

CHINA UNICOM LTD
Form 20-F
June 24, 2004

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

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

For the fiscal year ended December 31, 2003

OR

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

For the transition period from to

Commission file number 1-15028

CHINA UNICOM LIMITED

(Exact Name of Registrant as Specified in Its Charter)

N/A

(Translation of Registrant's Name Into English)

Hong Kong

(Jurisdiction of Incorporation or Organization)

75th Floor, The Center
99 Queen's Road Central
Hong Kong

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(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.

12,553,172,070 Ordinary Shares as of December 31, 2003.

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

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

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NOTE REGARDING FORWARD-LOOKING STATEMENTS

This annual report for the year ended December 31, 2003 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 abilities to expand network capacity and increase network efficiency, our ability to develop new technology applications and offer new services, the advantages of code division multiple access, or CDMA, technology and our ability to realize such advantages and successfully execute our CDMA-related strategy, our ability to leverage our position as an integrated telecommunications operator and expand into new businesses and new markets, future growth of market demand for our services, and future regulatory and other developments in the Chinese telecommunications industry.

Such 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 a number of factors, including, without limitation, any changes in the regulatory policies of the Ministry of Information Industry, or MII, and other relevant government authorities in China, 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 Chinese government's policies with respect to economic growth, foreign exchange, foreign investment and entry by foreign companies into China's telecommunications market. In addition, our future network expansion and other capital expenditure and development plans are dependent on numerous factors, including the availability of adequate financing on acceptable terms, the adequacy of currently available spectrum or availability of additional spectrum and the adequate and timely supply of equipment when required. Please also see the "Risk Factors" section under Item 3.

CERTAIN DEFINITIONS

As used in this annual report, references to "us", "we", "our", "the Company" and "Unicom" are to China Unicom Limited. Unless the context otherwise requires, these references include all of our subsidiaries. In respect of any time prior to our incorporation, references to "us", "we", "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 its subsidiaries, including us and our subsidiaries. Please also see "A. History and Development of the Company" "Acquisition of Unicom New World and the Sale of Guoxin Paging" under Item 4 for our current shareholding structure.

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, 1999, 2000, 2001, 2002 and 2003 and our selected consolidated balance sheet data as of December 31, 1999, 2000, 2001, 2002 and 2003. The selected consolidated balance sheet data as of December 31, 2002 and 2003 and income statement and cash flow data for the years ended December 31, 2001, 2002 and 2003 have been derived from our audited consolidated financial statements included in this annual report. The selected consolidated balance sheet data as of December 31, 1999, 2000 and 2001 and income statement and cash flow data for the years ended December 31, 1999 and 2000 have been derived from our audited consolidated financial statements that are not included in this annual report. The financial statements for periods prior to our restructuring and initial public offering in 2000 reflect historical results of operations and financial positions of the businesses that were transferred to us from Unicom Group in 2000 in contemplation of our initial public offering.

Our financial statements are prepared in accordance with generally accepted accounting principles in Hong Kong, or HK GAAP. Under HK GAAP, prior to 2003, deferred taxation was accounted for at the current taxation rate in respect of timing differences between net income as computed for taxation purposes and net income as stated in the income statement. A deferred tax asset was not recognized unless the related benefits are expected to crystallize in the foreseeable future. Upon the adoption of SSAP 12 in 2003, deferred taxation is provided in full, using the liability method, on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the financial statements. Taxation rates enacted or substantively enacted at the balance sheet date are used to determine deferred taxation. Deferred tax assets are recognized to the extent that it is probable that future taxable income will be available against which the temporary differences can be utilized. Under HK GAAP, the adoption of SSAP 12 in 2003 represents a change in accounting policy which has been applied retrospectively so that the comparative data presented have been restated to conform to the changed policy. A detailed description is set forth in Note 3(a) to the financial statements.

In addition, financial statements prepared in accordance with HK GAAP vary in certain material respects from generally accepted accounting principles in the United States, or US GAAP. In accordance with HK GAAP, we adopted the purchase method to account for our acquisition from Unicom Group of certain cellular businesses and assets held by Unicom New Century Telecommunications Corporation Limited, or Unicom New Century, and Unicom New World Telecommunications Corporation Limited, or Unicom New World. The acquisition of Unicom New Century became effective on December 31, 2002 and the acquisition of Unicom New World became effective on December 31, 2003, as described in A. History and Development of the Company Restructuring and Acquisition of Unicom New Century and Acquisition of Unicom New World and the Sale of Guoxin Paging under Item 4. Accordingly, our consolidated income statements and, except as otherwise noted, all other HK GAAP financial information presented in this annual report include the operating results of Unicom New Century only for the year ended

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December 31, 2003, and do not include the operating results of Unicom New World. Under the purchase method, our consolidated balance sheet as of December 31, 2002 includes the financial position of Unicom New Century and our consolidated balance sheet as of December 31, 2003 includes the financial position of Unicom New Century and Unicom New World. In contrast, under US GAAP, these acquisitions would be accounted for as transfers of entities under common control. The financial statements prepared under US GAAP would retroactively be 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 be accounted for at historical cost and the results of operations of the acquired businesses would be included in the consolidated financial statements for the earliest period presented.

Under HK GAAP, 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 the 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.

See Note 41 to the consolidated financial statements included in this annual report for a summary of the principal differences between HK GAAP and US GAAP that have a significant effect on our financial statements.

	As of or for the year ended December 31					
	1999 RMB	2000 RMB	2001 RMB	2002 RMB	2003 RMB	2003 US\$(1)
(in millions, except number of shares and per share data)						
Income Statement Data:						
<u>Hong Kong GAAP (As restated) (2):</u>						
Operating revenue (Turnover):						
Cellular Business	5,314	12,188	20,505	30,613	56,927	6,878
GSM Business	5,314	12,188	20,505	27,388	40,304	4,870
CDMA Business				3,225	16,623	2,008
Paging Business	9,047	8,483	4,342	2,161	1,403	170
Long Distance Business		556	1,489	2,766	2,273	275
Data Business	79	481	1,550	2,173	2,624	317
Internet Business		59	270	620	813	98
Total service revenue	14,440	21,767	28,156	38,333	64,040	7,738
Sales of telecommunications products	3,010	1,925	1,237	2,244	3,596	434
Total operating revenue	17,450	23,692	29,393	40,577	67,636	8,172
Operating expenses	(14,634)	(18,470)	(24,129)	(33,253)	(59,122)	(7,143)
Operating income	2,816	5,222	5,264	7,324	8,514	1,029
Loss on sale of discontinued operation (Guoxin Paging)					663	80

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	As of or for the year ended December 31					
	1999 RMB	2000 RMB	2001 RMB	2002 RMB	2003 RMB	2003 US\$(1)
	(in millions, except number of shares and per share data)					
Income before taxation	1,759	4,482	5,463	6,303	6,096	737
Net income	927	3,324	4,602	4,598	4,217	510
Basic net income per share (3)	0.095	0.297	0.367	0.366	0.336	0.041
Number of shares outstanding for basic net income per share (in thousands) (3)	9,725,000	11,208,224	12,552,996	12,552,996	12,553,010	12,553,010
Diluted net income per share (3)		0.297	0.367	0.366	0.336	0.041
Number of shares outstanding for diluted net income per share (in thousands) (3)	9,725,000	11,208,224	12,552,996	12,552,996	12,568,683	12,568,683
Basic net income per ADS (4)	0.953	2.966	3.666	3.663	3.359	0.406
Number of ADS outstanding for basic net income per share (in thousands) (3)	972,500	1,120,822	1,255,300	1,255,300	1,255,301	1,255,301
Diluted net income per ADS (4)		2.966	3.666	3.663	3.355	0.405
Number of ADS outstanding for diluted net income per share (in thousands) (3)	972,500	1,121,968	1,255,300	1,255,300	1,256,869	1,256,869
US GAAP (As restated) (2)&(5)						
Operating revenue			32,501	50,415	71,958	8,694
Operating income from continuing operations			7,921	9,753	10,701	1,293
Net income before discontinued operation, and cumulative effect of change in accounting policy			5,866	5,493	6,070	733
Loss from discontinued operation, net of tax			710	422	1,342	162
Effect of change in accounting policy (transitional adjustment of goodwill impairment upon the adoption of SFAS 142)				42		
Net income			5,155	5,028	4,728	571
Basic net income per share before discontinued operation and effect of change in accounting policy (3)			0.467	0.438	0.484	0.058
Basic net income per ADS before discontinued operation and effect of change in accounting policy (4)			4.673	4.376	4.836	0.584
Basic net income per share after discontinued operation and effect of change in accounting policy (3)			0.411	0.401	0.377	0.046

Basic net income per ADS after
discontinued operation and effect
of change in accounting policy

(4)	4.107	4.006	3.767	0.455
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Balance sheet Data:

Hong Kong GAAP (As restated) (2):

Bank balances and cash	6,002	44,717	18,413	14,433	9,220	1,114
Property, plant and equipment, net	33,227	52,864	75,748	107,487	118,105	14,270
Total assets	45,504	113,057	128,278	149,628	149,838	18,104
Net assets	11,207	58,336	62,884	67,219	69,615	8,411
Short-term debt and current portion of other long-term debt	7,894	8,501	7,933	15,330	18,173	2,196
Obligations under finance lease-current portion			8	17	25	3

As of or for the year ended December 31

	1999	2000	2001	2002	2003	2003
	RMB	RMB	RMB	RMB	RMB	US\$(1)
(in millions, except number of shares and per share data)						
Obligations under finance lease-non current portion			101	101	100	12
Other long-term debt	12,234	27,151	36,337	37,686	36,213	4,375
Shareholders equity	8,676	57,452	62,054	66,653	69,615	8,411
US GAAP (As restated) (2)&(5)						
Property, plant and equipment, net				118,787	118,124	14,272
Total assets				164,636	150,413	18,173
Obligations under finance lease-current portion				17	25	3
Obligations under finance lease-non current portion				101	100	12
Other long-term debt				45,520	36,213	4,375
Shareholders equity				64,215	65,913	7,964

Other Financial Data:**Hong Kong GAAP:**

Net cash provided by operating activities	4,511	9,344	11,078	13,054	22,565	2,726
Net cash used in investing activities	(13,930)	(30,551)	(46,125)	(5,166)	(19,051)	(2,302)
Net cash provided by (used in) financing activities	11,084	59,921	8,743	(11,868)	(8,778)	(1,061)

US GAAP (As restated) (5):

Net cash provided by operating activities			15,320	18,215	25,992	3,140
Net cash used in investing activities			(62,971)	(10,256)	(20,272)	(2,449)
Net cash provided by (used in) financing activities			21,015	(12,773)	(11,379)	(1,375)

(1) The translation of RMB into US dollars has been made at the rate of RMB8.2767 to US\$1.00, the noon buying rate in New York City for cable transfer in RMB as certified for customs purposes by the Federal Reserve Bank of New York on December 31, 2003. The translations are solely for the convenience of the reader.

(2) The adoption of HK SSAP12 Income Tax (revised) in 2003 represents a change in accounting policy which has been applied retrospectively so that the comparative data presented have been restated to conform to the changed policy. See Note 3(a) set forth in the financial statements for detailed information.

(3) See Notes 15 and 41 to the financial statements included in this Form 20-F on how basic and diluted net income per share are calculated under HK GAAP and US GAAP, respectively.

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

(5) The US GAAP amounts as of December 31, 2003 and 2002 and for each of the years in the three-year period ended December 31, 2003 are presented as if the acquisitions of Unicom New Century and Unicom New World had been in existence since the beginning of the earliest period presented.

Historical Exchange Rates Information

We publish our financial statements in Renminbi, or RMB, the legal tender currency in the People's Republic of China. 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 RMB8.2767 to US\$1.00 and HK\$7.7640 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 31, 2003.

The noon buying rates on June 18, 2004 were RMB8.2766 to US\$1.00 and HK\$7.7997 to US\$1.00, respectively. The average noon buying rates for 1999, 2000, 2001, 2002 and 2003 were RMB8.2785, RMB8.2784, RMB8.2772, RMB8.2772 and RMB8.2771, respectively, to US\$1.00, and HK\$7.7599, HK\$7.7936, HK\$7.7996, HK\$7.7996 and HK\$7.7864, 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 2003	8.2772		8.2765		7.7670		7.7628	
January 2004	8.2772		8.2767		7.7775		7.7632	
February 2004	8.2773		8.2769		7.7845		7.7686	
March 2004	8.2774		8.2767		7.7980		7.7842	
April 2004	8.2772		8.2768		7.8000		7.7870	
May 2004	8.2773		8.2768		7.8010		7.7895	

B. Capitalization and Indebtedness

Not applicable.

C. Reasons for the Offer and Use of Proceeds

Not applicable.

D. **Risk Factors**

Risks Relating to Our Business

Our cellular businesses face intense 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 result in slower subscriber growth, lower tariffs and higher customer acquisition costs for us, which would adversely affect our results of operations, financial condition and growth prospects.

Our cellular businesses face intense competition from China Mobile. China Mobile is the largest cellular operator in China and in our cellular service areas and has competitive advantages over us in customer base, overall network coverage and quality, financial resources, network management, technical

expertise and brand recognition. We are experiencing intense competition from China Mobile in many of our cellular service areas, and such competition may continue and further intensify. In particular, continued price competition between China Mobile and us in many service areas has accelerated the decline of the average revenue per user per month, or ARPU, of our cellular services, and adversely affected our profitability.

In addition, our cellular services also compete with the local wireless telecommunications services of China Telecom and China Netcom, known as Little Smart services, that are based on their fixed line networks and primarily utilize the personal handyphone system, or PHS, technology. They are offered as extensions of fixed line services and, with such features as calling-party-pays arrangements, carry significantly lower tariffs than cellular services. The Little Smart services were previously offered primarily in small- to medium-sized cities, but have been introduced in most major cities nationwide in 2003. According to public reports, these services have attracted over 40 million users in China and their subscriber base is continuing to grow quickly.

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

Our CDMA services may fail to gain sufficient market share.

We launched our CDMA services in January 2002 and introduced CDMA 1X wireless data services in March 2003. Prior to the introduction of our CDMA services, digital cellular services in China were mostly based on the global system for mobile communications, or GSM, technology. The majority of cellular subscribers in China today continues to be GSM subscribers. 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 phone number. As of March 31, 2004, the total number of our CDMA subscribers has reached 21.62 million in our service areas. Nevertheless, CDMA technology and services have yet to gain broader market acceptance in China. In addition, as Unicom Group only began to construct CDMA networks in 2001, the present coverage of CDMA networks may not be as extensive in some areas as the coverage of existing GSM networks, including those of our competitor, China Mobile. CDMA services are also perceived to have limitations in international roaming due to the lack of CDMA networks in many countries.

Whether our CDMA services can gain broader market acceptance will continue to be subject to a number of uncertainties, including:

whether we can attract quality CDMA cellular subscribers in sufficient numbers,

whether the high-speed CDMA 1X wireless data services can attract sufficient targeted customers,

whether we can effectively promote our CDMA services and successfully execute our strategy of promoting the service as enterprise, infotainment, health-conscious and trendy services to mid- to high-end cellular subscribers,

whether we can successfully market a sufficient quantity and variety of high-quality CMDA handsets through our sales channels, and

whether we can further improve the coverage of the CDMA networks in certain service areas to provide quality services necessary to attract our targeted customers.

As a result of these uncertainties, the growth and profitability of our CDMA cellular services and our overall business results of operation and financial condition, may be adversely affected.

The development of our CDMA and GSM services may not be coordinated effectively.

The majority of our current cellular services users subscribe to cellular services based on the GSM standard. We mainly target our new CDMA service offerings to mid- to high-end cellular subscribers. At the same time, our GSM cellular services primarily target the mass market. To the extent the development of the two services is not effectively coordinated, our CDMA cellular services may compete with our GSM services for subscribers. In 2003, a majority of our CDMA subscribers were subscribers to the GSM cellular services of our main competitor, new users of cellular services or subscribers who subscribed to our CDMA services in addition to their GSM services, but some of our CDMA subscribers were subscribers of our GSM services. In addition, the CDMA business may also compete for our financial, management, human and other resources otherwise allocated to our GSM cellular services. If the development of our CDMA and GSM services is not coordinated effectively or we cannot obtain adequate resources for both our GSM and CDMA cellular services, the growth and profitability of these businesses and our results of operations, financial condition and growth prospects may be adversely affected.

Our churn rates have been increasing.

In accordance with the industry trend, the churn rates of our GSM and CDMA cellular businesses have been increasing. In 2003, the churn rate of our GSM cellular services increased to 29.1% from 14.6% in 2002, and the churn rate of our CDMA cellular services reached 11.52% after its introduction in 2002. The increase in the churn rate of our GSM services was mainly due to the following factors:

with the revocation of one-time connection fees and the decline in prices for SIM cards, cellular subscribers' cost of switching networks has been lowered;

due to high competition from Little Smart services in the mass market, cellular operators have responded by lowering prices for cellular services, resulting in the frequent switching of networks by cost-sensitive subscribers; and

as pre-paid services grew, the frequency of changes in phone numbers by the same customer increased, which contributed to the churn rate.

The increase in the churn rate of our CDMA cellular services was primarily due to the following factors:

the termination of CDMA services by some CDMA subscribers at the end of their contract periods under the CDMA handset rental programs we began in 2002;

the introduction of pre-paid CDMA services, which are characterized by a higher churn rate than post-paid services, led to an increase in the proportion of pre-paid services subscribers; and

the increase in the proportion of cost-sensitive subscribers among new subscribers as a result of continuing expansion of our CDMA cellular services in the mass market.

Increased churn rate may adversely affect our market share and increase our costs of additional customer acquisitions and bad debt, which would adversely affect our results of operations, financial condition and growth prospects.

In order to accelerate the growth of our CDMA business, we offered CDMA handset promotional packages, which increased our operating expenses in the short-term and may adversely affect our profitability.

In order to accelerate the development of the CDMA business and subscriber growth during the product introduction period, we began to offer certain CDMA handset promotional packages in the second half of 2002. Under those arrangements, CDMA handsets were provided to the 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 cost of the handsets provided to subscribers under these contractual arrangements, treated as deferred customer acquisition costs, were deferred, to the extent recoverable, and amortized over the contractual periods to match with minimum contract revenue. As of December 31, 2003, amortization of such deferred customer acquisition costs amounted to approximately RMB5,837 million and the carrying amount of such costs amounted to RMB4,447 million for our wholly-owned operating subsidiaries, China Unicom Corporation Limited, or CUCL, Unicom New Century and Unicom New World. These promotional packages tend to increase our operating expenses and require us to maintain an inventory of CDMA handsets with the associated inventory risk. In addition, some of those subscribers terminated our CDMA services at the end of their contractual periods and therefore increased our churn rate. While we significantly reduced the use of such arrangements in 2003 and have decreased the carrying amount of the deferred customer acquisition costs substantially, the carrying amount of such costs remain significant. As of March 31, 2004, the carrying amount of such costs amounted to RMB3,487 million for CUCL, Unicom New Century and Unicom New World. As a result, although the use of these CDMA promotional packages has accelerated the growth of our CDMA business, they may adversely affect the profitability of our CDMA business and our overall results of operations.

Our long distance, data and Internet businesses remain relatively small comparing to the fixed line operators, and competition from China Telecom and China Netcom may adversely affect our growth and profitability in these businesses.

The fixed line operators of China Telecom and China Netcom currently hold a dominant market position in the public switched long distance telephony and data services markets in China in their respective service areas. They are also the dominant 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 customer base, financial resources, network coverage and last-mile access. The growth of our long distance, data and Internet businesses has been hindered by our lack of licenses to operate local telephony networks. Competition from China Telecom and China Netcom may continue to adversely affect the growth and profitability of our long distance, data and Internet businesses and consequently our overall results of operations, financial condition and growth prospects.

Failure or inability to continue to expand and upgrade our networks timely and effectively and changes in telecommunications technology and technological standards could hinder our growth.

The growth of our businesses depends on whether we are able to continue to 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. Rapid growth of our cellular subscribers in some of our cellular service areas had in the past resulted in our reaching or exceeding our existing network capacity, which limited our

subscriber growth in those areas. The ability to attract corporate customers for our long distance, data and Internet services often depends on our ability to construct metropolitan area networks and local access networks connecting these customers and their offices with our nationwide networks. We also need to continue to improve the quality of our existing networks in order to enhance the quality of our 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. Such changes may render our networks and systems obsolete or inadequate. As a result of such changes, we may need to make significant changes to existing networks and infrastructure or build new networks, which may require substantial capital expenditures.

Our ability to expand and improve our networks 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,

retain experienced management and technical personnel,

obtain relevant government permits and approvals and gain access to office towers, residential buildings and other sites for network construction,

enter into interconnection and other arrangements with other operators, and

obtain adequate network equipment and software.

Difficulties we may encounter in expanding and upgrading our networks, if not adequately resolved on a timely basis, could adversely affect our competitive position, results of operations, financial condition and growth prospects.

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

The effective provision of our cellular, long distance telephony and other services requires the interconnection between our networks and the networks of China Telecom, China Netcom, China Mobile and other 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 growth and profitability. 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 operations, growth and profitability.

Unicom Group, as our controlling shareholder, 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 77.42% of our issued share capital. As our controlling shareholder, it is able to influence our major business decisions through its control of our board of directors. The interests of Unicom Group as our controlling shareholder could conflict with the interests of the other holders of our shares and ADSs. Some of our executive directors and executive officers also serve as directors or executive officers of Unicom Group. In addition, our ope