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OPTIMISING INCENTIVE STRUCTURE TO BE MORE CLOSELY ALIGNED WITH
RESULTS AND PERFORMANCE

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 2017.

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 2017 are set out on pages 104 to 105 of this annual report.

Taking into consideration the Company’s profitability, debt and cash flow level and capital requirements for its future development, the Board has resolved to recommend at the forthcoming shareholders’ general meeting that the payment of a final dividend of RMB0.052 per ordinary share (“2017 Final Dividend”), totaling approximately RMB1,591 million for the year ended 31 December 2017. Going forward, the Company will continue to strive for enhancing its profitability and improving corporate efficiency and shareholders’ returns.

FINANCIAL INFORMATION

Please refer to the Financial Summary on pages 188 to 189 for the summary of the operating results, assets and liabilities of the Group for the five years ended 31 December 2017.

Please refer to the financial statements on pages 104 to 187 for the operating results of the Group for the year ended 31 December 2017 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 2017 is set out in the sections headed “Chairman’s Statement” on pages 10 to 17, “Business Overview” on pages 18 to 23, “Financial Overview” on pages 26 to 31, “Financial Statements” on pages 104 to 187, “Human Resources Development” on pages 90 to 91, “Social Responsibility” on pages 92 to 95, “Corporate Governance Report” on pages 42 to 66 and “Report of the Directors” on pages 70 to 87 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.

LOANS

Please refer to Notes 31, 36, 41.3 and 41.4 to the financial statements for details of the borrowings of the Group.

PROMISSORY NOTES

Please refer to Note 32 to the financial statements for details of the promissory notes of the Group.

CORPORATE BONDS

Please refer to Note 33 to the financial statements for details of the corporate bonds of the Group.

COMMERCIAL PAPERS

Please refer to Note 37 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 2017, 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 2017, no property, plant and equipment was pledged to banks as loan security (31 December 2016: Nil).

SHARE CAPITAL

Please refer to Note 28 to the financial statements for details of the share capital.

RESERVES

Please refer to page 108 and page 168 of this annual report for the movements in the reserves of the Group and the Company during the year ended 31 December 2017 respectively. As at 31 December 2017, the distributable reserve of the Company amounted to approximately RMB2,259 million (2016: approximately RMB1,421 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 108 of this annual report for the Consolidated Statement of Changes in Equity and page 168 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 2017 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 2017 represented approximately 28.1% 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 2017 accounted for approximately 49.7% 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 2017.

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;

“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 2017, 1,777,437,107 options were available for issue under the 2014 Share Option Scheme, representing approximately 5.81% 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 2017 and as at 31 December 2017, 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 2017, 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	0.0007%
Chung Shui Ming Timpson	Beneficial owner (Personal)	6,000	0.0000%

Save as disclosed in the foregoing, as at 31 December 2017, 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 2017, 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.

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

As at 31 December 2017, 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 Shareholders	Ordinary Shares Held		Percentage of Issued Shares
	Directly	Indirectly	
(i) China United Network Communications Group Company Limited (“Unicom Group”) ^{1,2}	–	24,683,896,309	80.67%
(ii) China United Network Communications Limited (“Unicom A Share Company”) ¹	–	16,376,043,282	53.52%
(iii) China Unicom (BVI) Limited (“Unicom BVI”) ¹	16,376,043,282	–	53.52%
(iv) China Unicom Group Corporation (BVI) Limited (“Unicom Group BVI”) ^{2,3}	8,082,130,236	225,722,791	27.15%

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 26.41% 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 0.74% 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 2017, 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 28 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 2017, 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

Shao Guanglu (appointed on 16 March 2017)

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. Li Fushen, Mr. Chung Shui Ming Timpson, and Mrs. Law Fan Chiu Fun Fanny 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 2017, 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 32 to 39 of this annual report for further details.

Mr. Wang Xiaochu, chairman of the Board and Chief Executive Officer of the Company, has served as a director of Telefónica S.A. since September 2015. Mr. Cesareo Alierta Izuel is a director of Telefónica Audiovisual Digital, S.L.U., which is an affiliate of Telefónica, S.A.

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 directors of PCCW Limited since November 2011. Mr. Lu Yimin 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. Mr. Shao Guanglu, an executive Director and Senior Vice President of the Company, has served as a non-executive director of PCCW Limited since March 2017.

Each of Telefónica S.A., 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 2017 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 2017 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 2017, the Group had approximately 251,786 employees, 588 employees and 181 employees in Mainland China, Hong Kong and other countries, respectively. Furthermore, the Group had approximately 15,035 temporary staff in Mainland China. For the year ended 31 December 2017, employee benefit expenses were approximately RMB 42.471 billion (for the year ended 31 December 2016: RMB36.907 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.

CONNECTED TRANSACTION - ISSUE OF NEW SHARES

On 22 August 2017, the Company and Unicom BVI entered into a share subscription agreement. The completion of allotment and issuance of the subscription shares took place on 28 November 2017. 6,651,043,262 new ordinary shares of the Company have been issued for a cash consideration of HKD13.24 per share to Unicom BVI and the gross proceeds amounted to HKD88,059.81 million (equivalent to approximately RMB74,953.87 million) and the net issue price amounted to HKD13.24 each. The closing price was HKD12.04 per share as quoted on the Hong Kong Stock Exchange as at the date of the share subscription agreement. Details of such issue have been disclosed in the circular dated 28 August 2017.

The share subscription is part of the mixed ownership reform plan implemented by Unicom Group. Through integrated planning on the mixed ownership reform plan, Unicom A Share Company actively introduced strategic investors which are engaged in businesses that are highly correlated with and complementary to the principal businesses of Unicom A Share Company and which reduced the state-owned shareholding in Unicom A Share Company, so as to progress with the mixed ownership reform. Through implementing the mixed ownership reform plan, Unicom A Share Company expects to further optimise its corporate governance in accordance with the market-oriented principles, focus on the development of its principal businesses, establish an innovative business model and further develop innovative businesses, so as to improve and enhance its overall efficiency and competitiveness and to achieve its strategic goals.

Report of The Directors

As disclosed in the circular in relation to the subscription of new shares by Unicom BVI issued by the Company on 28 August 2017, the use of proceed was intended to be utilised for the following purposes:

- (a) approximately HKD46,777.96 million (equivalent to approximately RMB39,816 million) for upgrading the 4G network capabilities of the Company, which involves the upgrading of the transmission capacity of existing nationwide 4G network, construction of new 4G stations, improving the interoperation with 5G network and construction of transmission network in connection with the interoperation;
- (b) approximately HKD23,011.85 million (equivalent to approximately RMB19,587 million) for technology validation and enablement and launch of trial programs in relation to the 5G network, which involve research, development and validation of 5G network related technologies, construction of 5G trial stations and establishment of basic 5G network capability;
- (c) approximately HKD2,728.01 million (equivalent to approximately RMB2,322 million) for developing innovative businesses, which involves the establishment of specialised teams and business platforms to back up the development of cloud computing, big data, the Internet of Things, industrial Internet, payment finance, video and other businesses; and
- (d) approximately HKD15,538.98 million (equivalent to approximately RMB13,226 million) for the repayment of the outstanding principal amount of loans obtained from the banks.

As at 31 December 2017, RMB19,902 million of the proceeds has been utilised for the following purposes:

(Unit: RMB, million)

Intended use of proceeds as set out in the circular	Intended amounts to be utilised as set out in the circular	Actual amounts utilised for the year ended 31 December 2017	Amounts not yet utilised as at 31 December 2017 (Note 1)
Upgrading the 4G network capabilities	39,816	6,580	33,236
Technology validation and enablement and launch of trial programs in relation to the 5G network	19,587	–	19,587
Developing innovative businesses	2,322	96	2,226
Repayment of the principal amount of loans	13,226	13,226	–

Note 1: As at 31 December 2017, approximately RMB55,049 million of the proceeds from issuance remains unused, which was temporarily used to supplement the Company's working capital. The remaining proceeds will be utilised according to the use of proceeds disclosed in the circular and the actual development plan of projects.

CONTINUING CONNECTED TRANSACTIONS

On 25 November 2016, China United Network Communications Corporation Limited (“CUCL”), a wholly-owned subsidiary of the Company, and Unicom Group entered into a comprehensive services agreement (the “2017-2019 Comprehensive Services Agreement”) to renew certain continuing connected transactions 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 are new continuing connected transactions, including deposit services, lending and other credit services, and other financial services. Pursuant to the 2017-2019 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 2017-2019 Comprehensive Services Agreement is valid for a term of three years starting from 1 January 2017 and expiring on 31 December 2019. Unicom Group is the ultimate controlling shareholder of the Company and is therefore a connected person of the Company under the Listing Rules.

Details of the continuing connected transactions under the 2017-2019 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 on-going 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. When determining the pricing standard or reasonable profit margin, to the extent practicable, management of the Company shall take into account the rates of at least two similar and comparable transactions entered with or carried out by Independent Third Parties or relevant industry profit margins in the corresponding period of reference. 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 2017, the total charges paid by CUCL to Unicom Group amounted to approximately RMB270 million.

Report of The Directors

(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 for the leasing of each other properties and ancillary facilities are based on market rates. Where there is no market rate or it is not possible to determine the market rate, the rate shall be negotiated and agreed between the two parties. Market rates refer to the rates at which the same or similar type of products or services are provided by Independent Third Parties in the ordinary course of business and under normal commercial terms. Negotiated rates refer to the rates based on the reasonable costs plus the amount of the relevant taxes and reasonable profit margin. When determining the pricing standard or reasonable profit margin, to the extent practicable, management of the Company shall take into account the rates of at least two similar and comparable transactions entered with or carried out by Independent Third Parties in the corresponding period of reference. The rental charges are payable quarterly in arrears.

For the year ended 31 December 2017, the rental charges paid by CUCL to Unicom Group amounted to approximately RMB1,017 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.

For the year ended 31 December 2017, the total revenue allocated to Unicom Group in relation to value-added telecommunications services amounted to approximately RMB30 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, and the pricing and/or charging standard of various materials procurement services, and storage and logistics services commission relevant to the direct material procurement are based on the market rates. Where there is no market rate or it is not possible to determine the market rate, the rate will be negotiated and agreed between the two parties. Market rates refer to the rates at which the same or similar type of assets or services is provided by Independent Third Parties in the ordinary course of business and under normal commercial terms. Negotiated rates refer to the rates based on the reasonable costs incurred in providing the services plus the amount of the relevant taxes and reasonable profit margin. When determining the pricing standard or "reasonable profit margin", to the extent practicable, management of the Company shall take into account the rates of at least two similar and comparable transactions entered into with Independent Third Parties in the corresponding period or the relevant industry profit margin for reference. The service charges due to Unicom Group will be settled on a monthly basis.

For the year ended 31 December 2017 the total charges paid by CUCL to Unicom Group amounted to approximately RMB60 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.

The charges for the provision of engineering design and construction services are based on market rates. Market rates refer to the rates at which the same or similar type of products or services are provided by Independent Third Parties in the ordinary course of business and under normal commercial terms. When determining the pricing standard, to the extent practicable, management of the Company shall take into account the rates of at least two similar and comparable transactions entered with or carried out by Independent Third Parties in the corresponding period of reference. In the event the recipient will determine the specific provider of engineering design and construction services through tender, the provider will be no less qualified and equipped than the Independent Third Parties, and will participate in the tender procedure in a similar manner as the Independent Third Parties. Under such circumstances, the pricing will be determined by the final rate according to the tender procedure.

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 2017, the total charges paid by CUCL to Unicom Group amounted to approximately RMB2,411 million.

Report of The Directors

(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 client 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 for the provision of ancillary telecommunications services are determined by the market rates between the two parties. Where there is no market rate or it is not possible to determine the market rates, the rate will be negotiated and agreed between the two parties. Market rates refer to the rates at which the same or similar type of assets or services are provided by Independent Third Parties under normal commercial terms. Negotiated rates refer to the rates based on the reasonable costs plus the amount of the relevant taxes and reasonable profit margin. When determining the pricing standard or "reasonable profit margin", to the extent practicable, management of the Company shall take into account the rates of at least two similar and comparable transactions entered into with Independent Third Parties in the corresponding period or the relevant industry profit margin for reference. 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 2017, the total services charges paid by CUCL to Unicom Group amounted to approximately RMB2,699 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 are determined by the market rates between the two parties. Where there is no market rate or it is not possible to determine the market rate, the rate will be negotiated and agreed between the two parties. Market rates refer to the rates at which the same or similar type of assets or services are provided by Independent Third Parties under normal commercial terms. Negotiated rates refer to the rates based on the reasonable costs plus the amount of the relevant taxes and reasonable profit margin. When determining the pricing standard or reasonable profit margin, to the extent practicable, management of the Company shall take into account the rates of at least two similar and comparable transactions entered into with Independent Third Parties in the corresponding period or the relevant industry profit margin for reference. 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 2017, the total services charges paid by CUCL to Unicom Group amounted to approximately RMB1,274 million, and the total services charges paid by Unicom Group to CUCL amounted to approximately RMB67 million.

(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 business support centre services to each other; (c) CUCL will provide hosting 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 2017, the total services charges paid by CUCL to Unicom Group amounted to approximately RMB83 million, and the services charges paid by Unicom Group to CUCL was negligible.

(9) Financial Services

CUCL or its subsidiaries agrees to provide financial services to Unicom Group, including deposit services, lending and other credit services, and other financial services. Other financial services include settlement services, acceptance of bills, entrusted loans, credit verification, financial and financing consultation, consultation, agency business, approved insurance agent services, and other businesses approved by China Banking Regulatory Commission.

The key pricing policies are follows:

(a) Deposit Services

The interest rate for Unicom Group's deposit with CUCL or its subsidiaries will be no more than the maximum interest rate promulgated by the People's Bank of China for the same type of deposit, the interest rate for the same type of deposit offered to other clients and the applicable interest rate offered by the general commercial banks in PRC for the same type of deposit.

(b) Lending and other credit services

The lending interest rate will follow the interest rate standard promulgated by the People's Bank of China, and will be no less than the minimum interest rate offered by CUCL and its subsidiaries to other clients for the same type of loan, and the applicable interest rate offered to Unicom Group by the general commercial banks in PRC for the same type of loan. For the year ended 31 December 2017, the maximum daily lending and other credit services balance (including accrued interests) amounted to approximately RMB704 million.

Report of The Directors

(c) **Other financial services**

The fees to be charged by CUCL or its subsidiaries for the provision of the financial services to Unicom Group will comply with the relevant prescribed rates for such services as determined by the People's Bank of China or the China Banking Regulatory Commission. Where no relevant prescribed rate is applicable, the fee will be determined with reference to market rates of similar financial services charges and agreed between the parties.

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

For the financial year ended 31 December 2017, the above continuing connected transactions have not exceeded their respective 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 2017–2019 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.

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 79 to 84 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 caps for the financial year ended 31 December 2017 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 2017. Please

refer to Note 41 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 2017.

CORPORATE GOVERNANCE REPORT

Report on the Company's corporate governance is set out in "Corporate Governance Report" on pages 42 to 66.

MATERIAL LEGAL PROCEEDINGS

As a company incorporated in Hong Kong and dual-listed in Hong Kong and the United States, the Company adopts the Companies Ordinance of Hong Kong, the Securities and Futures Ordinance of Hong Kong, Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited, the regulatory requirements for non-US companies listed in the United States, the Company's Articles of Association and other related laws and regulations as the basic guidelines for the Company's corporate governance.

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. The Company is required to comply with the Telecommunications Regulations of the People's Republic of China, Administrative Regulations on Telecommunications Companies with Foreign Investments, Cybersecurity Law of the People's Republic of China and other related laws and regulations. At the same time, oversea subsidiaries of the Company are also required to comply with the related laws and regulations where their business operations are located.

For the year ended 31 December 2017, 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 2017.

Report of The Directors

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 2017 and as at the date of this annual report.

DONATIONS

For the year ended 31 December 2017, the Group made charitable and other donations in an aggregate amount of approximately RMB12.65 million.

CLOSURE OF REGISTER OF MEMBERS

For the purpose of ascertaining the shareholders' rights to attend and vote at the Annual General Meeting (and any adjournment thereof), and entitlement to the 2017 Final Dividend, the register of members of the Company will be closed. Details of such closures are set out below:

(1) For ascertaining the shareholders' rights to attend and vote at the Annual General Meeting:

Latest time to lodge transfer documents for registration	4:30 p.m. of 4 May 2018
Closure of register of members	From 7 May 2018 to 11 May 2018
Record date	7 May 2018

(2) For ascertaining the shareholders' entitlement to the 2017 Final Dividend:

Latest time to lodge transfer documents for registration	4:30 p.m. of 17 May 2018
Closure of register of members	18 May 2018
Record date	18 May 2018

During the above closure periods, no transfer of shares will be registered. To be eligible to attend and vote at the Annual General Meeting, and to qualify for the 2017 Final Dividend, 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 the aforementioned latest times.

WITHHOLDING AND PAYMENT OF ENTERPRISE INCOME TAX FOR NON-RESIDENT ENTERPRISES IN RESPECT OF 2017 FINAL DIVIDEND

Pursuant to (i) the "Notice Regarding Matters on Determination of Tax Residence Status of Chinese-controlled Offshore Incorporated Enterprises under Rules of Effective Management" (the "Notice") issued by the State Administration of Taxation of the People's Republic of China (the "SAT"); (ii) the "Enterprise Income Tax Law of the People's Republic of China" (the "Enterprise Income Tax Law") and the "Detailed Rules for the Implementation of the Enterprise Income Tax Law of the People's Republic of China" (the "Implementation Rules"); and (iii) information obtained from the SAT, the Company is required to withhold and pay enterprise income tax when it pays the 2017 Final Dividend to its non-resident enterprise shareholders. The enterprise income tax is 10% on the amount of dividend paid to non-resident enterprise shareholders (the "Enterprise Income Tax"), and the withholding and payment obligation lies with the Company.

As a result of the foregoing, in respect of any shareholders whose names appear on the Company's register of members on the Dividend Record Date and who are not individuals (including HKSCC Nominees Limited, other custodians, corporate nominees and trustees such as securities companies and banks, and other entities or organisations), the Company will distribute the 2017 Final Dividend payable to them after deducting the amount of Enterprise Income Tax payable on such dividend. Investors who invest in the shares in the Company listed on the Main Board of The Stock Exchange of Hong Kong Limited through the Shanghai Stock Exchange or Shenzhen-Hong Kong Stock Exchange (the Shanghai-Hong Kong Stock Connect or Shenzhen-Hong Kong Stock Connect investors) are investors who hold shares through HKSCC Nominees Limited, and in accordance with the above requirements, the Company will pay to HKSCC Nominees Limited the amount of the 2017 Final Dividend after deducting the amount of Enterprise Income Tax payable on such dividend.

In respect of any shareholders whose names appear on the Company's register of members on the Dividend Record Date and who are individual shareholders, there will be no deduction of Enterprise Income Tax from the dividend that such shareholder is entitled to.

Shareholders who are not individual shareholders listed on the Company's register of members and who (i) are resident enterprises of the People's Republic of China (the "PRC") (as defined in the Enterprise Income Tax Law), or (ii) are enterprises deemed to be resident enterprises of the PRC in accordance with the Notice, and who, in each case, do not desire to have the Company withhold Enterprise Income Tax from their 2017 Final Dividend, should lodge 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, at or before 4:30 p.m. of 17 May 2018, and present the documents from such shareholder's governing tax authority in the

PRC confirming that the Company is not required to withhold and pay Enterprise Income Tax in respect of the dividend that such shareholder is entitled to.

If anyone would like to change the identity of the holders in the register of members, please enquire about the relevant procedures with the nominees or trustees. The Company will withhold for payment of the Enterprise Income Tax for its non-resident enterprise shareholders strictly in accordance with the relevant laws and requirements of the relevant government agencies and adhere strictly to the information set out in the Company's register of members on the Dividend Record Date. The Company assumes no liability whatsoever in respect of and will not process any claims, arising from any delay in, or inaccurate determination of, the status of the shareholders, or any disputes over the mechanism of withholding.

INDEPENDENT AUDITOR

The Hong Kong financial reporting and U.S. financial reporting for the year ended 31 December 2017 have been audited by KPMG and KPMG Huazhen LLP, respectively, which retire and, being eligible, offer themselves for re-appointment at the 2018 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 2018 annual general meeting.

By Order of the Board

Wang Xiaochu

Chairman and Chief Executive Officer

Hong Kong, 15 March 2018