or use our pre-paid services. We have developed a customer credit management system at the provincial branch level to enhance verification of the personal information of new subscribers and tighten credit control for new subscribers. We believe these measures will continue to improve our bad debt control.

Domestic and International Long Distance Services. We actively encourage customers to use our pre-paid services. For international long distance services, we generally only provide such services after receiving certain amounts of pre-paid deposits. In addition, we perform credit checks on potential customers. For high-volume users, we open telephone banking accounts at commercial banks, set credit limits on such accounts and settle with such customers on a monthly basis. We also monitor those high-volume users on a daily basis.

Internet services. We send e-mails to delinquent customers and use other methods to collect payment from delinquent customers. Accounts for individual customers which are delinquent for 20 days are suspended, and such accounts will be terminated if they are delinquent for more than 40 days. For corporate customers, our actions are based on the credit history of each delinquent customer.

Research and Development

We focus on technology innovation in coordination with our various business departments, in order to provide technical support to the development of our various businesses. In 2006, we established a China Unicom Patent Library and were granted 10 technology invention patents from the State Intellectual

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Properties Bureau of the PRC. We also received six scientific and technological progress awards from the China Institute of Communications. Among them, our CDMA/GSM dual-mode, dual-standby handset technology ranked first among all First Prize recipients.

In 2006, we also received an official mandate from the CDMA Development Group, an international consortium working on the adoption and evolution of 3G CDMA wireless systems around the world, to develop international mobile communications standards for dual-mode, dual-standby handsets.

Competition

The Chinese telecommunications market has six basic telecommunications service providers China Telecom, Unicom Group, China Mobile, China Netcom, China Satcom and China Railcom and thousands of value-added service providers. As a relatively new entrant into this highly competitive landscape, we believe the ***following strengths have contributed to the development and growth of our business in recent years:***

Integrated service offerings and a uniform and advanced telecommunications network We offer integrated cellular, domestic and international long distance, data and Internet services, and have a nationwide, uniform communications network that supports voice, data and Internet communications and allows us to provide integrated services to our customers and utilize our network resources in a cost-effective manner.

Unique service offerings Through our advanced integrated network platform and the implementation of our innovative marketing strategies, we introduced Worldwind CDMA and GSM dual-mode cellular services and a series of value-added services such as CDMA 1X wireless data services, uni value-added services and Unicom Horizon industry specific services, in order to satisfy the differentiated demand of our various customer segments.

Advanced technologies CDMA technology offers high bandwidth utilization, better voice quality, high data transmission capabilities, better security and lower handset radio transmitting power, and can be relatively cost-effectively and timely upgraded to 3G cellular telecommunications. We are the only provider for CDMA services in our service areas in China, and our CDMA network has been upgraded to CDMA 1X technology, which has higher data transmission capabilities. Our GSM services utilize 2G technology that is widely accepted internationally and we believe our GSM network coverage and voice quality meet international standards. Our uniform network platform (Unione) utilizes ATM+IP technology solutions to offer quality support to our voice, data, Internet, video conference, video telephony and mobile data services.

Professional and quality customer service Using the customer service resources of Unicom Group, we have built up a strong brand image in customer service that can be characterized as professional, differentiated and one-stop service under our uniform service brand of Unicom 10010.

However, the development of our business is also affected by certain competitive disadvantages, including:

Market position As a relatively new entrant to the market, we are still behind the traditional operators in such areas as market share and branding. Due to our late entry, we still need to strengthen our market position through expenditures to capture mid- to high-end customers. In addition, we are reliant on the dominant operators in terms of interconnection and settlement.

Financial resources Compared to the dominant operators such as China Mobile, our capital scale is relatively small, our debt ratio is relatively high, and our share of the market revenue and profit is relatively low.

Network coverage and upgrade While we have made significant improvements in network construction in recent years, network coverage in certain in-door or remote areas still needs improvement. In addition, we are still in the process of upgrading our GSM networks to launch more GPRS services in selected cities.

Cellular Competition

Our main competitor in the cellular communications business is China Mobile. China Mobile continues to have competitive advantages over us in brand name, market share, financial resources and network management experience. To compete against China Mobile, we continue to improve our network coverage and voice quality, enhance network quality, develop value-added services (such as our CDMA 1X wireless data services), improve customer service and customize our package service plans to meet our various subscribers specific needs. We also seek to leverage our position as a fully integrated telecommunications operator to provide one-stop telecommunications solutions for our subscribers. In addition, we seek to compete against China Mobile s GPRS wireless data services by the development of our CDMA 1X wireless data services, which offers such advantages as better voice quality, better security, higher data transmission rates and more comprehensive value-added wireless data services. Moreover, we have upgraded our GSM networks in selected cities and begun to offer GPRS wireless data services to our GSM subscribers in selected cities since 2007.

Our cellular services also compete with the wireless local communications services of China Telecom and China Netcom, known as Little Smart , which are based on their fixed line networks and primarily utilize PHS technology. These services were previously offered primarily in small- to medium-sized cities, but have been introduced in most cities nationwide. The Little Smart services reportedly have attracted a substantial subscriber base in China and compete with us mostly in the lower end of the cellular market. Although many cellular users use Little Smart services as a supplement, rather than an alternative, to their existing cellular services, the availability of Little Smart services has led to a decrease in effective cellular tariffs and reduced the overall usage volume of cellular services. The main competitive advantage of Little Smart services is their relatively low tariff rates. However, they generally have limited network coverage and roaming capability.

Since late 2006, the MII has stepped up its efforts to encourage wireless telecommunications operators to implement calling-party-pays billing arrangements by offering tariff packages with such billing arrangements in the future. In light of such a policy move, we have started to implement such billing arrangements in selected tariff packages offered in certain areas such as Beijing and Guangdong. In addition, the MII has also indicated that it may consider reducing the roaming fees cellular operators may charge their subscribers. Such regulatory actions may change the competitive environment of the PRC wireless telecommunications industry. For example, the implementation of calling-party-pays billing and the reduction of roaming charges may help us improve our competitive position against Little Smart service providers by reducing the price advantage of such services but it may also trigger more intensified competition among cellular service providers.

In addition, we expect that the PRC government s decision in respect of the 3G licenses may significantly change the overall competitive environment of the PRC wireless telecommunications industry and could further intensify the competition among cellular service providers. See D. Risk Factors Risks Relating to Our Business Our cellular businesses face competition from China Mobile Communications Corporation, or China Mobile, China Telecom Corporation Limited, or China Telecom, and China Network Communications Group Corporation, or China Netcom. Such competition may intensify and result in slower subscriber growth, lower tariffs and higher customer acquisition costs for us, which would materially adversely affect our financial condition, results of operations and growth prospects. and D. Risk Factors Risks Relating to the Telecommunications Industry in China Issuance of additional telecommunications service licenses including 3G licenses, may further intensify competition in the PRC telecommunications industry and materially adversely affect our financial condition, results of operations and growth prospects. under Item 3.

To implement differentiated management of our CDMA and GSM businesses and foster an appropriate degree of internal competition, which we believe will be beneficial to the enhancement of our overall competitiveness, we recently segregated the sales and marketing functions of the two businesses. As a result, the internal competition between the two businesses for our internal resources as well as cellular subscribers may increase. See D. Risk Factors Risks Relating to Our Business Our CDMA and GSM businesses compete with each other in certain areas, which may adversely affect the growth and profitability of these businesses. under Item 3.

Long Distance Telephony Competition

China Telecom and China Netcom are the dominant providers and our primary competitors in the public switched long distance business in their respective service areas. They have advantages over us in their respective service areas in brand name, market share, financial resources, service area coverage, last-mile access, extensive access networks and experience in fixed line telecommunications business. However, the separation of China Telecom into two companies along geographic lines has weakened the competitiveness of the resulting entities on a nationwide basis.

Since our network has been constructed recently and is equipped with the latest technology and advanced features, it enables us to offer a variety of high-quality services. Our long distance telephony services are also supported by a centralized billing system. However, our services are hindered by our lack of fixed line telephone number resources and last-mile access.

In recent years, competition in the IP telephony market has been intensifying. Our IP telephony services currently face intense competition from China Telecom, China Netcom, China Mobile, China Railcom and China Satcom. Currently, China Telecom and China Netcom are the market leaders in their respective service areas.

Data and Internet Competition

China Telecom and China Netcom are our major competitors in the data services business in their respective service areas. Other competitors include China Railcom and China Satcom. While China Telecom, China Netcom, China Railcom, China Mobile, China Satcom and we are the only Internet backbone operators in China, there are many retail Internet service providers throughout China. China Telecom and China Netcom have leading positions in the Internet access market and are the largest wholesale Internet service providers in their respective service areas. Our data and Internet networks have nationwide access, which offers convenience and flexibility to our institutional customers, whereas the respective networks of China Telecom and China Netcom only extend to their respective service areas.

The advanced features and design of our backbone network allow us to provide nationwide high quality virtual private network services, which are specifically tailored to the high-usage corporate customers and retail Internet service providers that we target. We have also built advanced metropolitan area networks and integrated access networks that allow us to connect to key commercial buildings throughout China. We also continue to cooperate with medium- to small-sized Internet service providers and other companies that have broadband access to concentrated residential areas to expand our broadband services.

Trademarks

We conduct our businesses under the Unicom name and logo. Unicom Group is the registered proprietor in China of the Unicom trademark in English and the trademark bearing the Unicom logo. Unicom Group is also the registered proprietor of the trademark of the word Unicom in Chinese. Unicom Group has granted us the right to use these trademarks on a royalty-free basis, and to license to us any trademark that it registers in China in the future which incorporates the word Unicom.

Regulatory and Related Matters

The telecommunications industry in China is subject to a high degree of government regulation. The primary regulatory authority of the Chinese telecommunications industry is the MII. The State Council, the National Development and Reform Commission (the successor to the former State Development Planning Commission), or the NDRC, the Ministry of Commerce (formerly, the Ministry of Foreign Trade and Economic Cooperation) and other governmental authorities also maintain regulatory responsibilities over certain aspects of the Chinese telecommunications industry.

The MII, under the supervision of the State Council, is responsible for, among other things:

- formulating and enforcing industry policies and regulations, as well as technical standards,
- granting telecommunications service licenses,
- supervising the operations and quality of service of telecommunications service providers,
- allocating and administering telecommunications resources such as spectrum and number resources,
- together with other relevant regulatory authorities, formulating tariff standards for telecommunications services,
- formulating interconnection and settlement arrangements between telecommunications networks, and
- maintaining fair and orderly market competition among service providers.

The MII has established a Telecommunications Administration Bureau in each province, which is mainly responsible for enforcement of telecommunications policies and regulations in that province.

The MII is in the process of drafting a telecommunications law that, once adopted by the National People s Congress, will become the basic telecommunications statute and provide the principal legal framework for telecommunications regulations in China. It is currently uncertain when the law will be adopted and become effective.

Telecommunications Regulations

The State Council promulgated the Telecommunications Regulations, which became effective as of September 25, 2000. The Telecommunications Regulations are substantially consistent with, and are primarily intended to streamline and clarify, the existing rules and policies for the telecommunications industry. They provide the current primary regulatory framework for China s telecommunications industry in the interim period prior to the adoption of the proposed telecommunications law.

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The Telecommunications Regulations are intended to develop a transparent and fair regulatory environment to foster orderly competition and encourage development in the telecommunications industry. The Telecommunications Regulations address all key aspects of the telecommunications industry, including entry into the industry, scope of business, tariff setting, interconnection arrangements, quality of services, technology standards and allocation of telecommunications resources.

Entry into the Industry

The Telecommunications Regulations adopt the existing regulatory distinction between basic and value-added telecommunications services. An addendum to the Telecommunications Regulations sub-categorizes basic and value-added telecommunications services. In February 2003, the MII revised the addendum to the Telecommunications Regulations; and the revised addendum took effect in April 2003. Basic telecommunications services include, among others, fixed line local and domestic long distance telephony services, international telecommunications services, IP telephony services, mobile voice and data services, Internet and other public data transmission services, lease or sale of network elements, and paging services. Value added telecommunications services include, among others, e-mail, voice mail, electronic data interchange, Internet access, Internet content and video conferencing services.

The MII promulgated Measures on the Administration of Telecommunications Business Licenses, which took effect on January 1, 2002. Those rules apply to the application for, examination and approval of, telecommunications business licenses in China. Providers of any basic telecommunications services as well as providers of value-added services in two or more provinces, autonomous regions and municipalities in China must apply for licenses from the MII. Licenses for basic telecommunications services will be granted through a tendering process.

After its accession to the WTO in December 2001, China promulgated the Administrative Regulations on Telecommunications Companies with Foreign Investment, effective on January 1, 2002, implementing its commitments to the WTO. Those commitments include the gradual reduction of foreign ownership restrictions in the telecommunications industry and the step-by-step opening of the telecommunications market in China to foreign operators. However, the presence or absence of foreign investments in an applicant for telecommunications licenses will presumably bear no direct relation to the decision on whether to issue licenses, in as much as the issuance of new licenses is governed by a separate set of rules and regulations. In recent years, China gradually fulfilled the market-opening commitments it made to the WTO and lifted many restrictions for foreign investors and service providers in respect of telecommunications services. The remaining restrictions regarding mobile services, value-added telecommunications services and fixed line services are as follows.

For mobile voice and data services:

§ there is no longer any geographic restriction and the foreign ownership shall be no more than 49%.

For value-added telecommunications services:

§ there is no longer any geographic restriction and foreign ownership shall be no more than 50%.

For fixed line services:

§ the services areas have been expanded to include services in and between 17 cities of Shanghai, Guangzhou, Beijing, Chengdu, Chongqing, Dalian, Fuzhou, Hangzhou, Nanjing, Ningbo, Qingdao, Shenyang, Shenzhen, Xiamen, Xi an, Taiyuan and Wuhan, or, the additional 14 cities; foreign ownership shall be no more than 35%; and after December 11, 2007, there will be no geographic restriction and ownership shall be no more than 49%.

Spectrum and Network Number Resources

The MII allocates all telecommunications-related frequencies, including those used in cellular, paging and microwave operations. The 800 MHZ, 900 MHZ and 1,800 MHZ frequency bands have been reserved for mobile cellular applications. The frequency assigned to a licensee may not be leased or transferred without obtaining the approval of the MII.

Since July 1, 2002, the MII has made some adjustments to the standard spectrum usage fees to be charged to teecommuincations network operators and the specific fee standards are as follows: (i) for the nation-wide GSM network frequency, an annual rate of RMB15 million per MHz of frequency, to be charged progressively over a period of three years, i.e., 50% for the first year; 75% for the second year and 100% for the third year and years thereafter; (ii) for the nation-wide CDMA network frequency, an annual rate of RMB15 million per MHz of frequency, to be charged progressively over a period of five years, i.e., 20% for the first year; 40% for the second year; 60% for the third year; 80% for the fourth year and 100% for the fifth year and thereafter and (iii) for any local telecommunications network frequency, an annual rate of RMB1.5 million per MHz of frequency for each province. In 2006, the aggregate fees we paid for frequency usage amounted to approximately RMB580 million.

The MII is also responsible for the administration of network number resources within China, including cellular network numbers and subscriber numbers. In January 2003, it issued the Administrative Rules for Telecommunications Network Numbers, which took effect on March 1, 2003. According to these rules, the telecommunications network number resources are properties of the PRC government, and the use of number resources by any telecommunications operator is subject to the approval of MII. Users of number resources, including us, are required to pay a usage fee to the PRC government. The rules also provide for procedures for application for the use, upgrade and adjustment of number resources by telecommunications operators.

In December 2004, the MII, the Ministry of Finance and the NDRC jointly issued the Provisional Administrative Measures with respect to the Collection of the Usage Fee of Telecommunications Network Number Resources, under which telecommunications companies are required to pay a usage fee to the PRC government by the 10th day of the first month of each quarter starting from 2005. Under these provisional measures, mobile telecommunications companies are required to pay an annual usage fee of RMB12 million for each network number. In addition, we are also required to pay usage fees for certain other network numbers. In 2006, the usage fees we paid for network numbers totaled RMB44.24 million.

Tariff Setting and Price Controls

The levels and categories of our current tariffs are subject to regulation by various government authorities, including the MII, the NDRC, and, at the local level, the relevant provincial Telecommunications Administration Bureaus and price regulatory authorities. Under the Telecommunications Regulations, telecommunications tariffs are categorized into State-fixed tariffs, State-guidance tariffs and market-based tariffs. For example, there are State-guidance tariffs for cellular services, fixed line telephony services and leased lines services that are set jointly by the MII and the NDRC. Tariffs for telecommunications services where adequate competition has already developed may be set by the service providers as market-based tariffs. The government is required to hold public hearings before setting or changing important State-tariff rates, which are attended by telecommunications

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operators, consumers and others. Operators are required to provide complete and adequate cost data and other materials for those hearings.

In 1997, the PRC government granted us preferential treatment by allowing us to vary our cellular tariffs by up to 10% from the State-guidance rates.

In December 2000, the MII, the former State Development Planning Commission and the Ministry of Finance jointly issued a tariff adjustment circular, which provides for tariff adjustments for a wide range of telecommunications services. Effective from February 21, 2001, we have adopted these government tariff adjustments.

In June 2001, the Ministry of Finance and the MII jointly issued a circular to revoke certain fees including one-time installation fees charged to the fixed line telephone users and one-time activation fees charged to the cellular subscribers.

In June 2004, the MII and the NDRC jointly issued a notice aimed at further strengthening the regulatory oversight of telecommunications tariffs. The notice requires telecommunications services providers to strengthen their internal control and management of tariff setting activities. Specifically, the notice requires services providers to strictly comply with the relevant government regulations relating to the procedures for the approval and registration of telecommunications tariffs.

In August 2005, the MII and NDRC jointly issued a notice stipulating that, with the exception of IP telephony services, maximum charges for many telecommunications services may not exceed the current level of charges.

In September 2006, the MII issued a notice stipulating that the telecommunications operators shall be responsible for the accuracy of the fees to be charged and collected for the wireless information services. In providing the wireless information services, the telecommunications operators shall respect users choice and information rights and treat users in a fair manner.

Beginning in 2006, the MII has stepped up efforts to encourage wireless telecommunications operators to adopt calling-party-pays billing practices. MII has encouraged new service packages featured with calling-party-pays billing arrangements. In addition, MII officials have also indicated that they may evaluate the existing policy that caps the roaming charges at a certain level, to further reduce roaming fees wireless operators charge their subscribers. We do not know if or when such regulations will be promulgated or implemented.

Interconnection Arrangements

On October 28, 2003, the MII issued regulations on interconnection and settlement arrangements, which superseded the provisional regulations on interconnection and settlement arrangements issued by the MII in 1999 and 2001, respectively. The regulations contain specific provisions regarding, among other things, revenue sharing methods and settlement mechanisms and interconnection agreements among telecommunications service providers. The Telecommunications Regulations reaffirmed the obligations of dominant telecommunications operators in China to provide interconnection with other operators. We have entered into interconnection and settlement agreements with China Telecom, China Netcom, China Mobile and China Railcom that implement the regulatory requirements.

The following table sets forth our current interconnection revenue sharing and settlement arrangements with fixed line operators and China Mobile for local calls after the regulations issued in 2003.

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Network from which calls originated	Network at which calls terminated	Settlement Arrangement
Unicom s cellular network	Fixed line operators public fixed line network	(1) Unicom collects the local cellular usage charge from its subscribers (2) Unicom pays RMB0.06 per minute to fixed line operators
Fixed line operators public fixed line network	Unicom s cellular network	No revenue sharing or settlement
Unicom s cellular network	China Mobile s cellular network	(1) Each of Unicom and China Mobile collects the cellular usage charge from its subscribers (2) Unicom pays RMB0.06 per minute to China Mobile
China Mobile s cellular network	Unicom s cellular network	(1) Each of Unicom and China Mobile collects the cellular usage charge from its subscribers (2) China Mobile pays RMB0.06 per minute to Unicom

The following table sets forth our interconnection revenue sharing and settlement arrangement with fixed line operators and China Mobile for domestic long distance calls after the regulations issued in 2003.

Network from which calls originated	Network at which calls terminated	Settlement Arrangement
Unicom s cellular network at area A	Fixed line operators public fixed line network at area B, if through the long distance network of such fixed line operator	(1) Unicom collects the domestic long distance tariff and local call tariff from its subscribers (2) Unicom keeps RMB0.06 per minute and pays the rest of the domestic long distance tariff to fixed line operators
Unicom s cellular network at area A	Fixed line operators public fixed line network at area B, if through the long distance network of Unicom	(1) Unicom collects the domestic long distance tariff and local call tariff from its subscribers (2) Unicom pays RMB0.06 per minute to fixed line operators, and keeps the rest of the domestic long distance tariff
Fixed line operators public fixed line network at area A	Unicom s cellular network at area B, if through the long distance network of Unicom	(1) Fixed line operators collect the domestic long distance tariff from their subscribers (2) Fixed line operators keep RMB0.06 per minute and pay the rest to Unicom

Fixed line operators public fixed line network at area A	Unicom s cellular network at area B, if through the long distance network of such fixed line operator	(1) Fixed line operators collect the domestic long distance tariff from their subscribers (2) Fixed line operators pay RMB0.06 per minute to Unicom and keep the rest
Fixed line operators public fixed line network at area A	Fixed line operators public fixed line network at area B, if through the long distance network of Unicom	(1) Fixed line operators on the originating end collect the domestic long distance tariff from their subscribers (2) Fixed line operators keep RMB0.06 per minute and pay the rest to Unicom (3) Unicom then pays RMB0.06 per minute to fixed line operators on the receiving end
Unicom s cellular network at area A	China Mobile s cellular network at area B, if through the long distance network of China Mobile	(1) Unicom collects the domestic long distance tariff and local call tariff from its subscribers (2) Unicom keeps RMB0.06 per minute and pays the rest of the domestic long distance tariff to

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Network from which calls originated	Network at which calls terminated	Settlement Arrangement
		China Mobile
China Mobile s cellular network at area A	Unicom s cellular network at area B, if through the long distance network of Unicom	(1) China Mobile collects the domestic long distance tariff and local call tariff from its subscribers (2) China Mobile keeps RMB0.06 per minute and pays the rest of the domestic long distance tariff to Unicom

The following table sets forth our interconnection revenue sharing and settlement arrangement with fixed line operators for international long distance calls through their international gateways after the regulations issued in 2003.

Type of calls	Settlement Arrangements
Outgoing calls from Unicom s cellular network, if through the international long distance network of fixed line operators	(1) Unicom collects the international long distance tariff and local call tariff from its subscribers (2) Unicom keeps RMB0.06 or RMB0.54 per minute (depending on whether through Unicom s domestic long distance network) and pays the rest of the international long distance tariff to fixed line operators
Incoming calls to Unicom s cellular network, if through the international long distance network of fixed line operators	(1) Unicom receives RMB0.06 or RMB0.54 per minute from fixed line operators (depending on whether through Unicom s domestic long distance network)

The following table sets forth our interconnection revenue sharing and settlement arrangements with other operators for IP telephony long distance calls through our network after the regulations issued in 2003.

Network from which calls originated	Network at which calls terminated	Settlement Arrangement
Unicom s cellular network at area A	Other operators public telecommunications network at area B (if through Unicom s IP telephony network)	(1) Unicom collects the IP telephony long distance charges and local call tariff from its subscribers (2) Unicom pays RMB0.06 per minute to other operators on the receiving end
Other operators public telecommunications network at area A	Other operators public telecommunications network at area B (if through Unicom s IP telephony network)	(1) Unicom collects the IP telephony long distance charges from its subscribers (2) Unicom pays RMB0.06 per minute to other operators on the receiving end (3) No settlement between Unicom and other operators on the originating end

For all interconnection services, we are required to pay the interconnection fees regardless of our ability or inability to collect the tariff from our subscribers. The fixed line operators are required to pay interconnection fees regardless of their ability or inability to collect the tariff from their subscribers, except for the interconnection by fixed line subscribers calling our subscribers in the same region where no interconnection fee will be charged. Interconnection charges are accrued on a monthly basis based on the actual call volume and applicable tariff rate.

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Technical Standards

The MII sets industry technical standards for the Chinese telecommunications industry. Most of the standards set by the MII conform to the standards recommended by the International Telecommunications Union and other international telecommunications standards organizations. In January 2006, the MII issued the technical standards for TD-SCDMA, a 3G mobile telephony technology. In May 2007, the MII released the technical standards for two additional 3G technologies, WCDMA and CDMA2000. In cases where the MII has not set certain industry technical standards, we set our own enterprise technical standards. The MII also requires all network operators in China to purchase only telecommunications equipment certified by the MII, including cellular and paging equipment, radio equipment and interconnection terminal equipment.

Universal Services

Telecommunications service providers in China are required to fulfill universal service obligations in accordance with relevant regulations to be promulgated by the PRC government, and the MII has the authority to delineate the scope of its universal service obligations. The MII may also select universal service providers through a tendering process. The MII, together with the finance and pricing authorities, is also responsible for formulating administrative rules relating to the establishment of a universal service fund and compensation schemes for universal services. The MII and other relevant government authorities are still in the process of formulating the detailed regulations relating to the provision of such universal services. Such regulations, if promulgated, may require us to incur significant expenses to fulfill our universal service obligations and therefore could materially adversely affect our financial condition and results of operations.

The MII has required major Chinese telecommunications service providers, including Unicom Group, to participate in a project to provide telecommunications services in a number of remote villages in certain designated provinces in China as transitional measures prior to the formalization of a universal service obligation framework. In participating in this project, Unicom Group undertook the universal service obligation to extend telecommunications service coverage to a total of more than 5,700 administrative-level villages from 2004 to 2006 primarily through its CDMA and satellite transmission networks. In 2007, the MII indicated that it may consider requiring Unicom Group and other telecommunications service providers to further extend telecommunications service coverage to tens of thousands of natural villages in remote areas. We have been assisting Unicom Group in providing mobile telecommunications services to these remote villages and are responsible for the operation and maintenance of the relevant network facilities in our service areas.

See D. Risk Factors Risks Relating to the Telecommunications Industry in China The PRC government may require us, along with other telecommunications service providers in China, to provide universal services with specified obligations, and we may not be compensated adequately for providing such services. under Item 3.

Capital Investment

On July 16, 2004, the State Council promulgated, effective immediately, the Decision on Reform of Investment System, or the Investment Reform Decision, which significantly modified the government approval process for major investment projects in China. The Investment Reform Decision eliminated the government approval requirements for investment projects that do not involve direct government funding unless the investment projects are in the restricted sectors specified in the annually adjusted catalogue released by the State Council. The 2004 catalogue, which was attached as an annex to the Investment Reform Decision, sets forth approval requirements for individual investment projects in restricted sectors.

Within the telecommunications sector, the investment projects that require the approval of the NDRC include:

- domestic backbone transmission networks (including broadcasting and television networks);
- international telecommunications transmission circuits;
- international gateways;
- international telecommunications facilities for dedicated telecommunications networks; and
- other telecommunications infrastructure projects involving information security.

Others

As a company with substantially all of our operations in China, we, along with our controlling shareholder, Unicom Group, are subject to various regulations of the PRC government in addition to those regulating the telecommunications industry. PRC regulatory authorities, such as the State Bureau of Taxation, National Audit Office, State Administration of Industry and Commerce and local price bureaus, exercise extensive control over various aspects of our businesses and conduct various regular inspections, examinations and/or audits on us and Unicom Group. As required by the relevant PRC laws and regulations, Unicom Group, as one of the key State-owned enterprises under the direct supervision of the SASAC, is also subject to routine audits by the National Audit Office, or the NAO, including the senior management departure audit which involves a mandatory review by the NAO of the economic responsibilities of a departing senior management member of Unicom Group.

In addition, as our controlling shareholder, Unicom Group, is under the direct supervision of SASAC, SASAC has an indirect influence over us. In particular, SASAC may designate certain nominees and request Unicom Group to propose the appointment of such nominees as our directors and senior management; SASAC may also request Unicom Group to remove our directors and senior management in accordance with relevant procedures provided by applicable law and our articles of association.

C. Organizational Structure

We are incorporated in Hong Kong and are 76.59% indirectly owned by the Unicom Group and 23.41% owned by public shareholders as of May 31, 2007. See A. History and Development of the Company under Item 4. Set forth below are details of our significant subsidiaries:

Name of Subsidiary	Country of Incorporation	Ownership Interest
China Unicom Corporation Limited	China	100%
China Unicom International Limited	Hong Kong SAR	100%
China Unicom (Macau) Company Limited	Macau SAR	100%

D. Properties

Our principal executive offices are located in Hong Kong. We also maintain executive offices in Beijing. We own and lease a large number of offices, retail outlets, equipment rooms and base stations throughout China. A number of the properties that we lease and operate on do not have land use rights certificates or building ownership certificates. In some cases, we have not entered into formal lease agreements with the lessors or the lessors may not possess requisite title certificates. We believe that it is unlikely that we would be denied our right to use a large number of these properties at any given time.

Item 4A. Unresolved Staff Comments

None.

Item 5. Operating and Financial Review and Prospects

You should read the following discussion and analysis together with the selected financial data set forth in Item 3 and the consolidated financial statements included in this annual report. The financial statements have been prepared in accordance with HKFRS, which differ in certain respects from US GAAP. Note 38 to the consolidated financial statements summarizes the nature and effects of significant differences between HKFRS and US GAAP as they relate to our financial statements and provides a reconciliation to US GAAP of our net income and shareholders equity. In addition, Note 38 to our consolidated financial statements includes our condensed consolidated financial information prepared and presented in accordance with US GAAP for the relevant periods. Our consolidated financial statements present, and the discussion and analysis under this Item 5 pertain to, our consolidated financial position and results of operations as of December 31, 2005 and 2006 and for the years ended December 31, 2004, 2005 and 2006.

On December 31, 2002 and 2003, we completed the acquisition of Unicom New Century from Unicom Group, and the acquisition of Unicom New World from Unicom Group and sale of Guoxin Paging to Unicom Group, respectively. Our consolidated financial statements as of and for the year ended December 31, 2004 reflect the results of operations of both Unicom New Century (which was merged into CUCL in July 2004) and Unicom New World (which was merged into CUCL in September 2005), but do not include the results of operations of Guoxin Paging. Our consolidated financial statements for the year ended December 31, 2003 reflect the results of operations of Unicom New Century and Guoxin Paging but do not include the results of operations of Unicom New World. In addition, in September 2004, we completed the acquisition of Unicom International from Unicom Group. Accordingly, the operating results of Unicom International for the period from the effective date of the acquisition to December 31, 2004 have been included in our consolidated statement of income for the year ended December 31, 2004. See ¾ Acquisitions of Unicom New Century, Unicom New World and Unicom International and the Sale of Guoxin Paging below.

Overview

We are an integrated provider of telecommunications services in China and offer a comprehensive range of telecommunications services, including the following, which also constitute our major operating segments:

GSM cellular service in 21 provinces, 5 autonomous regions and 4 municipalities;

CDMA cellular service in 21 provinces, 5 autonomous regions and 4 municipalities of China and in Macau;

domestic and international long distance service and other related services nationwide in China; and

data and Internet and other related services nationwide in China.

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The table below sets forth revenue from our major businesses and the respective percentage of our total revenue in 2004, 2005 and 2006.

	For the year ended December 31,					
	2004(1)		2005		2006	
	RMB in millions	% of Total Revenue	RMB in millions	% of Total Revenue	RMB in millions	% of Total Revenue
Total revenue	79,087	100.0%	87,049	100.0%	94,294	100.0%
Total service revenue	77,397	97.9%	84,287	96.8%	90,027	95.5%
GSM	47,509	60.1%	52,135	59.9%	59,291	62.9%
CDMA	24,378	30.9%	27,577	31.7%	27,293	28.9%
Long distance revenue	1,848	2.3%	1,525	1.7%	1,068	1.2%
Data and Internet revenue	3,662	4.6%	3,050	3.5%	2,375	2.5%
Sales of telecommunications products	1,690	2.1%	2,762	3.2%	4,267	4.5%

(1) The adoption of HKFRS on January 1, 2005 resulted in changes in certain accounting policies which have been reflected in the financial statements either in accordance with the transitional provisions in the applicable accounting standards, or to the extent there are no transitional provisions, applied retrospectively. Accordingly, the comparative financial data prior to January 1, 2005 presented herein was restated, as

applicable, in 2005 to conform to the changed accounting policies.

Our service revenue comes primarily from the following:

Usage fees for our GSM, CDMA, long distance and data and Internet services, including, for our cellular subscribers, roaming-out fees for calls made by them outside their local service areas. We recognize usage fee revenue when the service is rendered.

Monthly fees, of fixed amounts, charged to certain of our GSM, CDMA, data and Internet subscribers for access to the relevant service. We recognize monthly fee revenue in the month during which the services are rendered.

Value-added service revenue from the provision of value-added services, such as short message services, personalized ring-back tone services, CDMA 1X wireless data services and certain receptionist services to subscribers.

Interconnection revenue from other telecommunications operators, including Unicom Group, for calls made from their networks to our networks and roaming-in fees for calls made by cellular subscribers of other operators using our cellular networks. We recognize interconnection revenue when the relevant calls are made by subscribers.

Rental income from leases of transmission lines on our networks and indefeasible rights of use (IRU) to Unicom Group, business customers and other telecommunications carriers in China. We recognize leased line rental revenue on a straight-line basis over the relevant lease term, except for the lease of specific and identified network assets that transfer substantially all the risks and rewards incidental to ownership to the lessee, which is recognized as capacity sales.

Along with the continued growth of China s telecommunications industry, particularly in the cellular communications sector, our total revenue in 2006 increased by 8.3% from 2005. This increase was primarily the result of the continued growth in revenue of our GSM cellular business. Service revenue from our cellular businesses has increased from RMB79.71 billion in 2005 to RMB86.58 billion in 2006, representing a growth of 8.6%. We aim to further leverage our position as an integrated telecommunications operator in order to continue to drive the growth of our GSM and CDMA cellular businesses.

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The following table sets forth our major costs and expenses items and income before income tax, both in terms of amount and as a percentage of total revenue in 2004, 2005 and 2006.

	For the year ended December 31,					
	2004		2005		2006	
	RMB in millions	% of Total Revenue	RMB in millions	% of Total Revenue	RMB in millions	% of Total Revenue
Total Revenue	79,087	100.0%	87,049	100.0%	94,294	100.0%
Costs and expenses	72,616	91.8%	79,947	91.8%	87,799	93.1%
Leased line and network capacities	7,398	9.4%	8,748	10.0%	8,764	9.3%
Interconnection charges	7,517	9.5%	8,372	9.6%	9,595	10.2%
Depreciation and amortization	19,011	24.0%	20,368	23.4%	22,423	23.8%
Employee benefit expenses	4,615	5.8%	5,616	6.5%	6,649	7.1%
Selling and marketing	19,523	24.7%	20,558	23.6%	19,252	20.4%
General, administrative and other expenses	10,500	13.3%	11,742	13.5%	13,415	14.2%
Cost of telecommunications products sold	2,563	3.2%	3,575	4.1%	4,930	5.2%
Finance costs	1,696	2.1%	1,099	1.2%	654	0.7%
Unrealized loss on changes in fair value of derivative component of the convertible bonds		0.0%		0.0%	2,397	2.5%
Interest income	-103	-0.1%	-96	-0.1%	-259	-0.3%
Other gains, net	-104	-0.1%	-35	-0.0%	-21	-0.0%
Income before income tax	6,471	8.2%	7,102	8.2%	6,495	6.9%

Our major costs and expenses include the following:

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

Selling and marketing expenses, including commissions, promotion and advertising expenses, amortization of capitalized customer acquisition costs of certain CDMA contractual subscribers and customer retention costs;

General, administrative and other expenses, primarily including operating lease expenses, repair and maintenance costs and provision for doubtful debts. Other components of general, administrative and other expenses include utilities, general office expenses and travel expenses;

Leased line and network capacities charges, representing lease expenses for transmission capacity from other operators and CDMA network capacities from Unicom Group;

Interconnection expenses, representing amounts paid to other operators, including Unicom Group, for calls from our networks to their networks and roaming-out fees paid to other operators, including Unicom Group, for calls made by our subscribers roaming in their networks;

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

Costs of telecommunications products sold; and

Unrealized loss on changes in fair value of derivative component of the convertible bonds.

As we continue to aim to strengthen management, integrate our businesses and control costs to achieve greater overall efficiency, total costs and expenses, as a percentage of total revenue in 2006, was 93.1%, representing an increase of 1.3% from that in 2005.

Acquisitions of Unicom New Century, Unicom New World and Unicom International and Sale of Guoxin Paging

In December 2002, we acquired from Unicom Group the GSM cellular assets and businesses and CDMA businesses of Unicom New Century in the following six provinces, two autonomous regions and one municipality in China: Sichuan, Heilongjiang, Jilin, Henan, Jiangxi, Shaanxi, Chongqing, Guangxi and Xinjiang. The total purchase price was HK$4,909,000,000, payable in cash. On July 30, 2004, Unicom New Century was merged into CUCL and legally dissolved upon the completion of such merger.

In December 2003, we acquired from Unicom Group the GSM cellular assets and businesses and CDMA businesses of Unicom New World in the following nine provinces and autonomous regions in China: Shanxi, Hunan, Hainan, Yunnan, Gansu and Qinghai provinces and Inner Mongolia, Ningxia Hui and Xizang autonomous regions. The total purchase price was HK$3,014,886,000, payable in cash. On the same date, we also completed the sale of the entire equity interests of Guoxin Paging to Unicom Group for a total sale price of HK$2,590,917,656, and such proceeds were applied to our general working capital. On September 1, 2005, Unicom New World was merged into CUCL and legally dissolved upon the completion of such merger.

In September 2004, we completed the acquisition from Unicom Group of Unicom International, a limited liability company established in Hong Kong engaging in voice wholesale business, telephone cards business, line leasing services, managed bandwidth services and mobile virtual network services in Hong Kong and the United States. The total purchase price was HK$37,465,996, payable in cash.

Under HKFRS, we have adopted the purchase method to account for our prior acquisitions from Unicom Group of Unicom New Century, which became effective on December 31, 2002, Unicom New World, which became effective on December 31, 2003, and Unicom International, which became effective in September 2004. Under the purchase method, our consolidated financial statements incorporate the results of operations of Unicom New Century, Unicom New World and Unicom International only from the effective dates of the respective acquisitions. The differences between the cost of the acquisitions and the fair value of the identifiable assets and liabilities acquired was recognized as goodwill or negative goodwill, which were amortized on a straight line basis over its beneficial life or the remaining weighted average useful life of the acquired identifiable non-monetary assets. We ceased the amortization of goodwill from January 1, 2005 upon the adoption of HKFRS and the accumulated amortization as of December 31, 2004 has been eliminated with a corresponding decrease in the cost of goodwill. We also derecognized the negative goodwill previously recognized on or prior to January 1, 2005, with a corresponding adjustment to the opening balance of retained earnings. Starting from January 1, 2005, we no longer amortize goodwill but test it for impairment on an annual basis or when there is indication of impairment.

Under US GAAP, the acquisitions of Unicom New Century, Unicom New World and Unicom International are accounted for as a transfer of businesses under common control. Under this method, the acquired assets and liabilities are accounted for at their historical cost under US GAAP and the consolidated financial statements prepared under US GAAP for all periods presented are retroactively restated as if

Unicom New Century, Unicom New World and Unicom International had always been part of our company since inception. This method is reflected in the significant differences between HKFRS and US GAAP provided in Note 38 to our consolidated financial statements.

The acquisitions of Unicom New Century and Unicom New World have had a material impact on our overall results of operations. In particular, our financial results in 2004 were significantly affected by the inclusion of the results of operations for Unicom New World we acquired effective December 31, 2003. These acquisitions have, among other things, significantly expanded the size of the telecommunications markets we serve and increased the number of our subscribers and usage of our services. As a result, our revenue and costs and expenses have also increased significantly.

Critical Accounting Policies

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

Capitalization of CDMA Customer Acquisition Costs

We have been operating the CDMA business since the beginning of 2002. In order to accelerate the development of the CDMA business and subscriber growth, we have offered certain promotional packages. As part of the contractual arrangements with certain CDMA contractual subscribers under these special promotional packages, CDMA handsets were provided to the subscribers for their use at no additional charge during the specified contract periods ranging from six months to two years. In return, the subscribers are required to incur a minimum amount of service fees during the contract period. If the contractual subscribers can fulfill the minimum contract spending amounts by the end of the contract period, they will not be obliged to repay the remaining costs of the CDMA handsets given for their use. In addition, to secure contract performance, these subscribers are required under their contracts to (i) prepay certain amounts of service fees or deposits, (ii) maintain a bank deposit in one of the designated commercial banks to secure their minimum contract amounts, or (iii) provide a guarantor who will compensate us for any loss in the event of the subscriber s non-performance of related contractual obligations.

We consider the costs of the CDMA handsets provided to contractual subscribers under these promotional packages as customer acquisition costs for the development of new CDMA contractual subscribers. Such customer acquisition costs are deferred to the extent expected to be recoverable, and amortized over the contractual periods (not exceeding two years), over which future economic benefits are expected to be received by us in the form of minimum contract revenue.

We determined the accounting policy for capitalization of customer acquisition costs of contractual CDMA subscribers after a careful evaluation of specific facts and circumstances, and believe that the capitalization of such costs is appropriate because future economic benefits are expected to be received by us in the form of future contractual revenues, taking into consideration (i) the historically high ARPUs and low churn rate, and low default or bad debt rates of these subscribers; (ii) our established procedures in and the relative low cost of enforcement of contracts in default; and (iii) the existence of specified contract periods with minimum contract spending amounts and built-in contractual safeguarding measures such as non-refundable prepayments, bank deposits, and guarantees received, as well as penalty clauses imposed on subscribers.

Therefore, we believe that the customer acquisition costs are recoverable from future revenue to be derived from these promotional packages, and the capitalization and amortization of these customer acquisition costs is an appropriate accounting policy. Furthermore, we continuously assess and evaluate the recoverability of these customer acquisition costs, based on detailed review of historical subscriber churn rates and estimated default rate. Based on our current assessment and evaluation, we believe that there is no significant problem in recovering the carrying amounts of the customer acquisition costs as of December 31, 2004, 2005 and 2006.

We have made the above recoverability assessments based on the current legal and operating environment relating to the subscribers contract performance and other information currently available to us. Actual results may differ significantly from the current situation and our current estimates. If the situation changes significantly in the future, we may need to accelerate the amortization of customer acquisition costs based on conditions at that time.

Recognition of Upfront Non-refundable Revenue and Direct Incremental Costs

We capitalize and amortize upfront non-refundable revenue, including connection fees and activation fees of SIM cards or user identity module cards, or UIM cards, from our GSM and CDMA cellular subscribers over the expected customer service period. Accordingly, the related direct incremental costs of acquiring and activating GSM and CDMA businesses, including costs of SIM or UIM cards and commissions which are directly associated with upfront non-refundable revenue received upon activation of cellular services, are also capitalized and amortized over the same expected customer service period. We only capitalize costs to the extent that they will generate future economic benefits. The excess of the direct incremental costs over the corresponding upfront non-refundable revenue, if any, are expensed to the statement of income immediately as incurred.

The expected customer service period for our cellular business is estimated based on the expected stabilized churn rates of subscribers after taking into account factors such as customer retention experience, the expected level of competition, the risk of technological or functional obsolescence of our services and the current regulatory environment. If the estimate of the expected stabilized churn rate changes for future periods as a result of unexpected changes in competitive environment, telecommunications technology development or regulatory environment, the amount and timing of recognition of these direct incremental costs and our deferred revenue would also change.

Lease of CDMA Network Capacity

We had entered into a CDMA network capacity lease agreement with Unicom Group and its wholly-owned subsidiary, Unicom New Horizon, in November 2001. Pursuant to this CDMA lease agreement, Unicom New Horizon agreed to lease the capacity of the CDMA network to us covering the nine provinces and the three municipalities. In addition, on December 31, 2002 and 2003, we acquired all the equity interests in Unicom New Century and Unicom New World, respectively, which together operate GSM and CDMA cellular businesses in another 12 provinces, one municipality and five autonomous regions in the PRC. Unicom New Century and Unicom New World had also respectively entered into a CDMA lease agreement with Unicom Group and Unicom New Horizon on similar terms and conditions. These lease agreements and the lease agreement entered in 2001 are collectively referred to as the Old CDMA Leases.

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According to the terms of the Old CDMA Leases, the initial lease period is one year, renewable for an additional one-year term at our own option. We have the exclusive right to lease and operate the CDMA network capacity in the above regions. Also, we have the option to add or reduce the capacity leased by giving advance notice. The lease fee per unit of capacity is calculated on the basis that if full capacity is leased, it would permit Unicom New Horizon to recover its investment in constructing the CDMA network in seven years, with an internal return of 8%. In January 2004, we renewed the CDMA network capacity for an additional one-year term. We had the option to purchase the network assets based on the appraised value of the network determined by an independent appraiser.

Unicom New Horizon has the legal ownership of the CDMA network, is directly responsible for the planning, financing and construction of the CDMA network, and directly enters into all contracts with suppliers and constructors. We believe we only bear the risks associated with the operation of the CDMA business during the relevant leasing periods and are free from any ownership risks of the CDMA network and the risks and rewards of ownership of the leased assets rest substantially with the lessor.

At the inception of the Old CDMA Leases, there was a high degree of uncertainty related to the market condition and operating results of the CDMA business. It was highly uncertain whether we would continue to lease the network in the future or to estimate the future network capacity to be leased. We were also unable to determine whether or not we would exercise the purchase option in the future. Given these uncertainties and due to the fact that the risks associated with the ownership of the CDMA assets substantially remained with Unicom Group and Unicom New Horizon, we accounted for the leasing of the CDMA network as operating leases for the initial three-year lease period, so as to reflect the respective rights and obligations of the relevant parties to the Old CDMA Leases.

On March 24, 2005, we entered into the 2005 CDMA Lease with Unicom Group and Unicom New Horizon to replace the Old CDMA Leases. Key terms of the 2005 CDMA Lease, including exclusive operating rights and purchase option, are substantially similar to those contained in the Old CDMA Leases except that the 2005 CDMA Lease has an initial term of two years and the lease fee of the CDMA Network is to be determined on the basis of the audited CDMA service revenue. Given that the uncertainties continued, we considered the risks associated with the ownership of the CDMA assets still substantially remain with Unicom Group and Unicom New Horizon, and have concluded the leasing of the CDMA network continues to be an operating lease.

On October 26, 2006, we entered into the 2006 CDMA Lease with Unicom Group and Unicom New Horizon to replace the 2005 CDMA Lease. The 2006 CDMA Lease became effective from January 1, 2007. Pursuant to the 2006 CDMA Lease, the initial lease period is for one year, renewable for an additional one-year term at our option. The lease fee of the CDMA network for 2007 and 2008 is calculated as follows:

- 31% of the audited CDMA service revenue of the lessee for each of the years 2007 and 2008; or

- 30% of the audited CDMA service revenue of the lessee for the year 2007 or 2008, where the audited CDMA income before taxation of the lessee for the relevant year is less than the audited CDMA income before taxation of the lessee for the year 2006 as set out in the relevant annual audited financial statements of the lessee;

provided, that the annual lease fee of the CDMA network shall not be less than a certain minimum level (the Minimum Lease Fee) regardless of the amount of CDMA service revenue for that year. The Minimum Lease Fee for 2007 shall be 90% of the total amount of lease fee paid by us to Unicom New Horizon for 2006 pursuant to the 2005 CDMA Lease. The Minimum Lease Fee for 2008 shall be 90% of the total amount of lease fee paid by us to Unicom New Horizon for 2007 pursuant to the 2006 CDMA Lease. The level of lease fee under the 2006 CDMA Lease has been set by reference to our view of the industry trends, including factors such as CDMA subscribers and average revenue per user per month levels.

Under the 2006 CDMA Lease, we believe the uncertainties of the CDMA business continue to exist, particularly due to the fact that (i) the service revenue of CDMA business was stagnant in 2006; (ii) the uncertainty of the future success of CDMA business arising from intense market competition; and (iii) the uncertainty of the future changes in technology, technological standards and government regulatory environment. Moreover, at the inception of the 2006 CDMA Lease, we were still unable to determine whether to renew the lease after the initial one-year lease term or whether to exercise the purchase option. As a result, we considered the risks associated with the ownership of the CDMA assets still substantially remain with Unicom Group and Unicom New Horizon, and have concluded the leasing of the CDMA network should still be accounted for as an operating lease in 2007. At the beginning of each future lease term, we will reassess the appropriate classification based on the relevant factors and circumstances at that time.

Based on the above accounting judgment made, the operating lease expense for the leasing of the CDMA network has been recorded in the statement of income, and the carrying value of the CDMA assets and the related liabilities have not been reflected in the balance sheets. For the years ended December 31, 2004, 2005 and 2006, we recorded lease expense of approximately RMB6.59 billion, RMB7.92 billion and RMB 8.08 billion, respectively, under the leased lines and network capacities in the statement of income.

Convertible Bonds

On July 5, 2006, we issued the zero coupon convertible bonds with an aggregate principal amount of USD1 billion. The three-year convertible bonds were issued with a conversion price of HKD8.63 and will mature on July 5, 2009. As the functional currency of us is RMB, the conversion option of the convertible bonds denominated in Hong Kong Dollars will not result in settlement by the exchange of a fixed amount of cash in RMB for a fixed number of our shares. In accordance with the requirements of HKAS 39, Financial Instruments Recognition and Measurement, the convertible bonds contract must be separated into two component elements: a derivative component consisting of the conversion option and a liability component consisting of the straight debt element of the bond.

The embedded conversion option of the convertible bonds has been separated from the host debt contract and accounted for as a derivative liability carried at fair value on the balance sheet with any changes in fair value being charged or credited to the statement of income in the period when the change occurs. The remainder of the proceeds is allocated to debt element of the convertible bonds, net of transaction costs, and is recorded as the liability component. The liability component is subsequently carried at amortized cost until extinguished on conversion or redemption. Interest expense is calculated using the effective interest method by applying the effective interest rate to the liability component through the maturity date. If the convertible bonds are converted, the carrying amounts of the derivative and liability components are transferred to share capital and share premium as consideration for the shares issued. If the convertible bonds are redeemed, any difference between the amount paid and the carrying amounts of both components is recognized in the statement of income.

The fair value of the conversion option which is not traded in an active market is determined by using valuation techniques. We use our judgment to select an appropriate valuation method and make assumptions that are mainly based on market conditions existing at each balance sheet date. The valuation model requires the input of subjective assumptions, including the volatility of share price, stock closing price, dividend yield, risk-free rate, and expected option life. Changes in subjective input assumptions can materially affect the fair value estimate. For the year ended December 31, 2006, we recognized unrealized loss of approximately RMB2.40 billion resulting from changes in the fair value of the conversion option of the convertible bonds.

Depreciation on Property, Plant and Equipment

Depreciation on our property, plant and equipment is calculated using the straight-line method to allocate cost or revalued amounts to residual values over the estimated useful lives. We review the useful lives and residual values periodically to ensure that the method and rates of depreciation are consistent with the expected pattern of realization of economic benefits from property, plant and equipment. We use estimates of useful lives of property, plant and equipment based on historical experience, taking into account anticipated technological changes. If there are significant changes from previously estimated useful lives, the amount of depreciation expense may be adjusted. The cost or revalued amount and accumulated depreciation on property, plant and equipment as of December 31, 2006 amounted to RMB205.76 billion and RMB94.38 billion, respectively, as compared to RMB186.69 billion and RMB74.31 billion, respectively, as of December 31, 2005.

Impairment of Non-current Assets

At each balance sheet date, we perform a review of internal and external sources of information to identify indications that our non-current assets, including property, plant and equipment and goodwill, may be impaired. In addition, we review (i) our assets that have indefinite useful lives or are not yet available for use are not subject to amortization and (ii) our assets that are subject to depreciation or amortization for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. We continually monitor our businesses, markets and business environment and make judgments and assessments as to whether any impairment event or change has occurred. An impairment loss is recognized for the amount by which the asset s carrying amount exceeds its recoverable amount. The recoverable amount is the higher of (i) an asset s fair value less costs to sell and (ii) value-in-use. We estimate value-in-use based on estimated discounted pre-tax future cash flows of a cash-generating asset unit, which is the smallest group of assets that generates cash flows independently.

In making judgments on the recoverability of non-current assets, we need to assess whether: (i) an event has occurred that may affect an asset s value; (ii) the carrying value of an asset can be supported by the discounted pre-tax future cash flows from such asset and (iii) the cash flow is discounted at an appropriate rate. Changes in any of these assessments could result in significant changes to our estimates of the recoverability of our non-current assets.

Provision for Doubtful Debts

Accounts receivables are stated at cost, less provision for doubtful debts. We evaluate specific accounts receivable where there are indications that the receivable may be doubtful or is not collectible. We record a provision based on our best estimates to reduce the receivable balance to the amount that is expected to be collected. For the remaining receivable balances at each reporting date, we make a provision based on observable data indicating that there is a measurable decrease in the estimated future cash flows from the remaining receivable balances. We make such estimates based on our past experience, historical collection patterns, subscribers creditworthiness and collection trends. For general subscribers of cellular, long distance, data and Internet services, we make a full provision for receivables aged over three months, which is consistent with our credit policy with respect to relevant subscribers.

Our estimates described above are based on our past experience, subscribers creditworthiness and collection trends. If circumstances change (e.g., due to factors including developments in our business and

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the external market environment), we may need to re-evaluate our policies on doubtful debts, and make additional provisions in the future.

Provision for Subscriber Point Reward Program

We have implemented a subscriber point reward program, which is a bonus point-based scheme that rewards subscribers according to their service consumption, loyalty and payment history. The cost of the subscriber point reward program is charged to the statement of income as selling and marketing expenses, instead of a reduction of revenue. The estimated liability is recognized based on (i) the value of each bonus point awarded to subscribers and (ii) the number of bonus points relating to subscribers who are qualified or expected to be qualified to exercise their redemption right at each balance sheet date. If subscribers redeem rewards or their entitlements expire, the provision will be adjusted accordingly. We have recognized a liability for this program amounting to RMB0.56 billion as of December 31, 2006, as compared to RMB0.34 billion as of December 31, 2005. As we have not had much historical incentive redemption experience in the past, we may need to re-assess our accruing method for the potential bonus point liability when we obtain more reliable historical redemption statistics in the future.

Income Tax and Deferred Taxation

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

For the evaluation of temporary differences, we have assessed the likelihood that the deferred tax assets could be recovered. Major deferred tax assets relate to interest on loans from China-China-Foreign (CCF) joint ventures, loss arising from terminations of CCF arrangements, provisions for doubtful debts and write-down of inventory to net realizable value and additional depreciation deductible for tax purposes. Due to the effects of these temporary differences on income tax, we have recorded deferred tax assets amounting to RMB0.31 billion and RMB0.34 billion as of December 31, 2006 and 2005, respectively. Deferred tax assets are recognized based on our estimates and assumptions that they will be recovered from taxable income arising from the continuing operations in the foreseeable future.

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

Operating Results

Year Ended December 31, 2006 Compared to Year Ended December 31, 2005

In 2006, our revenue continued to increase, by 8.3% from RMB87.05 billion in 2005 to RMB94.29 billion in 2006. This growth was principally due to the steady growth of our GSM cellular business. For the reasons discussed below, our GSM and CDMA cellular businesses continued to increase in terms of revenues, while our long distance and data and Internet businesses continued to decrease in terms of revenues.

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Due to factors discussed below, in 2006 our costs and expenses increased by 9.8% to RMB87.80 billion from 2005. As a result, our income before income tax decreased by 8.5% to RMB6.50 billion, and our income before income tax margin decreased by 1.3% from that of 2005. Our net income in 2006 decreased by 24.3% to RMB3.73 billion from 2005, for reasons discussed below.

We issued the convertible bonds (as defined in ¾ Costs and Expenses below) to SKT in 2006. Due to the substantial increase in our share price during the period, we recorded an unrealized loss of approximately RMB2.40 billion on changes in the fair value of the derivative component of the convertible bonds. For detailed discussion, please refer to ¾ Liquidity and Capital Resource below and Note 17 to our consolidated financial statements. Excluding the effect of the RMB2.40 billion unrealized loss on changes in fair value of derivative component of the convertible bonds, our total costs and expenses would be RMB85.40 billion, an increase of 6.8% from 2005, which would be slower than the 8.3% growth in the total revenue in 2006, and our net income would be RMB6.13 billion, an increase of 24.3% from 2005.

Revenue

Revenue from our GSM cellular business grew steadily in 2006 and continued to generate a majority of our total revenue, while revenue from our CDMA cellular business slightly increased in 2006. Due to the increase of the percentage of sales of telecommunications products in the total revenue, revenues from our GSM and CDMA cellular businesses as a percentage of our total revenue increased from 94.7% in 2005 to 96.3% in 2006. The share of revenue from the CDMA cellular business in our total revenue decreased from 34.8% in 2005 to 33.5% in 2006, while the share of revenue from the GSM cellular business in our total revenue increased from 59.9% in 2005 to 62.9% in 2006 as a result of the revenue growth of our GSM business. Aggregate revenues from our long distance business and our data and Internet businesses represented 3.7% of our total revenue in 2006, as compared with 5.3% in 2005.

Cellular Revenue

For the reasons discussed below, revenues from our GSM and CDMA cellular businesses (including revenues from sales of telecommunications products) together increased by 10.2%, from RMB82.46 billion in 2005 to RMB90.85 billion in 2006.

GSM Cellular Business. Revenue from our GSM cellular business increased by 13.7%, from RMB52.14 billion in 2005 to RMB59.30 billion in 2006, primarily due to the continued increases in the total number of our total GSM cellular subscribers and in our subscribers average MOU as well as ARPU. The total number of our GSM cellular subscribers increased by 11.4%, from 95.07 million as of December 31, 2005 to 105.87 million as of December 31, 2006. ARPU from the GSM cellular business also increased 1.4%, from RMB48.5 in 2005 to RMB49.2 in 2006, primarily due to the increase in GSM value-added services. The average MOU per subscriber per month increased 17.3%, from 202.2 minutes in 2005 to 237.2 minutes in 2006.

The table below sets forth the revenue composition of our GSM cellular business and each revenue item s respective share of total GSM revenue in the years ended December 31, 2004, 2005 and 2006.

	2004		2005		2006	
	RMB in million	As percentage of total	RMB in million	As percentage of total	RMB in million	As percentage of total
Revenue	47,513	100.0%	52,139	100.0%	59,298	100.0%
Service Revenue	47,509	100.0%	52,136	100.0%	59,290	100.0%
Usage Fee	31,997	67.3%	32,077	61.5%	33,609	56.7%
Monthly Fee	6,922	14.6%	6,841	13.1%	7,370	12.4%
Interconnection Revenue	2,614	5.5%	3,466	6.6%	4,915	8.3%
Value-added Service Revenue	4,819	10.1%	7,967	15.3%	11,543	19.5%

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	2004		2005		2006	
	RMB in million	As percentage of total	RMB in million	As percentage of total	RMB in million	As percentage of total
Others	1,157	2.5%	1,785	3.5%	1,853	3.1%
Sales of Telecommunications Products	4	0.0%	3	0.0%	8	0.0%

As a result of the increase in the average MOU, which is partially offset by the decrease in effective tariffs, usage fees for GSM cellular services increased by 4.8% from RMB32.08 billion in 2005 to RMB33.61 billion in 2006, representing 56.7% of total GSM service revenue, a decrease from 61.5% in 2005. Monthly fees increased by 7.7%, from RMB6.84 billion in 2005 to RMB7.37 billion in 2006, and represented 12.4% of total GSM service revenue as compared with 13.1% in 2005. This increase is primarily due to our GSM expanded subscriber base. Interconnection revenue increased by 41.8% from RMB3.47 billion in 2005 to RMB4.92 billion in 2006, and represented 8.3% of total service revenue as compared with 6.6% in 2005. This increase is primarily due to the increased total usage of our GSM cellular services.

While continuing to meet the diverse needs of our customers in the mass market, our GSM cellular business aims to actively develop and promote value-added services. As a result, revenue from value-added services significantly increased its contribution to our total GSM cellular revenue. Revenue from our GSM value-added cellular services increased 44.9%, from RMB7.97 billion in 2005 to RMB11.54 billion in 2006. Its share of total GSM service revenue increased significantly from 15.3% in 2005 to 19.5% in 2006. Of the total revenue from GSM value-added cellular services, revenue from short messaging services increased 31.0% from RMB3.74 billion in 2005 to RMB4.90 billion in 2006, and its share of total GSM service revenue grew from 7.2% in 2005 to 8.3% in 2006.

CDMA Cellular Business. Our CDMA subscriber base has continued to expand. In 2006, revenue from our CDMA cellular business reached RMB31.55 billion in 2006, a 4.1% increase over RMB30.32 billion in 2005. This increase was primarily due to a 55.2% increase in the sales of telecommunications products. However, CDMA service revenue in 2006 was RMB27.29 billion and decreased by 1.0% from 2005 due to a 12.3% decrease of the ARPU from RMB75.1 in 2005 to RMB65.9 in 2006 which offset the increases in the total number of our CDMA subscribers and in total MOU. Such ARPU decrease was because certain high-end contractual customers did not renew their contracts upon expiration of the contract period under the CDMA handset promotional packages while the average ARPU of new customers was relatively lower.

The table below sets forth the revenue composition of our CDMA cellular business and each revenue item s respective share of total CDMA revenue for the years ended December 31, 2004, 2005 and 2006.

	2004		2005		2006	
	RMB in million	As percentage of total	RMB in million	As percentage of total	RMB in million	As percentage of total
Revenue	26,046	100.0%	30,320	100.0%	31,550	100.0%
Service Revenue	24,378	93.6%	27,577	91.0%	27,293	86.5%
Usage Fee	16,165	62.1%	16,727	55.2%	14,696	46.6%
Monthly Fee	4,638	17.8%	4,905	16.2%	5,025	15.9%
Interconnection Revenue	927	3.6%	1,399	4.6%	1,732	5.5%
Value-added Service Revenue	2,371	9.1%	4,116	13.6%	5,314	16.8%
Others	277	1.0%	430	1.4%	526	1.7%
Sales of Telecommunications	1,668	6.4%	2,743	9.0%	4,257	13.5%

Products

CDMA usage fees decreased by 12.1% from RMB16.73 billion in 2005 to RMB14.70 billion in 2006, and represented 53.8% of total CDMA service revenue as compared with 60.7% in 2005. The decrease of usage fees in the percentage of total CDMA service revenue was primarily due to the decrease in the ARPU of our CDMA subscribers. With the expansion of our CDMA 1X wireless data services in

2006, we have been actively developing our CDMA wireless data business, by making efforts to leverage the competitive edge of the CDMA technology. Revenue from CDMA value-added cellular services reached RMB5.31 billion in 2006, an increase of 29.1% from RMB4.12 billion in 2005, and accounted for 19.5% of total service revenue from the CDMA cellular business in 2006. Of the total revenue from CDMA value-added cellular services, revenue from CDMA 1X wireless data services increased 49.2% from RMB1.33 billion in 2005 to RMB1.99 billion in 2006, and its share of total CDMA service revenue grew from 4.8% in 2005 to 7.3% in 2006. We expect revenue from value-added CDMA services will continue to grow significantly, as we will continue to focus on the development and marketing of such value-added services.

Monthly fees increased by 2.4% from RMB4.91 billion in 2005 to RMB5.03 billion in 2006, and represented 18.4% of total CDMA service revenue as compared with 17.8% in 2005. The increase of monthly fees in the percentage of total CDMA service revenue was primarily due to an increasing number of subscribers who subscribe to package plans that set minimum monthly fee. Interconnection revenue increased by 23.8% from RMB1.40 billion in 2005 to RMB1.73 billion in 2006, and represented 6.3% of total service revenue as compared with 5.1% in 2005. This increase is primarily due to the increased usage of our CDMA cellular services.

Long Distance and Data and Internet Revenue

Long Distance Business. Revenue from our domestic and international long distance business (including revenues from sales of telecommunications products) decreased by 30.3%, from RMB1.53 billion in 2005 to RMB1.07 billion in 2006. Such decrease is primarily due to the continued decrease in tariffs as a result of intensified competition as well as a decrease in the total minutes of outgoing long distance calls.

Data and Internet Business. Revenue from our data and Internet businesses (including revenues from sales of telecommunications products) decreased by 22.2% from RMB3.06 billion in 2005 to RMB2.38 billion in 2006 primarily due to the decrease in tariffs as a result of intensified competition and our termination of unprofitable services and products.

As a result of the foregoing, revenues from our long distance and data and Internet businesses were RMB3.45 billion, a decrease of 24.9% from 2005.

Costs and expenses

Costs and expenses in 2006 were RMB87.80 billion, representing an increase of 9.8% over 2005, exceeding the 8.3% growth in revenue for the same period. Excluding the effect of the RMB2.40 billion unrealized loss on changes in fair value of derivative component of the convertible bonds, costs and expenses would be RMB85.40 billion, increase by 6.8% from 2005, which would be slower than the 8.3% growth in the total revenue in 2006. Certain items of costs and expenses, however, had a higher rate of increase, such as the 14.6% increase in interconnection charges and the 18.4% increase in employee benefit expenses and 14.3% increase in the general, administrative and other expenses. As our various business segments continued to develop, interconnection charges also increased faster than our revenue in 2006 since the interconnection rates remain unchanged while our effective tariffs have been declining due to continued price competition in 2006. Our employee benefit expenses also grew faster than our revenue in 2006 due to factors including a general increase in employee insurance and social security expenses and an increase in share-based compensation costs. Due to increased rents for bases stations, sales outlets, maintenance fees, utilities charges and other expenses, general, administrative and other expenses increased by 14.3% from RMB11.74 billion in 2005 to RMB13.42 billion in 2006.

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In 2006, we continued to implement the business strategy of effective growth , i.e., profit-driven growth, by strengthening cost control and optimization of our expense structure in order to ensure continued growth in earnings. Our costs and expenses as a percentage of total revenue stood at 93.1% in 2006, as compared with 91.8% in 2005. Excluding the effect of the RMB2.40 billion unrealized loss in connection with the convertible bonds, costs and expenses as a percentage of total revenue would be 90.6%.

The table below illustrates the major expense items from 2004, 2005 and 2006 and their respective shares of total revenue.

	For the year ended December 31,					
	2004		2005		2006	
	RMB in million	% of Total Revenue	RMB in million	% of Total Revenue	RMB in million	% of Total Revenue
Costs and expenses	72,616	91.8%	79,947	91.8%	87,799	93.1%
Leased lines and network capacities	7,398	9.4%	8,748	10.0%	8,764	9.3%
Interconnection charges	7,517	9.5%	8,372	9.6%	9,595	10.2%
Depreciation and amortization	19,011	24.0%	20,368	23.4%	22,423	23.8%
Employee benefit expenses	4,615	5.8%	5,616	6.5%	6,649	7.1%
Selling and marketing	19,523	24.7%	20,558	23.6%	19,252	20.4%
General, administrative and other expenses	10,500	13.3%	11,742	13.5%	13,415	14.2%
Cost of telecommunications products sold	2,563	3.2%	3,575	4.1%	4,930	5.2%
Finance costs	1,696	2.1%	1,099	1.2%	654	0.7%
Unrealized loss on changes in fair value of derivative component of the convertible bonds		0.0%		0.0%	2,397	2.5%
Interest income	-103	-0.1%	-96	-0.1%	-259	-0.3%
Other gains, net	-104	-0.1%	-35	-0.0%	-21	-0.0%

Leased Lines and Network Capacities. With the increase in the lease fee from 29% of the audited service revenue of the CDMA business in 2005 to 30% of the audited service revenue of the CDMA business in 2006, the lease expense for CDMA network capacities slightly increased by 0.2%, from RMB7.92 billion in 2005 to RMB8.08 billion in 2006. Leased lines and network capacities expenses as a percentage of total revenue decreased slightly from 10.0% in 2005 to 9.3% in 2006.

Interconnection Charges. Interconnection charges reached RMB9.60 billion in 2006, representing an increase of 14.6% from 2005, primarily due to the increase in interconnection traffic volume as a result of the development of our GSM and CDMA cellular business and long distance, data and Internet businesses. Interconnection charges as a percentage of total revenue also slightly increased from 9.6% in 2005 to 10.2% in 2006.

Depreciation and Amortization. Depreciation and amortization expenses increased by 10.1% to RMB22.42 billion in 2006, being a higher growth rate than the growth rate in revenue. The increase in depreciation and amortization expenses resulted from expanded network capacity and the expansion of assets scale, including increased investments in GSM equipment and increased scale of construction-in-process. Depreciation and amortization expenses as a percentage of total revenue increased slightly from 23.4% in 2005 to 23.8% in 2006.

Employee Benefit Expenses. As of the end of 2006, we had 53,120 employees, a slight increase from 53,070 at the end of 2005. Our employee benefit expenses increased from RMB5.62 billion in 2005 to RMB6.65 billion in 2006 representing an increase of 18.4% from 2005. Its share as a percentage of total revenue increased from 6.5% in 2005 to 7.1% in 2006. The increase in employee benefit expenses in 2006 was mainly due to the following factors: (i) increase in headcount resulting from business expansion; (ii) a general increase in mandatory employee insurance and social security expenses; and (iii) increase of share-based compensation costs from grant of new share options under the share option scheme in 2006.

Selling and Marketing. Our major selling and marketing expenses included commissions, promotion and advertising expenses, amortization of customer acquisition costs of contractual CDMA subscribers and customer retention costs. Due to our effective cost control measures, selling and marketing expenses totaled RMB19.25 billion in 2006, a decrease of 6.4% from 2005. Amortization of contractual CDMA subscribers acquisition costs in 2006 were RMB4.21 billion, a decrease of 29.3% from 2005. The balance of unamortized deferred CDMA subscriber acquisition costs decreased from RMB2.94 billion as of the end of 2005 to RMB2.10 billion as of the end of 2006 primarily due to our efforts in reducing the use of CDMA handset promotional packages. Due to the continued growth in the subscriber base of our various business segments, the commissions to distributors and sales agents rose to RMB9.84 billion, an increase of 10.7%. Promotion and advertising expenses were RMB2.63 billion, an increase of 3.9%. As a result of our effective cost management, selling and marketing expenses as a percentage of revenue decreased from 23.6% in 2005 to 20.4% in 2006.

General, Administrative and Other Expenses. As a result of our increased network maintenance costs due to the expiration of many equipment warranties, increased rents for sales outlets, base stations, increased utilities charges, and increased other expenses such as audit and audit-related expenses, our general, administrative and other expenses were RMB13.42 billion in 2006, representing an increase of 14.3% from RMB11.74 billion in 2005. General, administrative and other expenses as a percentage of total revenue increased slightly from 13.5% in 2005 to 14.2% in 2006.

Cost of Telecommunications Products Sold. The cost of telecommunications products sold increased by 37.9% from RMB3.58 billion in 2005 to RMB4.93 billion in 2006. This increase was primarily due to the increase in the number of CDMA handsets we purchased through Unicom Huasheng and sold to our customers. The share of cost of telecommunications products sold as a percentage of revenue increased from 4.1% in 2005 to 5.2% in 2006.

Interest Income and Finance Costs. Our interest income was RMB0.26 billion in 2006, representing a significant increase of 169.3% from RMB0.10 billion in 2005. Our finance costs decreased from RMB1.10 billion in 2005 to RMB0.65 billion in 2006, primarily due to the reductions in our bank loans. In addition, we recorded a foreign exchange gain of RMB0.37 billion as compared to RMB0.27 billion in 2005, primarily due to the revaluation of Renminbi against U.S. dollars, which significantly contributed to the decrease of our finance costs. The above factors resulted in net finance costs of RMB0.40 billion in 2006, a decrease of 60.6% from the net finance costs of RMB1.00 billion in 2005.

Unrealized Loss on Changes in Fair Value of Derivative Component of Convertible Bonds. In accordance with the requirements of applicable accounting standards, the bond contract underlying the convertible bonds must be separated into two components: a derivative component consisting of the conversion option and a liability component consisting of the straight debt element of the bond. The conversion option is carried at fair value on the balance sheet with any changes in fair value being charged or credited to the income statement in the period when the change occurs. The fair value of the derivative component of the convertible bonds is calculated using the Binomial model, which considers various factors including exercise price, volatility, expected dividend yield, risk free rate, expected life of options and the closing price of our share at valuation date. Due to the substantial increase in our share price from HKD6.95 as of July 5, 2006 (the issuance date of the convertible bonds), to HKD11.40 as of December 31, 2006, the fair value of the derivative component in respect of the convertible bonds has increased and therefore resulted in an unrealized loss on changes in fair value of derivative component of the convertible bonds of the RMB2.40 billion recognized in the statement of income. The unrealized loss had no effect on

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our cash flows or other aspects of our operations in 2006. For more detailed discussions of such unrealized loss in connection with the convertible bonds, please refer to Note 17 to our consolidated financial statements.

Segment income before income tax

In 2006, our income before income tax reached RMB6.50 billion, a decrease of 8.5% from 2005. Excluding the effect of the RMB2.40 billion unrealized loss on changes in fair value of derivative component of the convertible bonds, our income before income tax would be RMB8.89 billion, an increase of 25.2% from 2005, our income before taxation margin was 6.9% and 8.2% in 2006 and 2005, respectively.

GSM Cellular Business. In our GSM cellular business, segment income before income tax was RMB7.48 billion in 2006, an increase of 2.8% from 2005. The increase in the segment income before income tax of our GSM cellular business mainly reflects the 31.6% increase in total MOU and 1.4% increase in the ARPU for our GSM cellular business, partially offset by the decrease in the effective tariff. Our segment income before taxation margin in the GSM cellular business decreased from 14.0% in 2005 to 12.6% in 2006 primarily due to the increases in marketing expenses, interconnection charges and administrative expenses.

CDMA Cellular Business. Our segment income before income tax was RMB1.06 billion in 2006 for our CDMA business, as compared to the segment loss before income tax of RMB0.2 billion in 2005. The increase of segment income before income tax of our CDMA cellular business was primarily due to the continued expansion of CDMA cellular business subscriber base, the rapid growth of CDMA value-added services and the effective control of sales and marketing costs, partially offset by the decrease in CDMA cellular subscribers average MOU per month and the ARPU.

Long Distance Business. In our long distance business, segment income before income tax increased 104.3%, from RMB0.18 billion in 2005 to RMB0.38 billion in 2006, primarily due to effective control over operational expenses and termination of unprofitable services and products. As a result, the segment income before taxation margin in our long distance business increased from 6.8% in 2005 to 13.2% in 2006.

Data and Internet Business. In our data and Internet businesses, we had a segment income before income tax of RMB0.11 billion in 2006, compared with the segment loss before income tax of RMB0.04 billion in 2005.

Net Income

Income Tax. Our income tax increased to RMB2.76 billion in 2006, an increase of 27.3% from 2005. Our effective tax rates in 2005 and 2006 were 30.6% and 42.5%, respectively. Excluding the effects of the RMB2.40 billion unrealized loss on changes in fair value of derivative component of the convertible bonds, which, as discussed above, had no effect on our cash flows or other aspects of our operations in 2006, the effective tax rate would be 31.1%.

In addition, our future effective income tax rate depends on various factors, including applicable tax laws and regulations, the geographic composition of our pre-tax income and non-tax deductible expenses as incurred. Pursuant to the PRC Enterprise Income Tax Law that was enacted on March 16, 2007 and will become effective on January 1, 2008, a uniform enterprise income tax rate of 25% is adopted for all enterprises (including foreign-invested enterprises). The exact impact of this new law on our financial condition and results of operations will depend on detailed pronouncements that are to be issued.

Net Income. As a result of the foregoing, our net income was RMB3.73 billion in 2006, representing a decrease of 24.3% from 2005. Net income per share decreased by 24.5%, from RMB0.39 in 2005 to RMB0.30 in 2006. Excluding the effects of the RMB2.40 billion unrealized loss on changes in fair value of derivative component of the convertible bonds, which, as discussed above, had no effect on our cash flows or other aspects of our operations in 2006, our net income would be RMB6.13 billion, an increase of 24.3% from 2005, and net income per share that would be RMB0.49, increased by 24.0% from 2005.

Impact of Differences between HKFRS and US GAAP

In addition to the above management discussion and analysis of our results of the operation under HKFRS between the years ended December 31, 2006 and 2005, in connection with the preparation and reconciliation of our consolidated financial statements in accordance with US GAAP, except for the accounting treatment of the convertible bonds discussed in Note 38 to our consolidated financial statements included in this annual report, we believe there are no material differences between HKFRS and US GAAP that would have a significant impact on the discussion and analysis of our results of operations between the years ended December 31, 2006 and 2005. Our combined revenue under US GAAP increased from RMB87.25 billion in 2005 to RMB94.50 billion in 2006, representing an increase of 8.3%. Our net income under US GAAP increased from RMB5.01 billion in 2005 to RMB6.16 billion in 2006, representing an increase of 22.8%. See also Note 38 to the consolidated financial statements for a more detailed summary of all significant accounting differences between HKFRS and US GAAP that are relevant to us.

Year Ended December 31, 2005 Compared to Year Ended December 31, 2004

In 2005, our revenue continued to increase, by 10.1% from RMB79.09 billion in 2004 to RMB87.05 billion in 2005. This growth was principally due to the relatively rapid growth of our CDMA cellular business and steady growth of our GSM cellular business. For the reasons discussed below, our cellular businesses continued to increase in terms of revenues and in their percentage contribution to our overall business, while our long distance, data and Internet businesses continued to decrease in terms of revenues and in their contribution to our business.

Due to factors discussed below, in 2005 our costs and expenses grew 10.1%, the same rate as that of our revenue. As a result, while our income before income tax increased by 9.8% to RMB7.10 billion, our income before income tax margin stood at 8.2%, the same as that of 2004. Segment income before income tax margin in our GSM cellular business decreased from 14.3% in 2004 to 14.0% in 2005. Our CDMA cellular business maintained relatively rapid growth in 2005 and its loss before income tax decreased by 64.5%. In our long distance and data and Internet businesses, segment income before income tax decreased 66.8% in 2005 and segment income before income tax margin decreased to 1.7% in 2005 from 4.8% in 2004.

Our net income in 2005 increased by 9.7% to RMB4.93 billion, for reasons discussed below.

Revenue

Revenue from our GSM cellular business grew steadily in 2005 and continued to generate a majority of our total revenue, while revenue from our CDMA cellular business maintained its growth in 2005 and further increased its share of our total revenue for the year. Revenues from our GSM and CDMA cellular businesses represented 94.7% of our total revenue in 2005, as compared with 93.0% in 2004. The share of revenue from the CDMA cellular business in our total revenue increased from 32.9% in 2004 to 34.8% in 2005, while the share of revenue from the GSM cellular business in our total revenue slightly decreased from 60.1% in 2004 to 59.9% in 2005. Revenues from our long distance and data and Internet

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businesses decreased from RMB5.53 billion in 2004 to RMB4.59 billion in 2005. Aggregate revenues from our long distance business and our data and Internet businesses represented 5.3% of our total revenue in 2005, as compared with 7.0% in 2004. We believe the changes in our revenue composition reflect our focus on the development of our cellular businesses.

Cellular Revenue

For the reasons discussed below, revenues from our GSM and CDMA cellular businesses (including revenues from sales of telecommunications products) together increased by 12.1%, from RMB73.56 billion in 2004 to RMB82.46 billion in 2005.

GSM Cellular Business. Revenue from our GSM cellular business increased by 9.7%, from RMB47.51 billion in 2004 to RMB52.14 billion in 2005, primarily due to the continued increases in the total number of our total GSM cellular subscribers and in our subscribers average MOU. The total number of our GSM cellular subscribers increased by 12.8%, from 84.27 million as of December 31, 2004 to 95.07 million as of December 31, 2005. With the continually increasing cellular penetration in China, an increasing proportion of new subscribers are relatively low-end subscribers. As a result, ARPU from the GSM cellular business declined 1.8%, from RMB49.4 in 2004 to RMB48.5 in 2005. The average MOU per subscriber per month increased 7.0%, from 188.9 minutes in 2004 to 202.2 minutes in 2005.

The table below sets forth the revenue composition of our GSM cellular business and each revenue item s respective share of total GSM revenue in the years ended December 31, 2003, 2004 and 2005.

	2003		**2004**		**2005**	
	RMB in million	**As percentage of total**	**RMB in million**	**As percentage of total**	**RMB in million**	**As percentage of total**
Revenue	41,201	100.0%	47,513	100.0%	52,139	100.0%
Service Revenue	41,153	99.9%	47,509	100.0%	52,136	100.0%
Usage Fee	29,072	70.6%	31,997	67.3%	32,077	61.5%
Monthly Fee	7,042	17.1%	6,922	14.6%	6,841	13.1%
Interconnection Revenue	1,927	4.7%	2,614	5.5%	3,466	6.6%
Value-added Service Revenue	1,978	4.8%	4,819	10.1%	7,967	15.3%
Others	1,134	2.7%	1,157	2.5%	1,785	3.5%
Sales of Telecommunications Products	48	0.1%	4	0.0%	3	0.0%

The growth in total usage of our GSM cellular services has been offset to some extent by the decrease in the ARPU. As a result, usage fees for GSM cellular services only increased by 0.3% from RMB32.00 billion in 2004 to RMB32.08 billion in 2005, representing 61.5% of total GSM service revenue, a decrease from 67.3% in 2004. Monthly fees decreased by 1.2%, from RMB6.92 billion in 2004 to RMB6.84 billion in 2005, and represented 13.1% of total GSM service revenue as compared with 14.6% in 2004. This decrease is primarily due to an increasing proportion of new subscribers who subscribe to package plans charging no monthly fee. Interconnection revenue increased by 32.6% from RMB2.61 billion in 2004 to RMB3.47 billion in 2005, and represented 6.6% of total service revenue as compared with 5.5% in 2004. This increase is primarily due to the increased total usage of our GSM cellular services.

While continuing to meet the diverse needs of our customers in the mass market, our GSM cellular business aims to actively promote value-added services. As a result, revenue from value-added services significantly increased its contribution to our total GSM cellular revenue. Revenue from our GSM value-added cellular services increased 65.3%, from RMB4.82 billion in 2004 to RMB7.97 billion in 2005. Its share of total GSM service revenue increased from 10.1% in 2004 to 15.3% in 2005. Of the total revenue from GSM value-added cellular services, revenue from short messaging services increased 34.1% from RMB2.79 billion in 2004 to RMB3.74 billion in 2005, and its share of total GSM service revenue grew from 5.9% in 2004 to 7.2% in 2005.

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CDMA Cellular Business. Our CDMA subscriber base has continued to expand at a relatively fast pace. In 2005, the growth in our CDMA subscriber base resulted in increased revenue from the CDMA cellular business. Revenue from our CDMA cellular business reached RMB30.32 billion in 2005, a 16.4% increase over RMB26.05 billion in 2004. This increase was primarily due to a 17.6% increase in our CDMA subscribers.

The table below sets forth the revenue composition of our CDMA cellular business and each revenue item s respective share of total CDMA revenue for the years ended December 31, 2003, 2004 and 2005.

	2003		**2004**		**2005**	
	RMB in million	**As percentage of total**	**RMB in million**	**As percentage of total**	**RMB in million**	**As percentage of total**
Revenue	18,063	100.0%	26,046	100.0%	30,320	100.0%
Service Revenue	16,667	92.3%	24,378	93.6%	27,577	91.0%
Usage Fee	11,672	64.6%	16,165	62.1%	16,727	55.2%
Monthly Fee	3,488	19.3%	4,638	17.8%		