

REPORT OF THE *DIRECTORS*

The board of directors (the "Board") of China Unicom (Hong Kong) Limited (the "Company") is pleased to present its report together with the audited financial statements of the Company and its subsidiaries (the "Group") for the year ended 31 December 2016.

PRINCIPAL ACTIVITIES

The principal activity of the Company is investment holding. The principal activities of Company's subsidiaries are the provision of cellular and fixed-line voice and related value-added services, broadband and other Internet-related services, information communications technology services, and business and data communications services in the PRC.

RESULTS AND APPROPRIATION

The results of the Group for the year ended 31 December 2016 are set out on pages 86 to 87 of this annual report.

Taking into consideration the Company's profitability, debt, cash flow level and capital requirements for its future development, the Board has resolved not to pay a dividend for the year 2016. The Company will strive to enhance its profits while paving the way for paying a dividend for the year 2017.

FINANCIAL INFORMATION

Please refer to the Financial Summary on pages 162 to 163 for the summary of the operating results, assets and liabilities of the Group for the five years ended 31 December 2016.

Please refer to the financial statements on pages 86 to 161 for the operating results of the Group for the year ended 31 December 2016 and the respective financial positions of the Group and the Company as at that date.

BUSINESS REVIEW

The business review of the Group for the year ended 31 December 2016 is set out in the sections headed "Chairman's Statement" on pages 8 to 15, "Business Overview" on pages 16 to 19, "Financial Overview" on pages 22 to 27, "Financial Statements" on pages 86 to 161, "Human Resources Development" on pages 74 to 75, "Social Responsibility" on pages 76 to 79, "Corporate Governance Report" on pages 36 to 57 and "Report of the Directors" on pages 58 to 71 respectively of this annual report. All references herein to other sections or reports in this annual report form part of this Report of the Directors.

REPORT OF THE DIRECTORS

LOANS

Please refer to Notes 30, 34 and 39.1(b) to the financial statements for details of the borrowings of the Group.

PROMISSORY NOTES

Please refer to Note 31 to the financial statements for details of the promissory notes of the Group.

CORPORATE BONDS

Please refer to Note 32 to the financial statements for details of the corporate bonds of the Group.

COMMERCIAL PAPERS

Please refer to Note 35 to the financial statements for details of the commercial papers of the Group.

CAPITALISED INTEREST

Please refer to Note 15 to the financial statements for details of the interest capitalised by the Group for the year.

EQUITY-LINKED AGREEMENTS

Other than the share option scheme as disclosed in this Report of Directors, as at 31 December 2016, no equity-linked agreements were entered into by the Group during the year or subsisted.

PROPERTY, PLANT AND EQUIPMENT

Please refer to Note 15 to the financial statements for movements in the property, plant and equipment of the Group for the year.

CHARGE ON ASSETS

As at 31 December 2016, no property, plant and equipment was pledged to banks as loan security (31 December 2015: Nil).

SHARE CAPITAL

Please refer to Note 27 to the financial statements for details of the share capital.

RESERVES

Please refer to page 90 and page 145 of this annual report for the movements in the reserves of the Group and the Company during the year ended 31 December 2016 respectively. As at 31 December 2016, the distributable reserve of the Company amounted to approximately RMB1,421 million (2015: approximately RMB4,153 million).

SUBSIDIARIES AND ASSOCIATES

Please refer to Notes 18 and 19 to the financial statements for details of the Company's subsidiaries and the Group's associates.

CHANGES IN SHAREHOLDERS' EQUITY

Please refer to page 90 of this annual report for the Consolidated Statement of Changes in Equity and page 145 for the Statement of Changes in Equity.

EMPLOYEE BENEFIT EXPENSES

Please refer to Note 8 to the financial statements for details of the employee benefit expenses provided to employees of the Group.

PRE-EMPTIVE RIGHTS

There are no provisions for pre-emptive rights in the articles of association of the Company requiring the Company to offer new shares to the existing shareholders in proportion to their shareholdings.

REPORT OF THE DIRECTORS

MAJOR CUSTOMERS AND SUPPLIERS

The Group's sales to its five largest customers for the year ended 31 December 2016 did not exceed 30% of the Group's total turnover for the year.

The Group's purchases from its largest supplier for the year ended 31 December 2016 represented approximately 23.2% of the Group's total purchases for the year. The total purchases attributable to the five largest suppliers of the Group for the year ended 31 December 2016 accounted for approximately 47.3% of the total purchases of the Group for the year.

None of the Directors nor their respective associates (as defined in the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited (the "Listing Rules") nor any shareholder of the Company (which to the knowledge of the Directors owns more than 5% of the Company's share capital) had any interests in the five largest suppliers of the Group for the year ended 31 December 2016.

SHARE OPTION SCHEME OF THE COMPANY

2014 Share Option Scheme

Pursuant to a resolution passed at the annual general meeting held on 16 April 2014, the Company adopted a new share option scheme (the "2014 Share Option Scheme"). The purpose of the 2014 Share Option Scheme was to recognise the contribution that certain individuals have made to the Company, to attract and retain the best available personnel and to promote the success of the Company. The 2014 Share Option Scheme is valid and effective for a period of 10 years commencing on 22 April 2014 and will expire on 22 April 2024. Following the expiry of the 2014 Share Option Scheme, no further share option can be granted under the 2014 Share Option Scheme, but the provisions of the 2014 Share Option Scheme will remain in full force and effect to the extent necessary to give effect to the exercise of any share

options granted prior thereto or otherwise as may be required in accordance with the provisions of the 2014 Share Option Scheme. Under the 2014 Share Option Scheme:

- (1) share options may be granted to employees including all Directors;
- (2) any grant of share options to a Connected Person (as defined in the Listing Rules) of the Company must be approved by the independent non-executive Directors of the Company (excluding any independent non-executive Director of the Company in the case such Director is a grantee of the options) and all grants to connected persons shall be subject to compliance with the requirements of the Listing Rules, including where necessary the prior approval of the shareholders;
- (3) the maximum aggregate number of shares in respect of which share options may be granted shall be calculated in accordance with the following formula:

$$N = A - B - C$$

where:

"N" is the maximum aggregate number of shares in respect of which share options may be granted pursuant to the 2014 Share Option Scheme;

"A" is the maximum aggregate number of shares in respect of which shares options may be granted pursuant to the 2014 Share Option Scheme and any other share option schemes of the Company, being 10% of the aggregate of the number of shares in issue as at the date of adoption of the 2014 Share Option Scheme;

REPORT OF THE DIRECTORS

“B” is the maximum aggregate number of shares underlying the share options already granted pursuant to the 2014 Share Option Scheme; and

“C” is the maximum aggregate number of shares underlying the options already granted pursuant to any other share option schemes of the Company.

Shares in respect of share options which have lapsed in accordance with the terms of the 2014 Share Option Scheme and any other share option schemes of the Company will not be counted for the purpose of determining the maximum aggregate number of shares in respect of which options may be granted pursuant to the 2014 Share Option Scheme.

- (4) the option period commences on any day after the date on which such share option is offered, but may not exceed 10 years from the offer date;
- (5) the subscription price shall not be less than the higher of:
 - (a) the closing price of the shares on the Hong Kong Stock Exchange on the offer date in respect of the share options; and
 - (b) the average closing price of the shares on the Hong Kong Stock Exchange for the five trading days immediately preceding the offer date;

- (6) the total number of shares in the Company issued and to be issued upon exercise of the share options granted to a participant of the 2014 Share Option Scheme (including both exercised and outstanding share options) in any 12-month period must not exceed 1% of the issued share capital of the Company; and
- (7) the consideration payable for each grant is HKD1.00.

No share options had been granted since adoption of the 2014 Share Option Scheme.

As at 31 December 2016, 1,777,437,107 options were available for issue under the 2014 Share Option Scheme, representing approximately 7.42% of issued share capital of the Company as at the date of this annual report.

Directors', Chief Executives' and Employees' Interests Under the Share Option Scheme of the Company

For the year ended 31 December 2016 and as at 31 December 2016, none of the Directors of the Company or chief executives or employees of the Company had any interests under any share option scheme of the Company.

REPORT OF THE DIRECTORS

DIRECTORS' AND CHIEF EXECUTIVES' INTERESTS AND SHORT POSITIONS IN SHARES, UNDERLYING SHARES AND DEBENTURES

As at 31 December 2016, the interests and short positions of Directors and chief executives of the Company and their respective close associates in any shares, underlying shares and debentures of the Company or any of its associated corporations (as defined in Part XV of the Hong Kong Securities and Futures Ordinance (the "SFO")) as recorded in the register required to be kept under Section 352 of the SFO or as otherwise notified to the Company and the Stock Exchange of Hong Kong Limited pursuant to the Model Code for Securities Transactions by Directors of Listed Issuers (the "Model Code") as set out in Appendix 10 of the Rules Governing the Listing of Securities on the Hong Kong Stock Exchange (the "Listing Rules"), were as follows:

Name of Director	Capacity	Ordinary Shares Held	Percentage of Issued Shares
Cheung Wing Lam Linus	Beneficial owner (Personal)	200,000	0.0008%
Chung Shui Ming Timpson	Beneficial owner (Personal)	6,000	0.0000%

Save as disclosed in the foregoing, as at 31 December 2016, none of the Directors or chief executives of the Company or their respective close associates had any interests or short positions in any shares, underlying shares, or debentures of the Company or any of its associated corporations (as defined in Part XV of the SFO) as recorded in the register required to be kept pursuant to Section 352 of the SFO or as otherwise notified to the Company and the Hong Kong Stock Exchange pursuant to the Model Code.

Furthermore, save as disclosed in the foregoing, during the year ended 31 December 2016, none of the Directors or chief executives (including their spouses and children under the age of 18) of the Company had any interests in or was granted any right to subscribe in any shares, underlying shares, or debentures of the Company or any of its associated corporations, or had exercised any such rights.

REPORT OF THE DIRECTORS

MATERIAL INTERESTS AND SHORT POSITIONS OF SUBSTANTIAL SHAREHOLDERS IN SHARES AND UNDERLYING SHARES OF THE COMPANY

As at 31 December 2016, the following persons (other than disclosed under the section headed "Directors' and Chief Executives' Interests and Short Positions in Shares, Underlying Shares and Debentures") had the following interests and short positions in the shares or underlying shares of the Company as recorded in the register required to be kept pursuant to Section 336 of Part XV of the SFO:

Name of Shareholder	Ordinary Shares Held		Percentage of Issued Shares
	Directly	Indirectly	
(i) China United Network Communications Group Company Limited ("Unicom Group") ^{1,2}	–	18,032,853,047	75.30%
(ii) China United Network Communications Limited ("Unicom A Share Company") ¹	–	9,725,000,020	40.61%
(iii) China Unicom (BVI) Limited ("Unicom BVI") ¹	9,725,000,020	–	40.61%
(iv) China Unicom Group Corporation (BVI) Limited ("Unicom Group BVI") ^{2,3}	8,082,130,236	225,722,791	34.69%

Notes:

- Unicom Group and Unicom A Share Company directly or indirectly control one-third or more of the voting rights in the shareholders' meetings of Unicom BVI, and in accordance with the SFO, the interests of Unicom BVI are deemed to be, and have therefore been included in, the respective interests of Unicom Group and Unicom A Share Company.
- Unicom Group BVI is a wholly-owned subsidiary of Unicom Group. In accordance with the SFO, the interests of Unicom Group BVI are deemed to be, and have therefore been included in, the interests of Unicom Group.
- Unicom Group BVI holds 8,082,130,236 shares (representing 33.75% of the total issued shares) of the Company directly. In addition, Unicom Group BVI is also deemed under the SFO to be interested in 225,722,791 shares (representing 0.94% of the total issued shares) of the Company held as trustee on behalf of a PRC shareholder.

Apart from the foregoing, as at 31 December 2016, no person had any interest or short position in the shares or underlying shares in the Company as recorded in the register required to be kept under Section 336 of the SFO.

Please also refer to Note 27 to the consolidated financial statements for details of the share capital of the Company.

REPURCHASE, SALE OR REDEMPTION OF LISTED SHARES OF THE COMPANY

For the year ended 31 December 2016, neither the Company nor any of its subsidiaries had repurchased, sold or redeemed any of the Company's listed shares.

REPORT OF THE DIRECTORS

COMPOSITION OF THE BOARD

The following is the list of Directors during the year and up to date of this report.

Executive Directors:

Wang Xiaochu

(Chairman and Chief Executive Officer)

Lu Yimin

Li Fushen

Zhang Junan (resigned on 1 November 2016)

Non-Executive Director:

Cesareo Alierta Izuel

Independent Non-Executive Directors:

Cheung Wing Lam Linus

Wong Wai Ming

Chung Shui Ming Timpson

Law Fan Chiu Fun Fanny

Pursuant to the articles of association of the Company, Mr. Cesareo Alierta Izuel, Mr. Cheung Wing Lam Linus and Mr. Wong Wai Ming will retire by rotation at the forthcoming annual general meeting of the Company and, being eligible, offer themselves for re-election.

Please refer to Note 8 to the financial statements for details of the emoluments of the Directors.

INDEPENDENCE OF INDEPENDENT NON-EXECUTIVE DIRECTORS

The Company has received from each of its independent non-executive Directors the annual confirmation of his independence pursuant to Rule 3.13 of the Listing Rules and the Company considers that all independent non-executive Directors are currently independent.

DIRECTORS' INTEREST IN CONTRACTS

Save for the service agreements between the Company and the executive Directors, as at 31 December 2016, the Directors did not have any material interest, whether directly or indirectly, in any significant contracts entered into by the Company.

None of the Directors for Re-Election at the forthcoming annual general meeting has an unexpired service agreement which is not terminable by the Company within one year without payment of compensation (other than statutory compensation).

DIRECTORS' INTEREST IN COMPETING BUSINESSES

Unicom Group and the A Share Company are engaged in telecommunications business and other related businesses in China that are similar to and/or compete with those of the Company. Executive directors of the Company also hold executive positions with Unicom Group and the A Share Company. Please refer to the section headed "Directors and Senior Management" on pages 28 to 33 of this annual report for further details.

Mr. Wang Xiaochu, Chairman and Chief Executive Officer of the Company, has served as a director of Telefónica since September 2015. Mr. Cesareo Alierta Izuel, a Non-Executive Director of the Company, has served as a director of Telefónica since January 1997.

Mr. Lu Yimin, an Executive Director and President of the Company, has served as a Non-Executive Director of PCCW Limited since May 2008 and the Deputy Chairman of the Board of PCCW Limited since November 2011. Mr. Lu has also served as a Non-Executive Director of HKT Limited and HKT Management Limited (the trustee-manager of the HKT Trust) since November 2011. Mr. Li Fushen, an Executive Director and Chief Financial Officer of the Company, has served as a Non-Executive Director of PCCW Limited since July 2007 and as a Non-Executive Director of HKT Limited and HKT Management Limited since November 2011.

REPORT OF THE DIRECTORS

Each of Telefónica, PCCW Limited, HKT Limited and HKT Management Limited, is engaged in the telecommunications business and other related businesses that may compete with those of the Company.

Apart from the above, there are no competing interests of directors which are disclosable under Rule 8.10(2)(b) of the Listing Rules at any time during the year of 2016 up to and including the date of this annual report.

DIRECTORS OF SUBSIDIARIES

The names of all directors who have served on the boards of the subsidiaries of the Company during the year ended 31 December 2016 and up to the date of this report of directors are available on the Company's website (<http://www.chinaunicom.com.hk>).

PERMITTED INDEMNITY

Pursuant to the Company's articles of association, subject to the applicable laws and regulations, every Director shall be indemnified out of the assets of the Company against all costs, charges, expenses, losses and liabilities which he/she may sustain or incur in the execution of his/her office or otherwise in relation thereto. The Company has taken out insurance against the liability and costs associated with defending any proceedings which may be brought against directors of the Group.

EMPLOYEE AND REMUNERATION POLICY

As at 31 December 2016, the Group had approximately 253,110 employees, 471 employees and 143 employees in Mainland China, Hong Kong and other countries, respectively. Furthermore, the Group had approximately 16,760 temporary staff in Mainland China. For the year ended 31 December 2016, employee benefit expenses were approximately RMB36.907 billion (for the year

ended 31 December 2015: RMB35.140 billion). The Group endeavors to maintain its employees' remuneration in line with the market trend and to remain competitive. Employees' remuneration is determined in accordance with the Group's remuneration and bonus policies based on their performance. The Group also provides comprehensive benefit packages and career development opportunities for its employees, including retirement benefits, housing benefits and internal and external training programmes, which are tailored in accordance with individual needs.

The Company has adopted share option schemes, under which the Company may grant share options to eligible employees for subscribing for the Company's shares.

CONTINUING CONNECTED TRANSACTIONS

On 24 October 2013 and 21 August 2015, respectively, China United Network Communications Corporation Limited ("CUCL"), a wholly-owned subsidiary of the Company, and Unicom Group entered into a comprehensive services agreement and its supplemental agreement (the "Comprehensive Services Agreement") to renew certain continuing connected transactions and revise annual cap. Pursuant to the Comprehensive Services Agreement, CUCL and Unicom Group shall provide certain services and facilities to each other and the receiving party shall pay the corresponding service fees in a timely manner. The Comprehensive Services Agreement is valid for a term of three years starting from 1 January 2014 and expiring on 31 December 2016. Unicom Group is the ultimate controlling shareholder of the Company and is therefore a connected person of the Company under the Listing Rules.

REPORT OF THE DIRECTORS

Details of the continuing connected transactions under the Comprehensive Services Agreement are as follows:

(1) Telecommunications Resources Leasing

Unicom Group agrees to lease to CUCL:

- (a) certain international telecommunications resources (including international telecommunications channel gateways, international telecommunications service gateways, international submarine cable capacity, international land cables and international satellite facilities); and
- (b) certain other telecommunications facilities required by CUCL for its operations.

The rental charges for the leasing of international telecommunications resources and other telecommunications facilities are based on the annual depreciation charges of such resources and telecommunications facilities provided that such charges would not be higher than market rates. CUCL shall be responsible for the ongoing maintenance of such international telecommunications resources. CUCL and Unicom Group shall determine and agree which party is to provide maintenance service to the telecommunications facilities referred to in (b). Unless otherwise agreed by CUCL and Unicom Group, such maintenance service charges would be borne by CUCL. If Unicom Group is responsible for maintaining any telecommunications facilities referred to in (b), CUCL shall pay to Unicom Group the relevant maintenance service charges which shall be determined with reference to market rate, or where there is no market rate, shall be agreed between the parties and determined on a cost-plus basis. CUCL and Unicom Group agree to settle the net rental charges and service charges due to Unicom Group on a quarterly basis.

For the year ended 31 December 2016, the total charges paid by CUCL to Unicom Group amounted to approximately RMB281 million.

(2) Property Leasing

CUCL and Unicom Group agree to lease each other properties and ancillary facilities owned by CUCL or Unicom Group (including their respective branch companies and subsidiaries).

The rental charges payable by CUCL and by Unicom Group are based on market rates or the depreciation charges and taxes in respect of each property, provided that such depreciation charges and taxes shall not be higher than the market rate. The rental charges are payable quarterly in arrears and are subject to review every year to take into account the then prevailing market rate of the properties leased in that year.

For the year ended 31 December 2016, the rental charges paid by CUCL to Unicom Group amounted to approximately RMB1,050 million, and the rental charges paid by Unicom Group to CUCL was negligible.

(3) Value-added Telecommunications Services

Unicom Group (or its subsidiaries) agrees to provide the customers of CUCL with various types of value-added telecommunications services.

CUCL shall settle the revenue generated from the value-added telecommunications services with the branches of Unicom Group (or its subsidiaries) on the condition that such settlement will be based on the average revenue for independent value-added telecommunications content providers who provide value-added telecommunications content to CUCL in the same region. The revenue shall be settled on a monthly basis.

REPORT OF THE DIRECTORS

For the year ended 31 December 2016, the total revenue allocated to Unicom Group in relation to value-added telecommunications services amounted to approximately RMB42 million.

(4) **Materials Procurement Services**

Unicom Group agrees to provide comprehensive procurement services for imported and domestic telecommunications materials and other domestic non-telecommunications materials to CUCL. Unicom Group also agrees to provide services on management of tenders, verification of technical specifications, installation, consulting and agency services. In addition, Unicom Group will sell cable, modem and other materials operated by itself to CUCL and will also provide storage and logistics services in relation to the above materials procurement.

Charges for the provision of materials procurement services are calculated at the rate of:

- (a) up to 3% of the contract value of those procurement contracts in the case of domestic materials procurement; and
- (b) up to 1% of the contract value of those procurement contracts in the case of imported materials procurement.

The charges for the provision of materials operated by Unicom Group are determined by reference to the following pricing principles (the "Pricing Principles"):

- (a) the government fixed price;
- (b) where there is no government fixed price but a government guidance price exists, the government guidance price;
- (c) where there is neither a government fixed price nor a government guidance price, the market price; or

- (d) where none of the above is applicable, the price to be agreed between the parties and determined on a cost-plus basis.

The charges for the provision of storage and logistics services are determined by reference to the market price, which is determined by reference to the following:

- (a) the price charged by an independent third party providing the services in the same or nearby location in an ordinary business transaction; or
- (b) the price charged by an independent third party providing the services in mainland China in an ordinary business transaction.

The service charges due to Unicom Group will be settled on a monthly basis.

For the year ended 31 December 2016 the total charges paid by CUCL to Unicom Group amounted to approximately RMB88 million.

(5) **Engineering Design and Construction Services**

Unicom Group agrees to provide to CUCL engineering design, construction and supervision services and IT services. Engineering design services include planning and design, engineering inspection, telecommunications electronic engineering, telecommunications equipment engineering and corporate telecommunications engineering. Construction services include services relating to telecommunications equipment, telecommunications routing, power supplies, telecommunications conduit, and technical support systems. IT services include services relating to office automation, software testing, network upgrading, research and development of new business, and development of support systems.

REPORT OF THE DIRECTORS

The charges for the provision of engineering design and construction services are determined by reference to the market price, which is determined by reference to the following:

- (a) the price charged by an independent third party providing the services in the same or nearby location in an ordinary business transaction; or
- (b) the price charged by an independent third party providing the services in mainland China in an ordinary business transaction.

The service charges will be settled between CUCL and Unicom Group as and when the relevant services are provided.

For the year ended 31 December 2016, the total charges paid by CUCL to Unicom Group amounted to approximately RMB4,487 million.

(6) Ancillary Telecommunications Services

Unicom Group agrees to provide to CUCL ancillary telecommunications services, including certain telecommunications pre-sale, on-sale and after sale services such as assembling and repairing of certain telecommunications equipment, sales agency services, printing and invoice delivery services, maintenance of telephone booths, customers' acquisitions and servicing and other customers' services.

The charges payable are determined by reference to the Pricing Principles and are settled between CUCL and Unicom Group as and when the relevant services are provided.

For the year ended 31 December 2016, the total services charges paid by CUCL to Unicom Group amounted to approximately RMB2,541 million.

(7) Comprehensive Support Services

Unicom Group and CUCL agree to provide comprehensive support services to each other, including dining services, facilities leasing services (excluding those facilities which are provided under the Telecommunications Resources Leasing above), vehicle services, health and medical services, labour services, security services, hotel and conference services, gardening services, decoration and renovation services, sales services, construction agency, equipment maintenance services, market development, technical support services, research and development services, sanitary services, parking services, staff trainings, storage services, advertising services, marketing, property management services, information and communications technology services (including construction and installation services, system integration services, software development, product sales and agent services, operation and maintenance services, and consultation services).

The service charges payable are determined by reference to the Pricing Principles and are settled between CUCL and Unicom Group as and when the relevant services are provided.

For the year ended 31 December 2016, the total services charges paid by CUCL to Unicom Group amounted to approximately RMB1,690 million, and the total services charges paid by Unicom Group to CUCL amounted to approximately RMB51 million.

REPORT OF THE DIRECTORS

(8) Shared Services

Unicom Group and CUCL agree to provide shared services to each other, including, but not limited to, the following: (a) CUCL will provide headquarter human resources services to Unicom Group; (b) Unicom Group and CUCL will provide central business support services to each other; (c) CUCL will provide trust services related to the services referred to in (a) and (b) above to Unicom Group; and (d) Unicom Group will provide premises to CUCL and other shared services requested by its headquarters. In relation to the services referred to in (b) above, CUCL will provide support services, such as billing and settlement services provided by the business support centre and operational statistics reports. Unicom Group will provide support services, including telephone card production, development and related services, maintenance and technical support and management services in relation to the telecommunications card operational system.

Unicom Group and CUCL share the costs related to the shared services proportionately in accordance with their respective total assets value, except that the total assets value of the overseas subsidiaries and the listed company of Unicom Group will be excluded from the total asset value of Unicom Group. The shared costs proportion will be agreed between Unicom Group and CUCL in accordance with the total assets value set out in the financial statements provided to each other, as adjusted in accordance with their respective total assets value on an annual basis.

For the year ended 31 December 2016, the total services charges paid by CUCL to Unicom Group amounted to approximately RMB104 million, and the services charges paid by Unicom Group to CUCL was negligible.

For the financial year ended 31 December 2016, the above continuing connected transactions have not exceeded their respective annual caps.

The Company has formulated and strictly implemented various systems including the *Administrative Measures of Connected Transactions of China Unicom* to ensure that connected transactions are properly entered into in accordance with pricing mechanisms and the terms of the transactions are fair and reasonable and are in the interests of the Company and the Shareholders as a whole.

The staff from the relevant business departments and the connected persons of the Company will negotiate the pricing terms of the continuing connected transactions. These pricing terms will be determined in accordance with the pricing policy principles set out in the relevant comprehensive services agreement, which should be fair and reasonable and subject to the review of the finance department.

The legal department is responsible for the review of the agreement for connected transactions. The finance department takes the lead in the daily management and supervision of connected transactions, including liaising with the relevant business departments for account reconciliation with connected parties, monitoring the implementation of connected transactions together with business departments on a routine basis and performing supervisory examination. The finance department regularly reports the status of the implementation of connected transactions to the Audit Committee. The audit department includes review on connected transactions into the scope of annual internal control assessment and reports the results to the management.

REPORT OF THE DIRECTORS

Furthermore, the aforesaid continuing connected transactions have been reviewed by independent non-executive directors of the Company. The independent non-executive directors confirmed that the aforesaid continuing connected transactions were entered into (a) in the ordinary and usual course of business of the Group; (b) either on normal commercial terms or better or, if there are not sufficient comparable transactions to judge whether they are on normal commercial terms, on terms no less favourable to the Group than terms available to or from independent third parties; and (c) in accordance with the relevant agreements governing them on terms that are fair and reasonable and in the interests of the shareholders of the Company as a whole.

The Company's independent auditor was engaged to report on the Group's continuing connected transactions in accordance with Hong Kong Standard on Assurance Engagements 3000 "Assurance Engagements Other Than Audits or Reviews of Historical Financial Information" and with reference to Practice Note 740 "Auditor's Letter on Continuing Connected Transactions under the Hong Kong Listing Rules" issued by the Hong Kong Institute of Certified Public Accountants. The independent auditor has issued an unqualified letter containing his findings and conclusions in respect of the continuing connected transactions disclosed by the Group in pages 65 to 69 of this annual report in accordance with paragraph 14A.56 of the Listing Rules. The independent auditors' letter has confirmed that nothing has come to their attention that cause them to believe that the continuing connected transactions:

- (A) have not been approved by the Board;
- (B) were not, in all material respects, in accordance with the pricing policies of the Group as stated in this annual report;
- (C) were not entered into, in all material respects, in accordance with the relevant agreements governing the continuing connected transactions; and
- (D) have exceeded their respective annual caps for the financial year ended 31 December 2016 set out in the previous announcements of the Company.

A copy of the independent auditor's letter has been provided by the Company to the Hong Kong Stock Exchange.

The Company confirms that it has complied with the requirements of Chapter 14A of the Listing Rules in relation to all connected transactions and continuing connected transactions to which any Group member was a party during 2016. Please refer to Note 39 to the financial statements for a summary of the related party transactions entered into by the members of the Group for the year ended 31 December 2016.

On 25 November 2016, CUCL and Unicom Group entered into the 2017-2019 Comprehensive Services Agreement, pursuant to which, CUCL and Unicom Group agreed to provide services to each other or by one to the other, including (i) telecommunications resources leasing; (ii) property leasing; (iii) value-added telecommunications services; (iv) materials procurement services; (v) engineering design and construction services; (vi) ancillary telecommunications services; (vii) comprehensive support services; (viii) shared services; and (ix) financial services. The above continuing connected transactions will be for a term of three years from 1 January 2017 to 31 December 2019. The services referred to in items (i) to (viii) are existing continuing connected transactions and their respective terms (except the pricing terms) are substantially the same as those set out in the Comprehensive Services Agreement dated 24 October 2013 entered into by CUCL and Unicom Group. The relevant pricing terms were elaborated or amended with a view to complying with the guidance letter on pricing

REPORT OF THE DIRECTORS

policies for continuing connected transactions and their disclosure published by the Stock Exchange in March 2014 and aligning them with the transactions contemplated under the 2017-2019 Comprehensive Services Agreement. The financial services referred to in item (ix) are new continuing connected transactions, including deposit services, lending and other credit services, and other financial services.

For further details of the above 2017-2019 Comprehensive Services Agreement, please refer to the announcement of the Company dated 25 November 2016.

CORPORATE GOVERNANCE REPORT

Report on the Company's corporate governance is set out in "Corporate Governance Report" on pages 36 to 57.

MATERIAL LEGAL PROCEEDINGS

For the year ended 31 December 2016, the Company had not been involved in any material litigation, arbitration or administrative proceedings. So far as the Company is aware of, no such litigation, arbitration or administrative proceedings were pending or threatened as at 31 December 2016.

PUBLIC FLOAT

Based on publicly available information and so far as Directors are aware, the Company has maintained the specified amount of public float as required by the Hong Kong Stock Exchange during the year ended 31 December 2016 and as at the date of this annual report.

DONATIONS

For the year ended 31 December 2016, the Group made charitable and other donations in an aggregate amount of approximately RMB9.35 million.

CLOSURE OF REGISTER OF MEMBERS Attending the Annual General Meeting

The register of members of the Company will be closed from 5 May 2017 to 10 May 2017, both days inclusive, for the purpose of ascertaining the shareholders' rights to attend and vote at the Annual General Meeting of the Company to be held on 10 May 2017 (and any adjournment thereof) (the "AGM"). In order to qualify for attendance and voting at the AGM, all transfers, accompanied by the relevant certificates, must be lodged with the Company's Share Registrar, Hong Kong Registrars Limited, at Shops 1712-1716, 17th Floor, Hopewell Centre, 183 Queen's Road East, Wan Chai, Hong Kong, by no later than 4:30 p.m. of 4 May 2017.

INDEPENDENT AUDITOR

The Hong Kong financial reporting and U.S. financial reporting for the year ended 31 December 2016 have been audited by KPMG and KPMG Huazhen LLP, respectively, which retire and, being eligible, offer themselves for re-appointment at the 2017 annual general meeting. A resolution to re-appoint KPMG and KPMG Huazhen LLP and to authorise the Directors to fix their respective remuneration will be proposed at the 2017 annual general meeting.

By Order of the Board

Wang Xiaochu

Chairman and Chief Executive Officer

Hong Kong, 15 March 2017