

2006 Annual Report

China Netcom Group Corporation (Hong Kong) Limited

April 2, 2007

A BROADENED WORLD



北京2008年奥运会合作伙伴
OFFICIAL PARTNER OF THE BEIJING 2008 OLYMPIC GAMES
HKSE: 906; NYSE: CN

Overall Performance

Business and Financial Results

Overall Performance

Mr. Zuo Xunsheng Chief Executive Officer

Forward-Looking Statements

This presentation and the presentation materials distributed herewith include forward-looking statements. All statements, other than statements of historical facts, that address activities, events or developments that China Netcom Group Corporation (Hong Kong) limited (“China Netcom”) expects or anticipates will or may occur in the future (including but not limited to projections, targets, estimates and business plans) are forward-looking statements. China Netcom’s actual results or developments may differ materially from those indicated by these forward-looking statements as a result of various factors and uncertainties, including but not limited to the level of demand for telecommunications services, competitive forces in more liberalized markets, the effects of tariff reduction initiatives, changes in the regulatory policies, and other risks and factors beyond our control. In addition, China Netcom makes the forward-looking statements referred to herein as of today and undertakes no obligation to update these statements.

The financial figures distributed herewith have been prepared in accordance with Hong Kong Financial Reporting Standards (“HKFRS”), Hong Kong Accounting Standards (“HKAS”) and interpretations issued by the Hong Kong Institute of Certified Public Accountants (“HKICPA”). They have also been prepared in accordance with the disclosure requirements of the Companies Ordinance and Rules Governing the Listing Securities on The Stock Exchange of Hong Kong Limited. They have been prepared under the historical cost convention modified by the revaluation of certain fixed assets in 2006, and on a going concern basis.

Since the Group disposed of the ANC Group during the year, in accordance with HKFRS 5 “Non-current assets held for sale and discontinued operations” issued by the HKICPA, the results and cash flows of the operations of the ANC Group have been presented as discontinued operations. The 2005 comparative figures in the income statement and statement of cash flow are restated accordingly.

In this presentation, unless otherwise specified, all financial and operational data do not include the data of discontinued operation.

Key Operational Data



HKSE: 906; NYSE: CN

	2005	2006	Change
<u>Subscribers</u>			
Fixed-line (Ex-PHS) (in thousands)	87,991	87,600	-0.4%
PHS (in thousands)	27,337	27,334	-0.01%
Broadband (in thousands)	11,475	15,081	+31.4%
<u>Market Share and Penetration⁽¹⁾</u>			
Fixed-line Market Share	92.3%	91.5%	-0.8PPT
Broadband Market Share	87.6%	87.5%	-0.1PPT
Broadband Penetration ⁽²⁾	12.6%	16.7%	+4.1PPT
Caller ID Penetration ⁽³⁾	66.1%	68.8%	+2.7PPT
<u>ARPU</u>			
Voice ARPU (RMB) ⁽⁴⁾	44.6	41.3	-7.4%
Broadband ARPU (RMB)	65.3	66.3	+1.5%
<u>Contribution Ratio</u>			
VAS Revenue / Total Revenue	4.9%	6.4%	+1.5PPT
Broadband and Internet-related Revenue / Total Revenue	10.2%	13.3%	+3.1PPT

(1) Market share in our Northern service region

(2) CNC broadband subscribers / CNC fixed-line subscribers (excluding PHS subscribers)

(3) CNC Caller ID subscribers / CNC fixed-line subscribers

(4) Including local voice, long distance and VAS

Key Financial Data

(Excl. Upfront Connection Fees)

(in RMB millions)	2005	% of Revenue	2006	% of Revenue	Change
Consolidated Revenue ⁽¹⁾	83,827		85,495		+2.0%
Revenue from Continuing Operation	82,456		84,515		+2.5%
Consolidated EBITDA ⁽¹⁾	42,150	50.3%	43,179	50.5%	+2.4%
Consolidated Net Profit ⁽¹⁾	10,483	12.5%	10,554	12.3%	+0.68%
CAPEX	27,247	33.0%	26,474	31.3%	-2.8%
Free Cash Flow ⁽²⁾	6,236	7.6%	7,476	8.8%	+19.9%

(1) Including continuing operations, discontinued operations and related adjustments

(2) Net cash flow from operating activities of continuing operations net of capital expenditure.

2006 Highlights

Solid Progress in Strategic Transformation and Innovation

- High-growth businesses grew by 31.6%⁽¹⁾, contribution to total revenue increased to 26%
- Revenues from high-growth businesses fully offset declines in fixed-line businesses

Multi-service-driven High-Growth Businesses

- Broadband revenue increased by 33.7%⁽²⁾
- VAS revenue increased by 35.5%
- ICT and business & data increased by 23.9%

Effective CAPEX Control and Strong Cash Flow

- CAPEX was RMB826 million less than guidance
- Free cash flow increased by 19.9%

Higher Returns to Shareholders

- Strategic collaboration drove improvements in management
- Continued improvement in corporate governance
- DPS increased by 18.7%

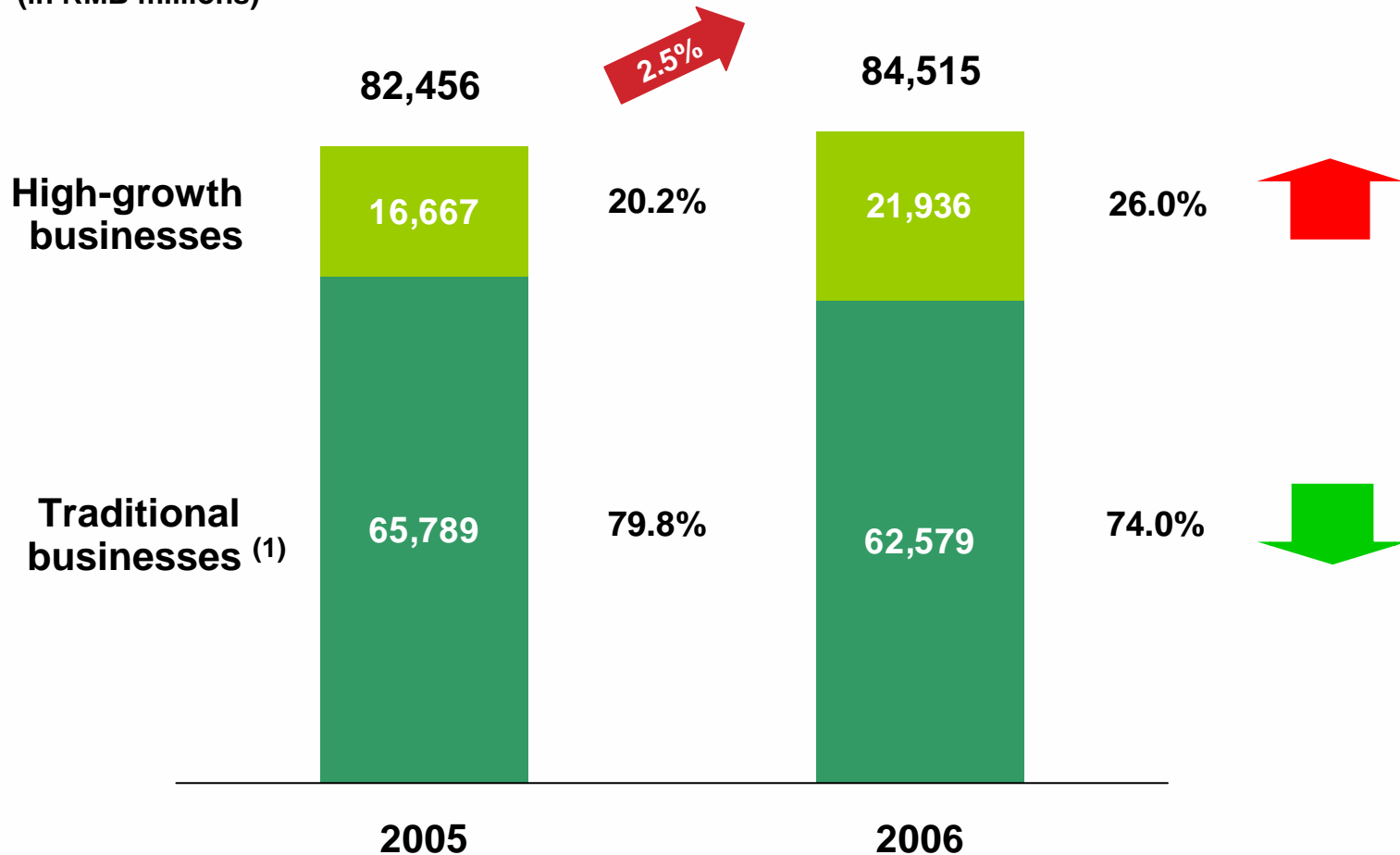
(1) Excluding upfront connection fees. All figures in this presentation exclude upfront connection fees unless otherwise stated

(2) Including other internet-related services

Solid Results in Strategic Transformation and Innovation

Revenue Structure

(in RMB millions)



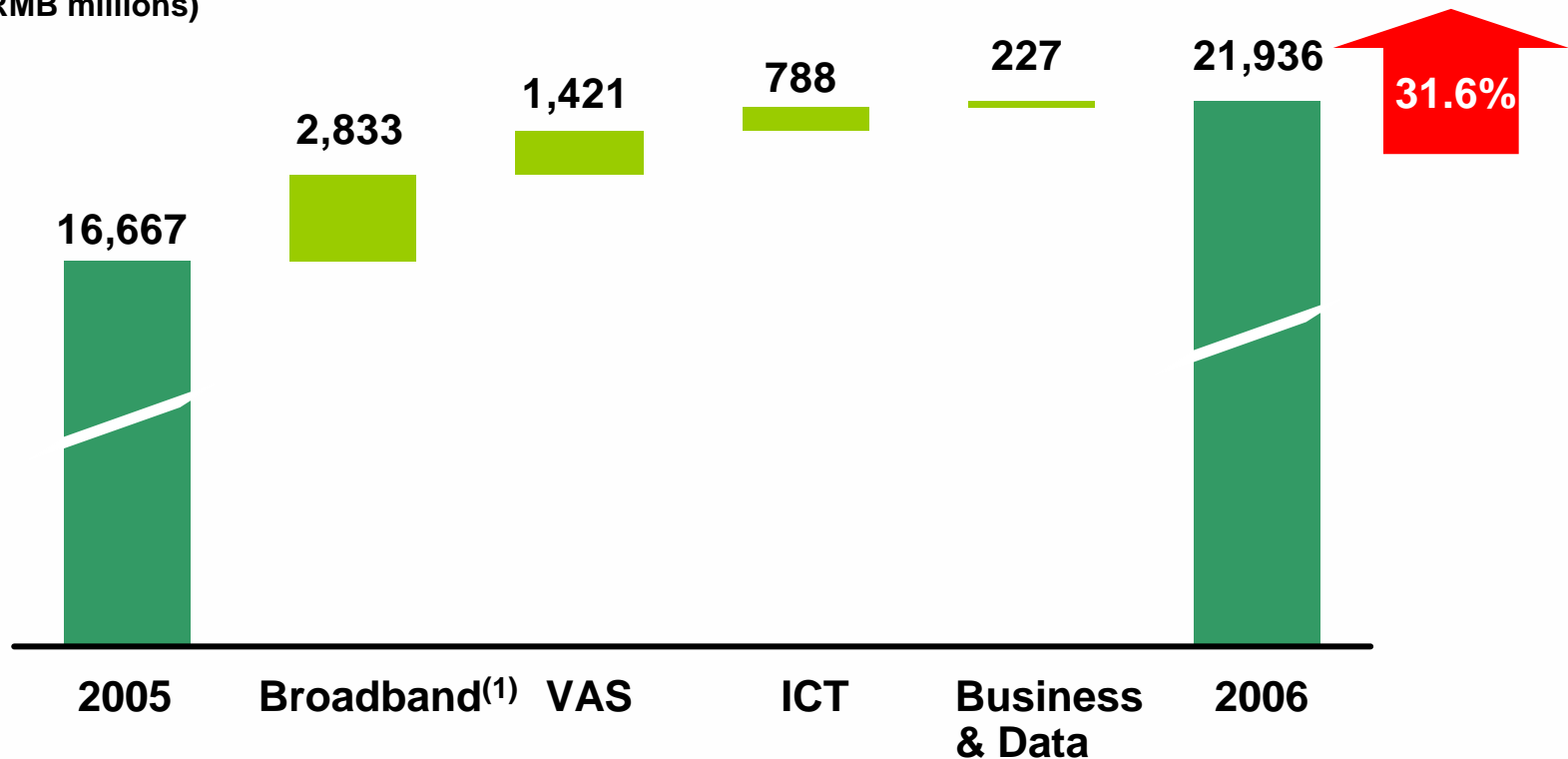
(1) Traditional businesses including local voice, long distance voice, Interconnection and other services

Development of High-Growth Businesses Driven by Multi-services

- High-growth businesses grew by 31.6%

Incremental High-Growth Business Revenue Breakdown

(in RMB millions)



(1) Including other Internet-related services

Broadband Business is Building Scale

Technological Advancements and Innovation...

Marketing innovation

- Bundling sales
- Flexible tariff policy
- “CNC Connected”

Product innovation

- Access + content + maintenance
- Broadband portal – CNC MAX
- IPTV、ICT

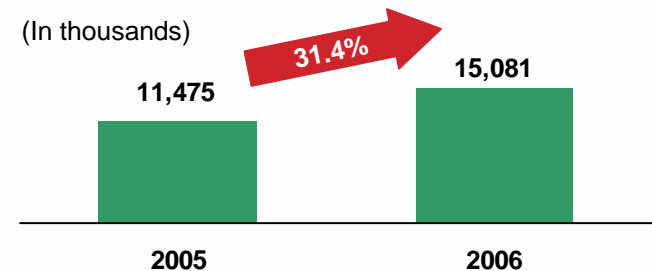
Terminals convergence



...allow Multi-dimensional Developments in Broadband Businesses

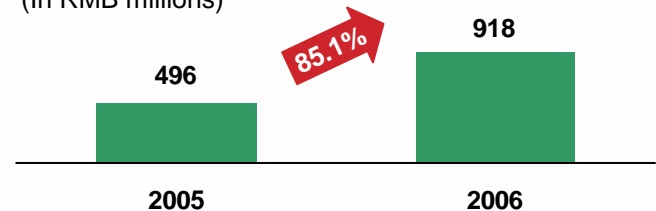
CNC broadband subscribers

(In thousands)



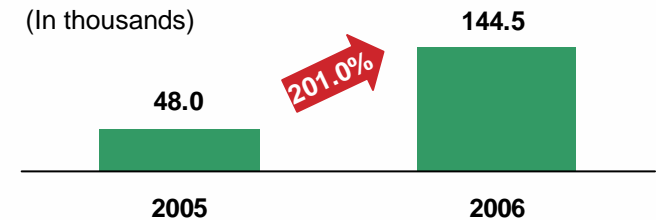
Broadband content and application revenue

(In RMB millions)



CNC IPTV subscribers

(In thousands)



ICT Business is On Board



Partners

- Major domestic IT companies
- Leading international IT companies
- International IT companies wishing to enter China

SME

- Network hosting
- ICT platform

MNC

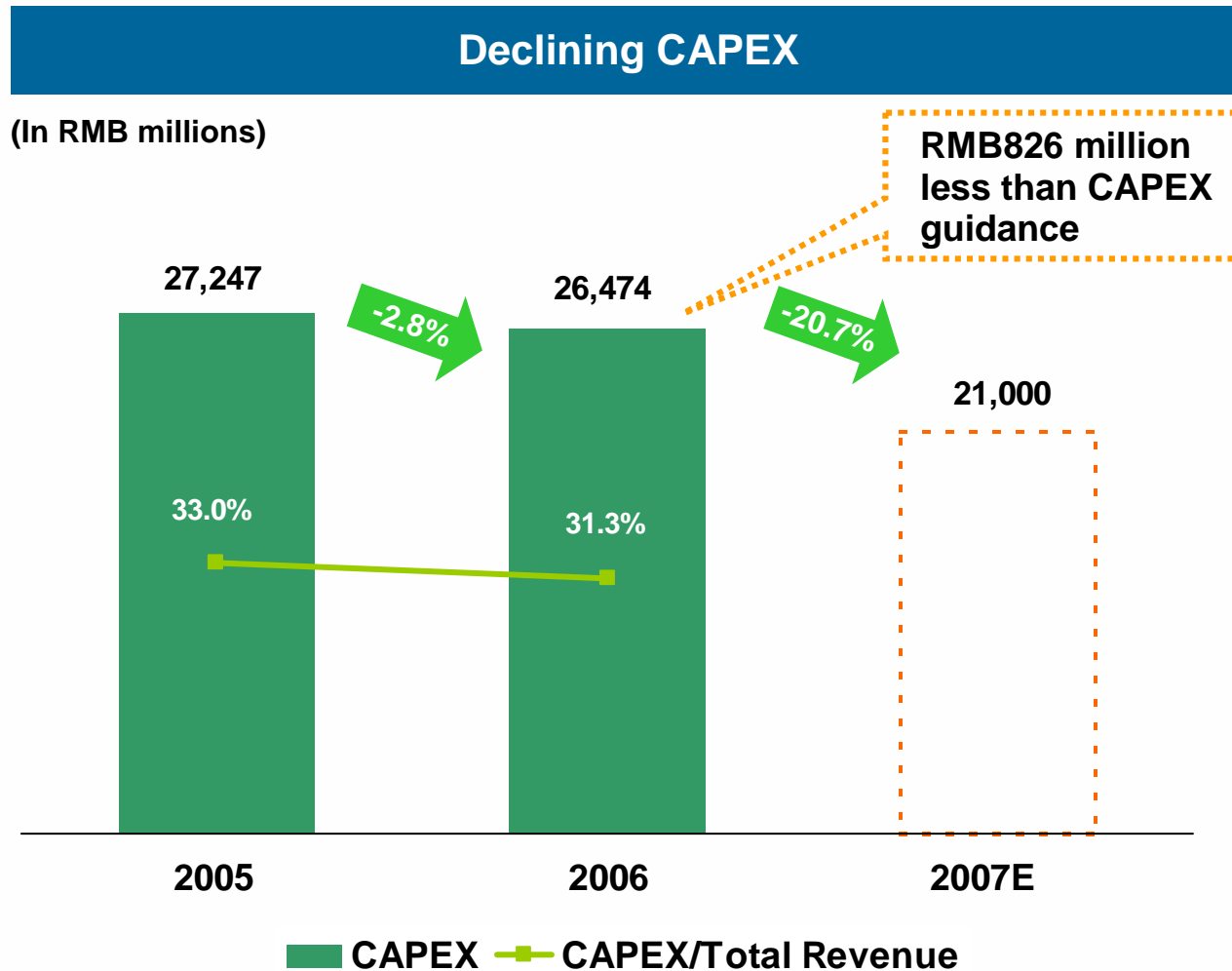
- Integrated systems consulting
- ICT platform
- Industry application systems

GOV

- “Broad Vision”
- LAN networking
- Outsourcing

- Securing existing customer relationships and maximizing customer value
- Acquiring new customers and expanding services

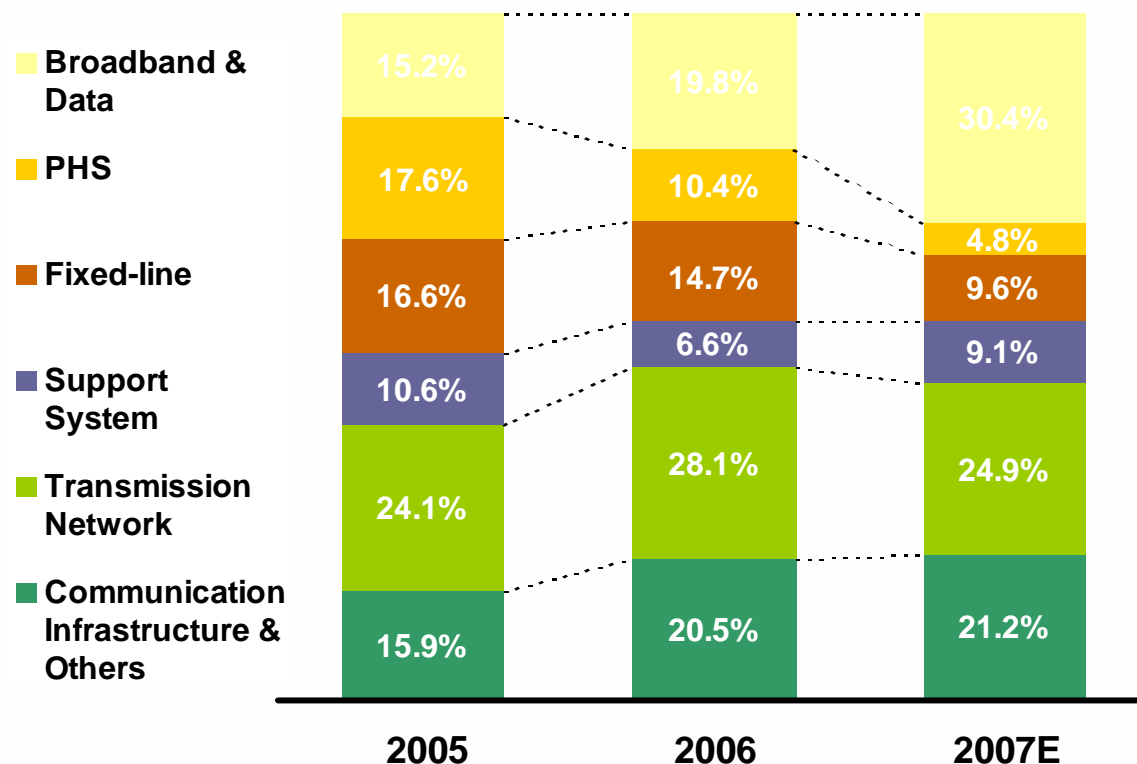
Effective CAPEX Control



High-Growth Businesses Focused CAPEX

Rationalized CAPEX Structure

(In RMB millions)



With a rapid decline in fixed-line business investment, CAPEX is focused on high-growth businesses. Compared to 2005,

- Investment in broadband and data is expected to increase by 15.2PPT in 2007
- Investment in PHS is expected to drop by 12.8PPT in 2007
- Investment in fixed-line businesses is expected to drop by 7.1PPT in 2007

Significant Increase in Free Cash Flow

(in RMB millions)

	2005	2006	Change
Operating Cash Flow Before Interest, Dividend And Tax	40,632	41,050	1.1%
<i>Interest Paid</i>	<i>(3,113)</i>	<i>(3,432)</i>	11.2%
<i>Dividend Received</i>	29	0	N.A
<i>Tax Paid</i>	<i>(4,065)</i>	<i>(3,668)</i>	-9.8%
Operating Cash Flow	33,483	33,950	+1.4%
<i>CAPEX</i>	<i>(27,247)</i>	<i>(26,474)</i>	-2.8%
Free Cash Flow	6,236	7,476	19.9%
Free Cash Flow/ Revenue	7.6%	8.8%	+1.2PPT

Improvements in Management Powered by Strategic Collaboration



+



Board	<ul style="list-style-type: none">■ 2 seats on Board■ Strategy Committee member
Strategy	<ul style="list-style-type: none">■ Involvement in medium to long-term strategy formulation
Innovation	<ul style="list-style-type: none">■ Co-CEO of CNC's National Laboratory of <i>Next-Generation Internet Broadband Applications</i>
Budget	<ul style="list-style-type: none">■ Involvement in budget process improvement■ Involvement in CAPEX bugeting
Business	<ul style="list-style-type: none">■ Call center■ Joint procurement

Improvements in Corporate Governance

2006 Corporate Governance highlights

Organization

Establishment of Board Committees in line with corporate governance best practices

Procedure

Strengthening roles of Board and Board Committees in key decision-making

Improved Board efficiency

- Performance evaluation of Directors, Board and Committees
- Director training and Field Trip
- Governance structure defined in *Corporate Governance Manual*

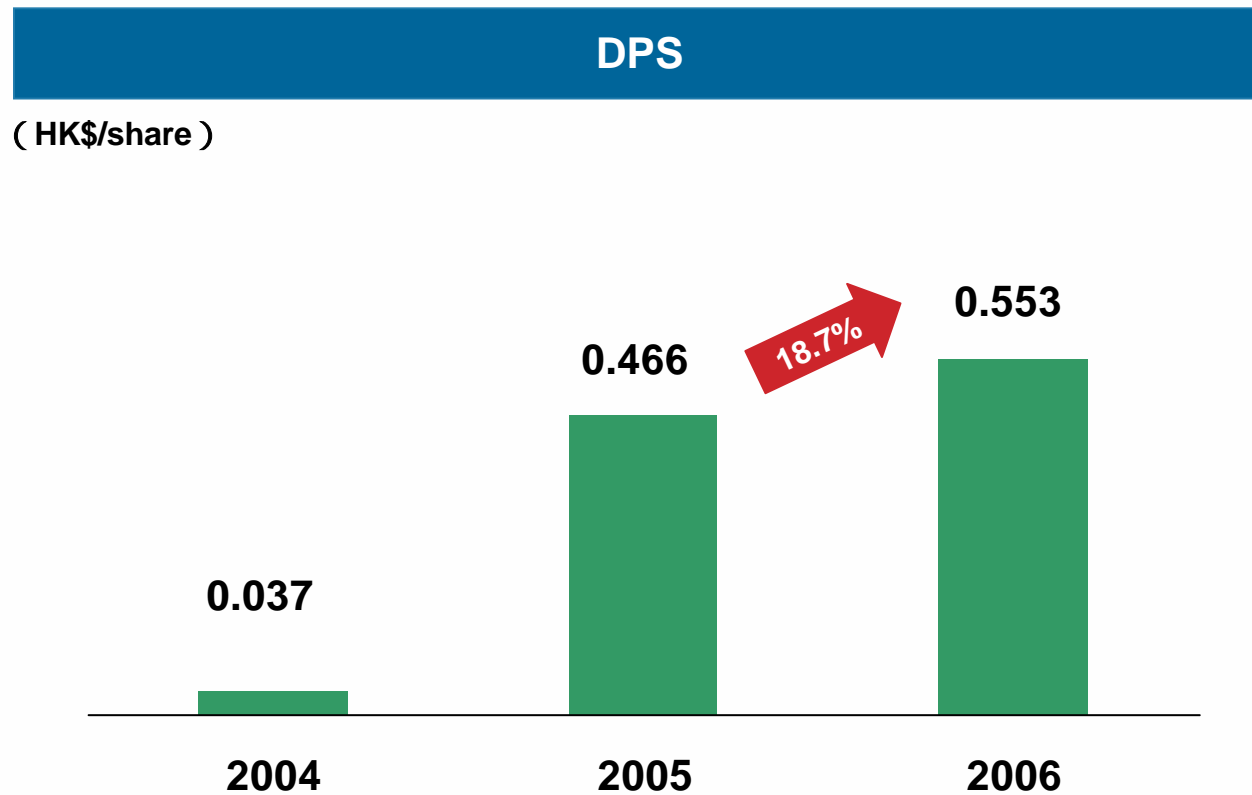
Evaluation of the Director's Performance in 2006

Director under evaluation:

Criteria		Descriptions	Score			
			17-20	11-16	6-10	1-5
			very good	good	medium	poor
Attendance and involvement	Meeting attendance	Attended required Board meetings and meetings of the Committees of which he/she is a member on time				
	Meeting involvement	Carefully reviewed meeting documents prior to meetings and was well-prepared for topics on meeting agenda; actively involved in meeting discussions and gave comments which conducive to decision-making at meeting				
	Advice on Company's operations and development	Ability to make constructive comments and suggestions to the Management on Company's operations and development				
Criteria		Descriptions	9-10	6-8	3-5	1-2
			very good	good	medium	poor
Objectivity and fairness		Objective and fair in making comments; safeguard interest of both Company and shareholders; show independence if being an independent director				
Criteria		Descriptions	5	4	2-3	1
			very good	good	medium	poor
Understanding of Company and industry	Understanding of Company strategy and results	Knowledge of Company current strategy, major projects, business development and results.				
	Understanding of industry and markets	Knowledge of industry development and market dynamics in China and abroad				
	Understanding of major difficulties and problems of Company	Knowledge of Company internal challenges and issues and of external factors which may influence Company's growth				
Expertise	Professional knowledge and experience	Professional knowledge and experience in being a director (assume important responsibilities in related areas and possess in-depth knowledge of relevant profession)				
	Capabilities	Ability to make strategic decisions, sound analysis and judgment and foster innovation				
Teamwork		Ability to communicate with other directors and help improve decision-making efficiency on the Board				
Total score of evaluation						
Comments and Advice						

Dividend Growth

- Proposed dividend payout ratio of 35% for year 2006



2007 Operating Strategy: Innovation & Transformation

Stabilize Traditional Businesses

Goals

- **Maintain existing customer base**
- **Increase subscriber value**

Measures

- Customer loyalty program
- Services bundling
- Channeling/branding
- Flexible tariff
- Rural market expansion
- More VAS products
- Flexible tariff policy
- Usage stimulation
- Customer needs Satisfaction

Expand High-Growth Businesses

- **Broadband**
- **VAS**
- **ICT**

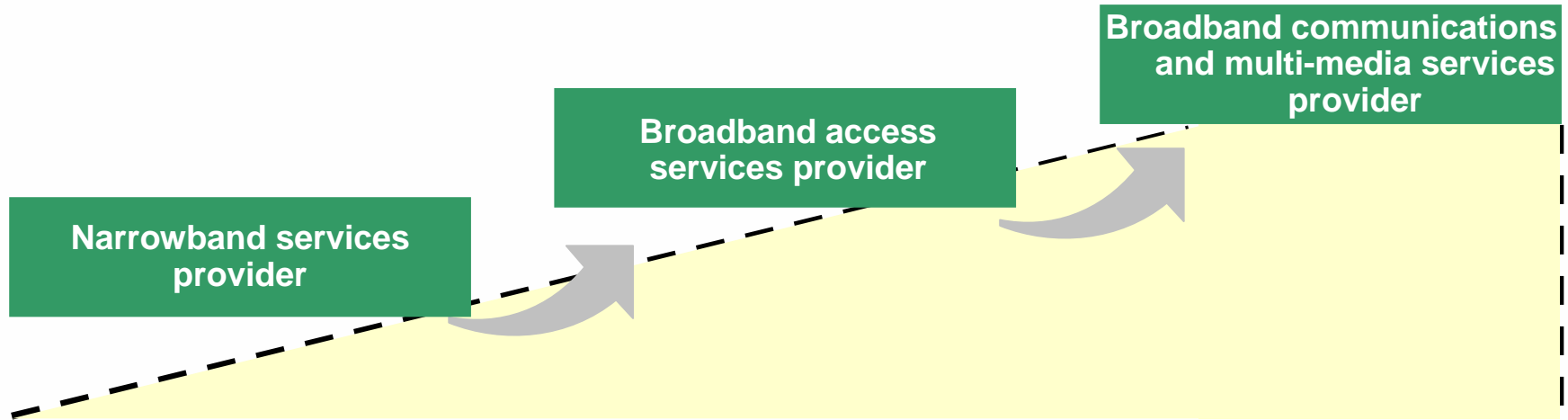
- Network coverage expansion
- Network quality improvement
- Content & application diversification
- Breakthroughs in IPTV
- Increase penetration
- Development and promotion of fixed-line value-added businesses
- Organizations and workflows consolidation
- Integrated service to customers

- **FMC**

- Fixed-mobile convergence
- Offer cross-network broadband multimedia information services

Strategic Transformation propelled by Innovation and Beijing Olympics

Serving customers' needs at all terminals across all networks



Unique Olympics opportunities



- Network speed upgrade & coverage expansion
- Content development
- Services and branding enhancement
- Marketing model reform

Organic innovation

- National Lab of NGI Broadband Applications
- Products & services
- Marketing model
- Management mechanisms
- Industry technologies

Strategic partnership

Corporate governance

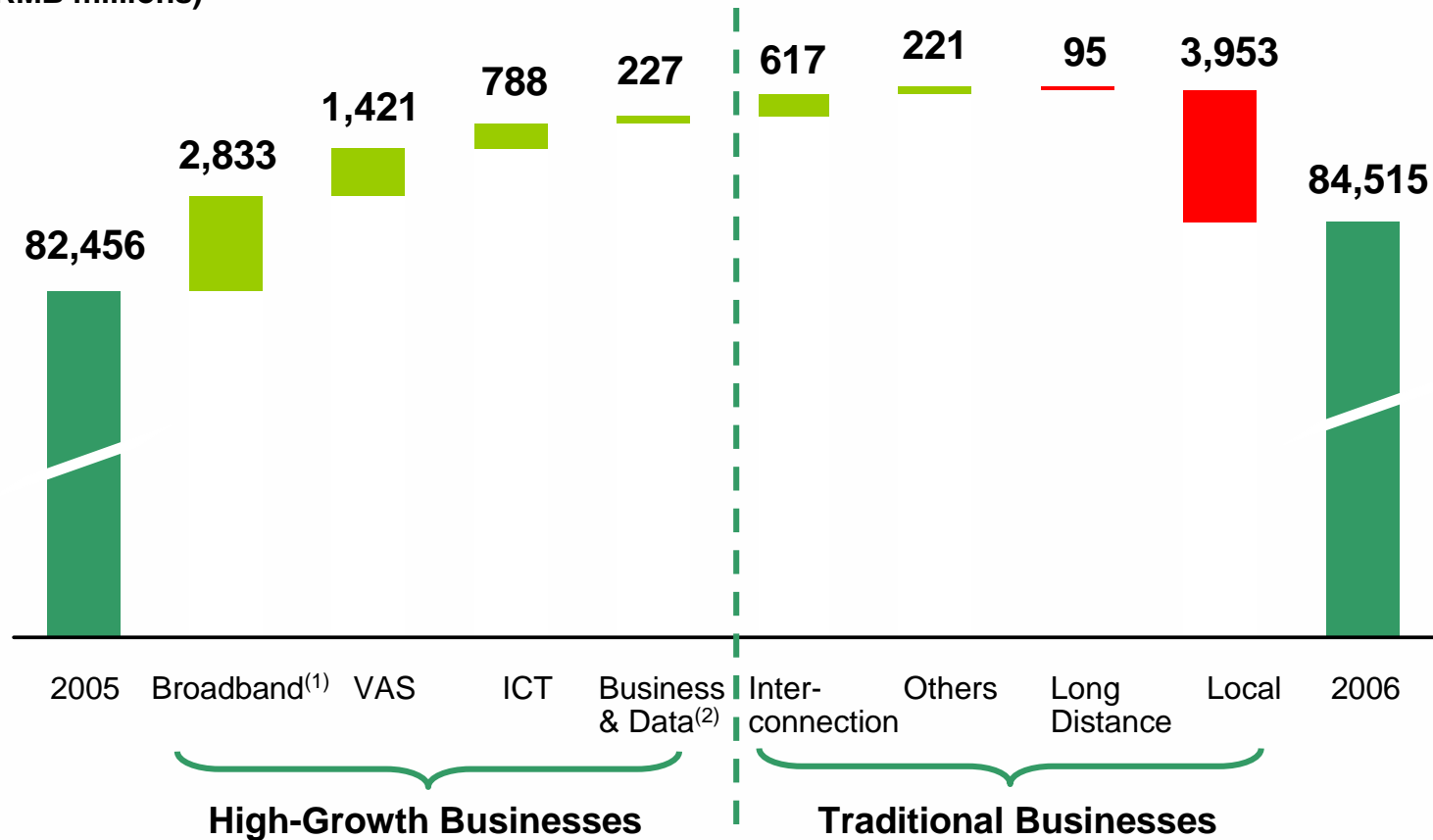
Business and Financial Results

Mr. Li Fushen Chief Financial Officer

Revenue Breakdown

Incremental Revenue Breakdown

(in RMB millions)



(1) Including other Internet-related services

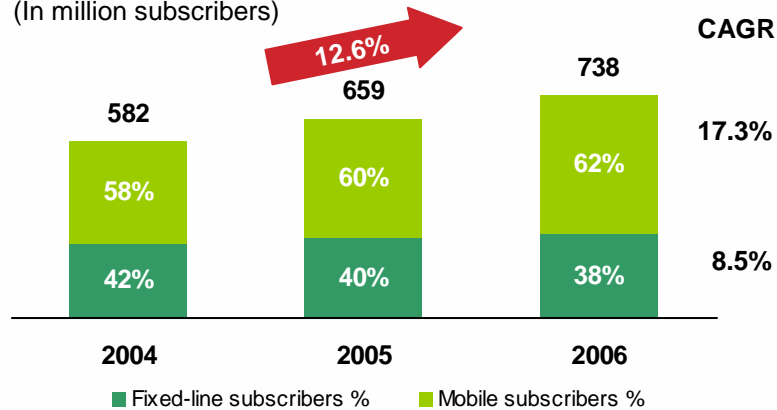
(2) Including managed data and leased line

Challenges to Local Telephone Services

Fixed-mobile substitution in China

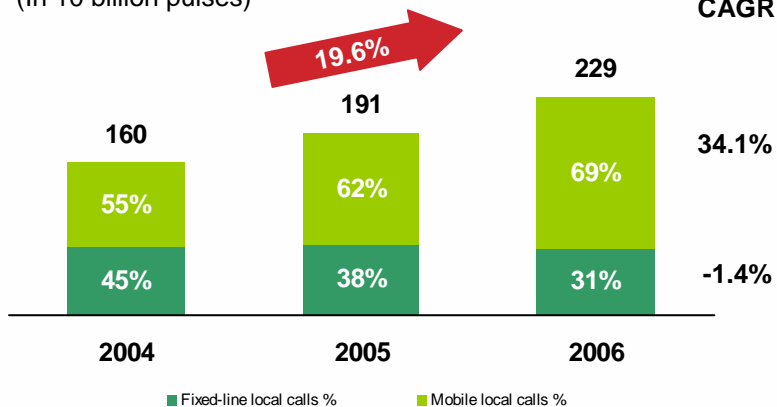
Volume and composition of subscribers ⁽¹⁾

(In million subscribers)



Volume & composition of local voice volume ⁽²⁾

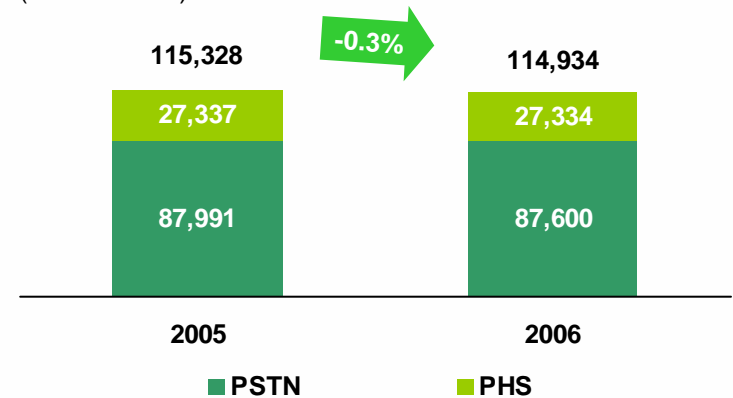
(In 10 billion pulses)



CNC local voice business under pressure

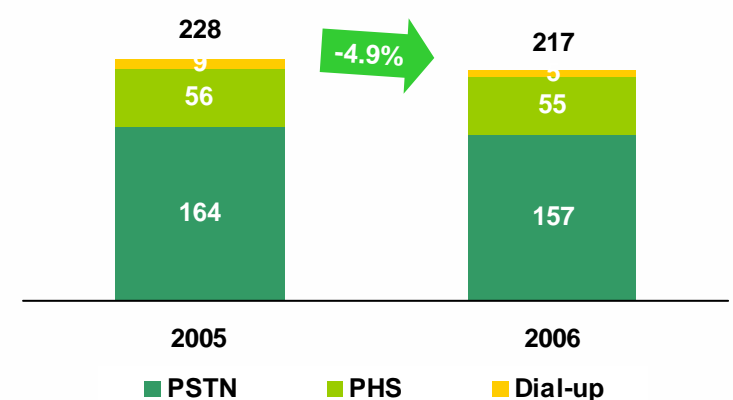
CNC Local subscribers

(In thousands)



CNC local call volume

(in billion pulses)



(1) Source: Telecommunications Statistics Monthly published by MII.

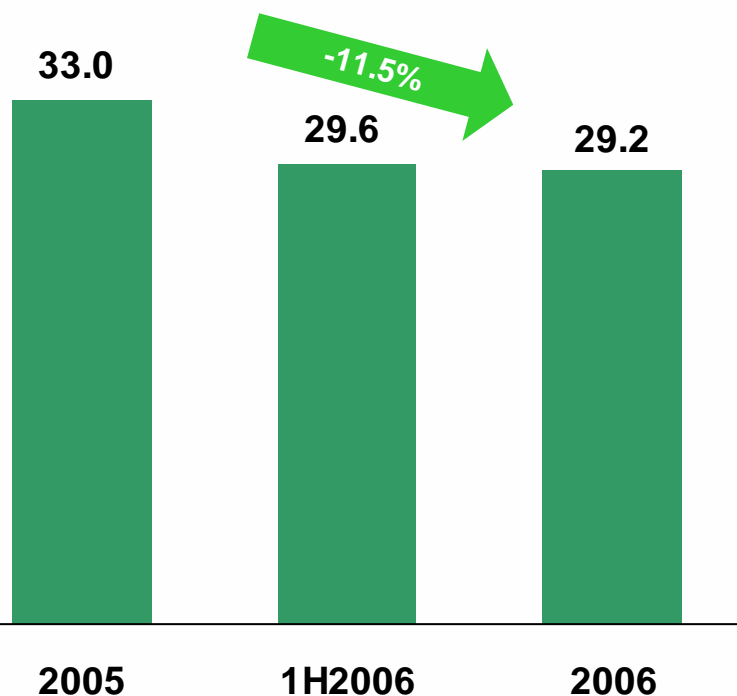
(2) Source: Telecommunications Statistics Monthly published by MII.

Declines in Local Telephone Services Revenues

- Due to an adjustment to tariffs for inter-district calls and impact from intensifying mobile substitution, revenue from local voice declined by 8.9%

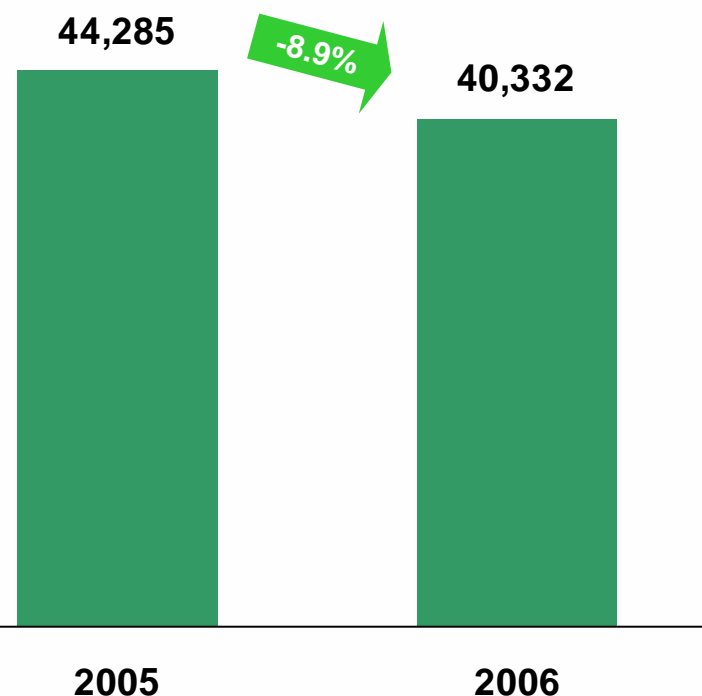
Local ARPU ⁽¹⁾

(In RMB)



Revenue⁽¹⁾

(In RMB millions)



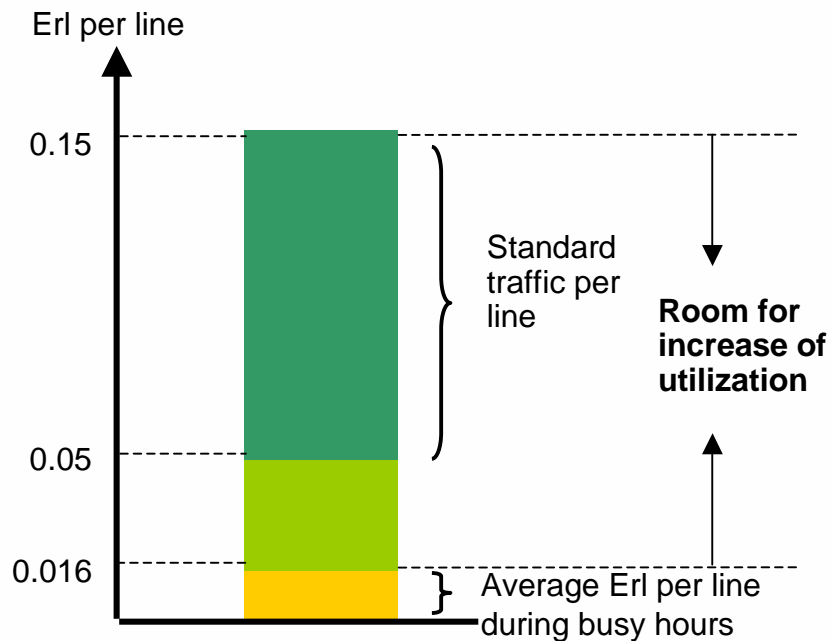
(1) Including PHS and excluding long distance and VAS

Dominance in Fixed Line Business Protected by Extensive Network Resources

Extensive network resources
and multi-services...

...provide opportunities for
Introduction of bundled services

Taiyuan, Shanxi Province as example



Retention measures

- Flexible tariff
- “Family 1+”
- Same number for both fixed-line and PHS
- Customer loyalty program

Pricing considerations

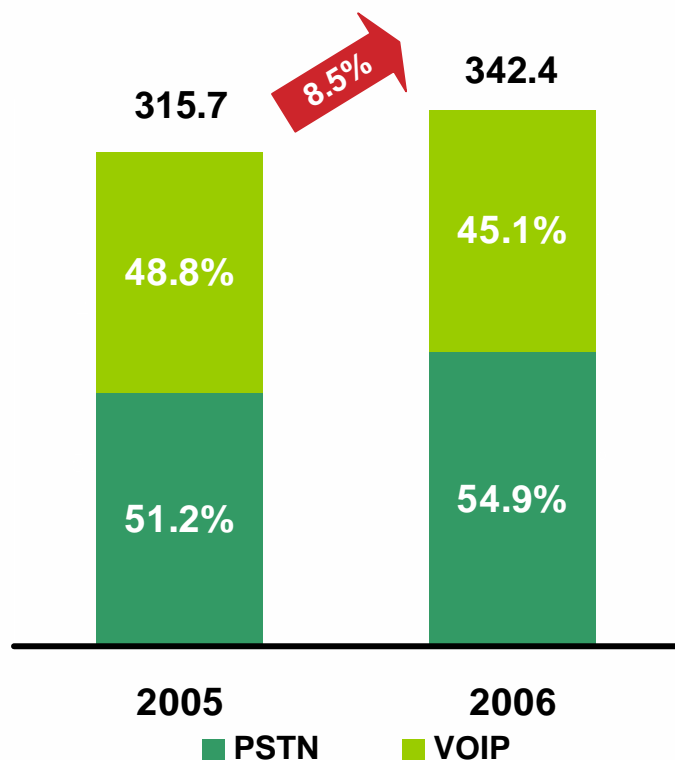
- Leveraging extensive network resources and multi-services to stimulate usage, reduce churn and stabilize overall revenue

Long-Distance Business Revenue in Slow Decline

- Long-distance volume grew by 8.5%, and PSTN volume as a percentage of total volume increased
- Revenue from long distance services declined marginally

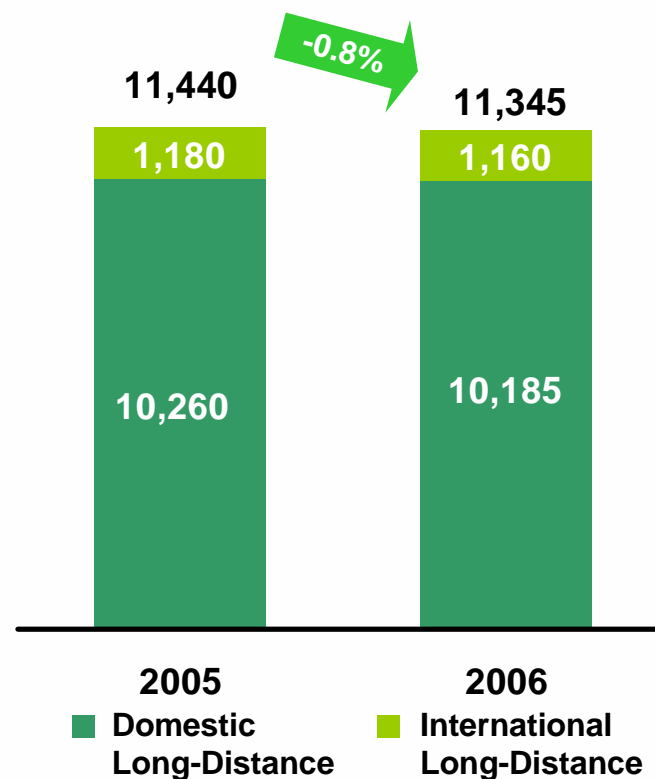
Long-Distance Volume

(in billion minutes)



Long-Distance Revenue

(In RMB millions)



Growth in VAS Revenues

■ VAS revenue increased by 35.5%, representing 6.4% of total revenues, up by 1.5PPT over 2005

VAS Subscribers Keep Increasing



- 15.77 million personalized ring subscribers
- 8.917 million fixed-line personalized ring subscribers

■ SMS

- 7.8 billion messages, a 15.3% growth over last year



- 68.8% penetration rate ⁽¹⁾



- Comprehensive information call center



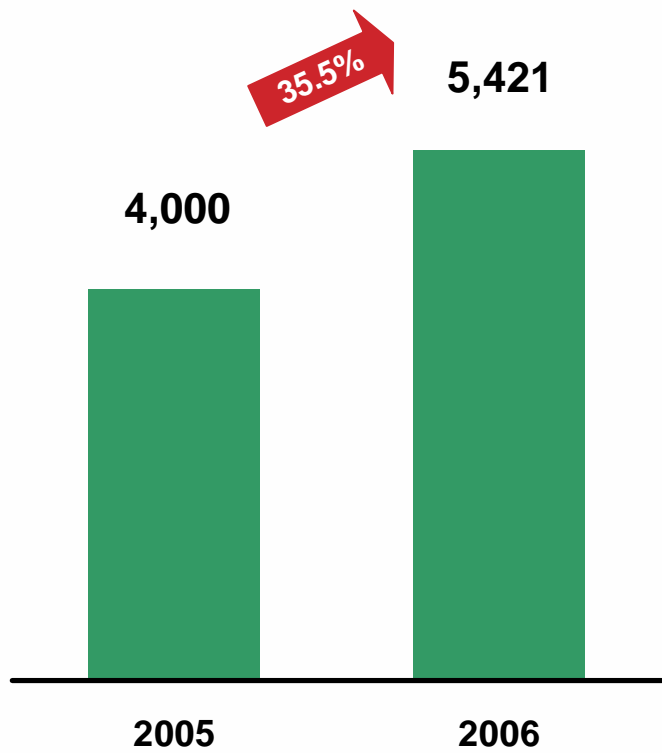
- 1 million cumulative subscribers for fixed-line voice mail service with bundled caller ID



- 0.6 million cumulative subscribers for virtual number service providing privacy for individual phone numbers

VAS Revenue

(In RMB millions)



(1) Penetration in our northern region. CNC Caller ID subscribers / CNC fixed-line subscribers

Positive Trend in Broadband ARPU

- Due to Broadband content and application revenue growth, broadband ARPU increased
- Multiple factors lead to growth in broadband revenue of 34.9%

Broadband ARPU (1)

(in RMB)

65.3



2005

66.3



2006

Broadband Revenue (1)

(In RMB millions)

7,824



2005

34.9%

10,556

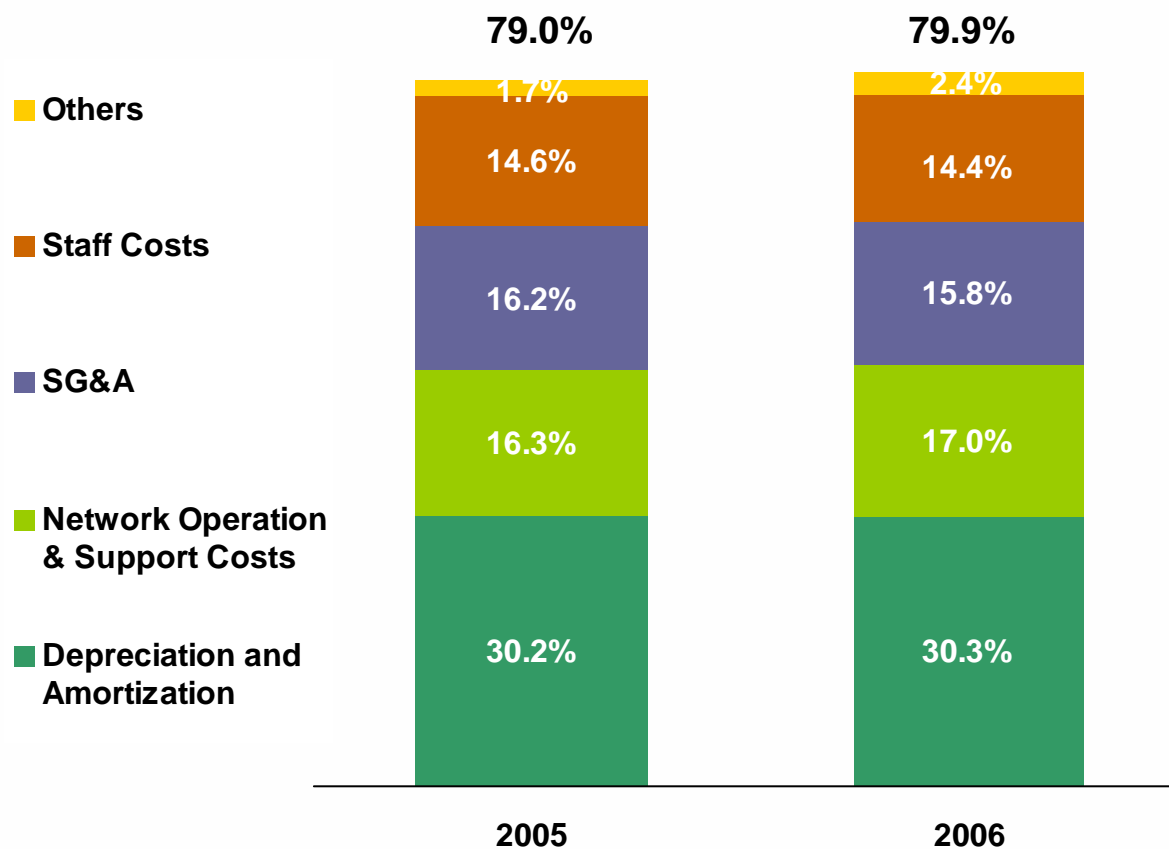


2006

(1) Broadband revenue excludes other Internet-related services revenue

Operating Expenses

OPEX / Revenue

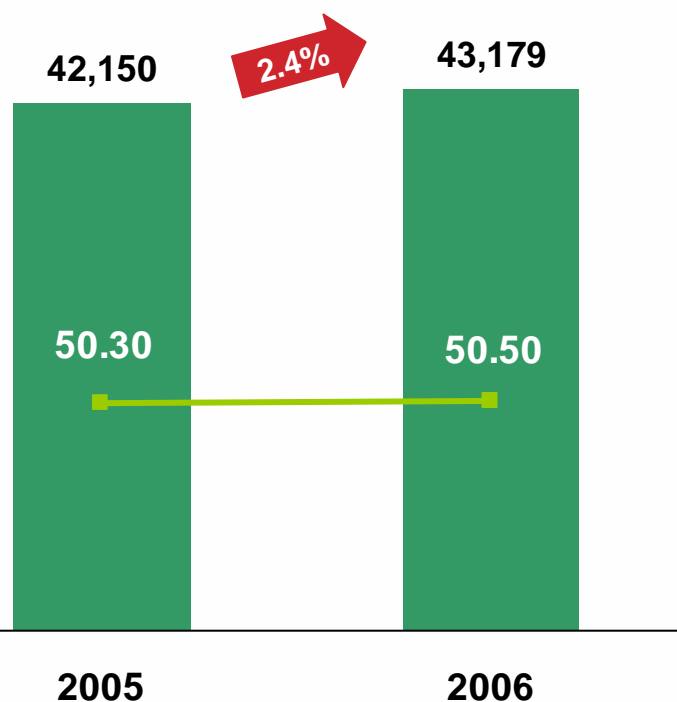


Operating Efficiency

Consolidated EBITDA and EBITDA Margin⁽¹⁾

(in RMB millions)

(%)

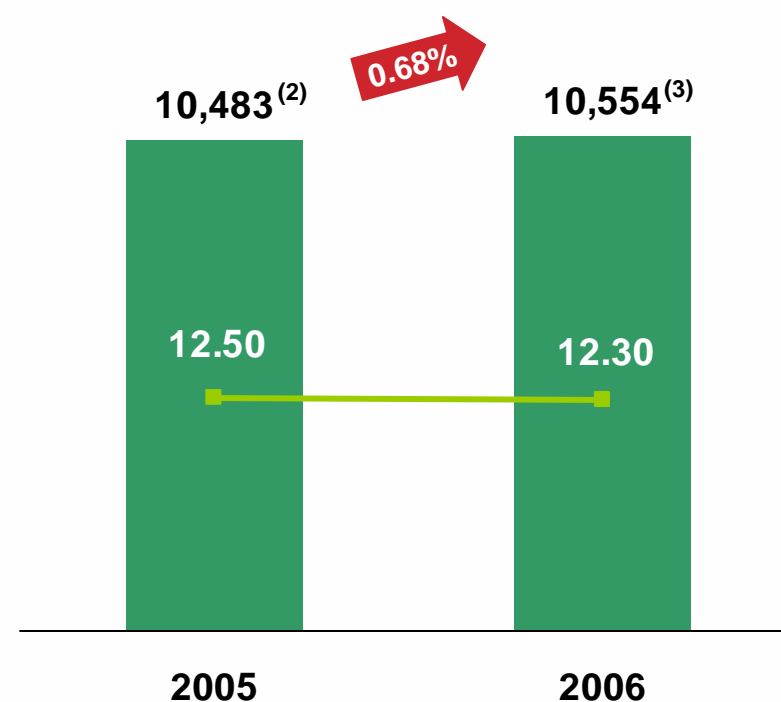


■ EBITDA — EBITDA Margin

Consolidated Net Profit and Net Profit Margin⁽¹⁾

(in RMB millions)

(%)



■ Net Profit — Net Profit Margin

(1) Including earnings from discontinued operation.

(2) Including the impact of the utilization of tax losses not recognized in previous years amounted to RMB837 million and loss from discontinued operations amounted to RMB266 million.

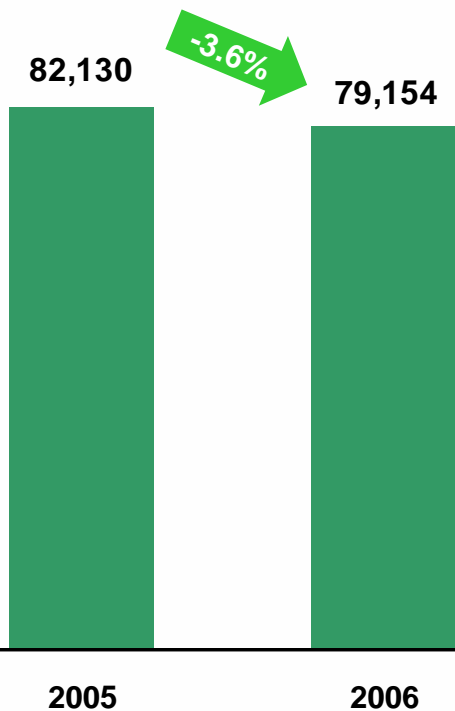
(3) Including impact of the deficit on revaluation of fixed assets amounted to RMB1,021 million and the profit from discontinued operations amounted to RMB1,819 million.

Total Debt and Financial Cost

- Total debt decreased by 3.6% as of year end 2006
- Average debt in 2006 higher than 2005. Total financial costs for 2006 increased by 16.2%.
- Debt-service capability strengthened alongside with improved EBITDA and decrease in total debt

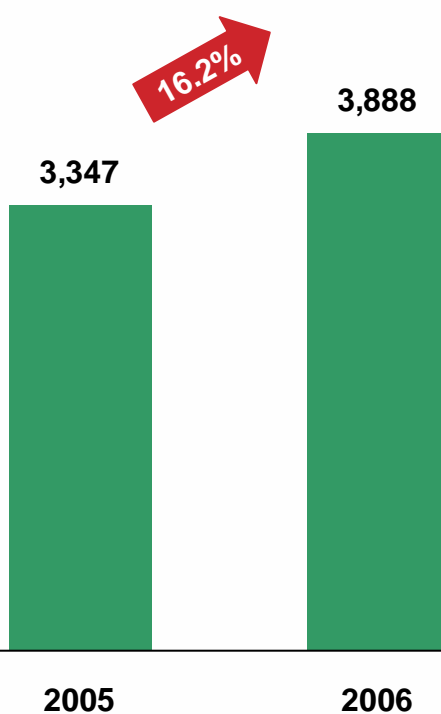
Total Debt

(In RMB millions)

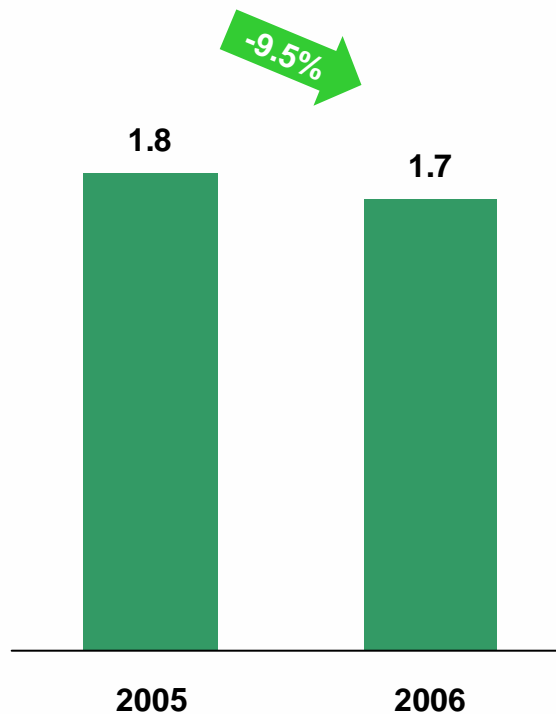


Financial Cost

(In RMB millions)



Net Debt/EBITDA



2007 Financial Strategy: Rigorous Financial Controls to Boost Cash Flow

Good corporate governance...

- Management resolution
- Board supervision
- Expertise from Telefonica

More rigorous financial control...

- Strict control over CAPEX
- Efficient cost utilization
- Growth-focused CAPEX

- Prioritization of CAPEX
- Revamping of budget process
- Better allocation of costs
- Enhancements in fund management

Leads to greater shareholder value

- Increase in cash flow
- Increase in EVA

Appendix I: Revenues Breakdown of Continuing Operations



HKSE: 906; NYSE: CN

(in RMB Millions)	2006	2005
		<i>Restated</i>
Local usage fees	22,274	24,582
Monthly telephone services	16,689	18,261
Upfront installation fees	1,369	1,442
DLD usage fees	10,185	10,260
ILD usage fees	1,160	1,180
Value-added services	5,421	4,000
Interconnection fees	8,400	7,783
Upfront connection fees	2,406	3,405
Broadband services	10,556	7,824
Other Internet-related services	692	591
Managed data services	1,505	1,656
Leased line income	2,974	2,596
Information communication technologies services	788	-
Other services	2,502	2,281
Total	86,921	85,861