

CHAIRMAN'S STATEMENT



WANG XIAOCHU
Chairman and Chief Executive Officer



DEAR SHAREHOLDERS,

In the first half of 2016, the Company endeavoured to attain long-term sustainable development, actively promoted the implementation of the new development strategy centered on “Focus, Cooperation and Innovation” and strived to mitigate the underlying shortcomings, such as network, terminals, channels, services, IT, systems and mechanisms. The Company achieved initial success in turning around the unfavorable conditions in business development and saw the emergence of positive business momentum. A more solid foundation has been built for healthy development in the future with stronger growth momentum.

OVERALL RESULTS

In the first half of 2016, service revenue of the Company bottomed out and reached RMB121.91 billion, up by 1.4% year-on-year and 6.0% half-on-half. Revenues from non-voice services accounted for 73.1% of the service revenue, representing a year-on-year increase of 4.8 percentage points, evidencing further optimisation of the revenue structure.

To promote long-term sustainable development, the Company braved short-term profit pressure, strengthened its fundamental capabilities, and increased cost initiatives as appropriate to strive for a gradual turnaround. During the first half of the year, the Company's EBITDA amounted to RMB41.28 billion, down by 18.2% year-on-year and up by 11.5% half-on-half, and accounted for 33.9% of the service revenue. Net profit of the Company was RMB1.43 billion, down by 79.6% year-on-year. The year-on-

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year decline in EBITDA and net profit was mainly because sales and marketing expenses increased significantly year-on-year during the period, and tower usage fee kick-in, higher energy charges and property rentals, etc. led to a substantial increase year-on-year in network, operation and support expenses. Compared to the loss attributable to equity shareholders of the Company (excluding the gain on disposal of tower assets) of approximately RMB3.36 billion in the second half of last year, net profit for the first half of this year showed substantial improvement.

Leveraging our own resources and strengths and through "Focus Strategy" and cooperation, the Company swiftly enhanced its network capabilities despite decline of capital expenditure by 39% year-on-year to RMB18.10 billion in the first half of the year. Benefitted from the gradual improvement in service revenue and the substantial decline in capital expenditure, free cash flow of the Company improved significantly and reached RMB23.83 billion; liabilities-to-assets ratio dropped by 0.2 percentage point to 61.9%.

Taking into account the Company's profitability, debt obligations and cash flows, capital required for future development, etc., the Board of Directors does not recommend the payment of interim dividend for the current year. The Board will submit a proposal for final dividend payment based on our overall results for the year for consideration at the shareholders' general meeting.

BUSINESS DEVELOPMENT

Mobile Service Sets to Accelerate as 4G Gaining Edge

In the first half of 2016, the Company achieved initial success in overcoming operational challenges. Mobile service revenue reached RMB73.04 billion, the decline of which narrowed from -8.0% last year to -0.6% during the period. The number of mobile billing subscribers turned around the downward trend for consecutive months last year, registering a net addition of 8.39 million and reaching a total of 260.70 million mobile billing subscribers. During the first half of the year, the Company expedited the 4G network construction with a focus on key areas and capitalised on the abundant handset line-up to drive subscriber upgrade. The Company also sped up the migration of 2G/3G users to 4G, and strengthened the integrated development of 4G, fixed-line broadband, video and applications, etc. to enhance customer experience and value. Sales capability was fully enhanced through target marketing, improved services and innovative business models. With the improvement in 4G network quality, terminal market share and competitiveness, the number of 4G subscribers of the Company witnessed a rapid growth with a net increase of 28.26 million in the first half of the year to a total of 72.42 million. Improvement in the mobile subscriber mix accelerated with the proportion of 4G subscribers to mobile billing subscribers increasing to 28% from 18% as at the end of last year. Mobile billing subscribers ARPU steadily improved. The mobile service growth is set to accelerate.



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Sustained Growth in Fixed-lined Service Amid Fierce Competition, Leveraging High-Bandwidth and Video Offerings

The Company actively leveraged its advantages in fibre network and informatisation to accelerate the development of its high-growth businesses such as Internet Data Centre (IDC), Information and Communications Technology (ICT), value-added and integrated information services, mitigating the risk of revenue decline in fixed-line voice. The Company continued to strengthen its integrated services offering including fixed-line, mobile and informatisation, and promoted the synergetic developments across various services. In the first half of the year, the fixed-line service revenue increased by 4.4% year-on-year to RMB48.23 billion, of which fixed-line voice revenue accounted for 14%, further lowering the impact of decline in fixed-line voice.

Faced with fierce market competition in the fixed-line broadband, the Company proactively strengthened and enhanced its differentiated competitive edge of "quality plus service" in the broadband service, upgraded network speed for subscribers, enriched offerings of high-bandwidth content and applications including 4K high-definition videos, improved end-to-end network user perception and service experience, and leveraged "Smart WO Family" to accelerate growth in innovative service for home Internet. In the first half of the year, the Company's fixed-line broadband access revenue amounted RMB22.23 billion, flat year-on-year, and fixed-line broadband subscribers increased by 4.7% year-on-year to 73.94 million, of which 62% were Fibre-to-the-home (FTTH) subscribers. "Smart WO Family" subscribers accounted for 21% of the fixed-line broadband subscribers, up by 8 percentage points compared to the end of last year.

Foster Scale Development in Key Innovative Services

The Company actively created new growth engines in innovative service, focusing on platform-based services and industrial Internet, and pushed forward development of innovative service including Internet of Things, IDC and cloud computing, Big Data, industry applications, payment/finance and so on. The Company expedited the informatisation deployment in key industries by setting up 7 industrial Internet bases and 9 incubators centered on 8 major areas, and won a number of large scale Internet+ projects. The Company accelerated overseas extension of IDC and cloud platform, enhancing business expansion capability. In the first half of the year, the Company's IDC and cloud computing revenue reached RMB4.76 billion, up 39% year-on-year. ICT revenue reached RMB3.28 billion, up 34% year-on-year.

The Company continued to innovate on data traffic operation, actively promoted its WO+ open capabilities, and facilitated the scale operation of dedicated and backward data traffic monetisation. In the first half of the year, the mobile handset data usage of the Company increased by 102% year-on-year; the monthly average DOU per 4G subscriber reached 1,246MB.

NETWORK DEPLOYMENT

Focusing on key areas and key services such as 4G and fixed-line broadband, the Company deepened cooperation and resources sharing to effectively deploy premium network. In the first half of the year, the proportion of investment in 4G network of the Company increased from 25% last year to 48%, with a net increase of 189,000 4G base stations to a total of 588,000. Leading advantage in network coverage, quality and speed in core areas gradually emerged, and user perception of network improved rapidly, building up foundation capabilities for accelerated development in the mobile service. As a result of an accelerated push in fibre broadband network upgrade, eight provinces in Northern China achieved "all fibre network", and city areas basically have access capability to 100Mbps connection. The Company continued to enhance its basic network capabilities such as transmission and carrying network.



DEEPENED COOPERATION AND INNOVATIVE TRANSFORMATION

The Company actively promoted open cooperation in various aspects. It pushed forward comprehensive and strategic cooperation with China Telecom to facilitate resources sharing within the industry, promote cost-effectiveness, efficiency and rapid improvement in the network capability. In the meantime, the Company also promoted 6-mode all-access terminals together with China Telecom and unified the standards for 4K smart set-top box and broadband service to further enhance service quality.

The Company deepened innovation in its systems and mechanisms. For the fundamental services, the Company promoted simplification of administration and pushed forward appropriate delegation and empowerment. For the innovative services, it will promote the innovation of corporate governance mechanism, systems and organisational structure of its professional subsidiaries. The Company also improved the service capability of its IT systems; optimised the staff promotion and incentive system and the staff structure; initiated internal innovation incubation projects; facilitated cost control and efficiency enhancement, and continuously lifted management efficiency and operational vibrancy.

CORPORATE GOVERNANCE AND SOCIAL RESPONSIBILITY

The Company insists on its aim of high standard in corporate governance. It continued to improve internal control and risk management, strengthen execution, and increase corporate transparency, leading to wide-spread recognition in the capital market for its efforts in management and corporate governance. This year, the Company was awarded a number of accolades, including "Asia's No.1 Best Managed Company – TMT Sector" by *FinanceAsia*, and "Asia's No. 1 Most Honored Telecom Company" by *Institutional Investor*.

The Company has long been dedicated to fulfilling its social responsibility. It actively supported the construction of smart cities and development of information technologies that benefit the livelihood of the general public, facilitating the progress of national informatisation and the transformation and upgrade of traditional industries. The Company innovated its service model, and built a green and secure network environment to provide reliable and convenient services to customers. Through energy conservation, emission reduction, resources co-building and co-sharing and deepened cooperation across the value chain, the Company strived to become a green and environmental-friendly enterprise. The Company also promoted fairness and harmony, cared about the career development and all-round growth of its employees, continued to engage in targeted poverty relief, donation and scholarship activities to contribute to society and establish a positive social image of the Company.





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OUTLOOK

Currently, the Company is undergoing a new stage of transformation, and facing both opportunities and challenges. As the government is vigorously promoting the integration of information technology and traditional industries to accelerate the development of new economy and nurture new driving forces, enormous market potential for the Internet of Things, cloud computing and Big Data, etc. are opening up. There is still room for mobile service consumption upgrade. In particular, businesses with significant growth prospects including data traffic, video service, smart applications, will become the key growth drivers. All of them provide major market opportunities for the Company's development. In the meantime, the traditional telecommunications sector is becoming saturated, and commoditised competition within the domestic telecommunications industry is intensifying. Cross-industry integration under new industry dynamics is exerting ever increasing pressure on the telecommunications industry. Policies such as "Speed Upgrade and Tariff Reduction" are also imposing certain challenges on the Company's business development and financial results improvement. The Company needs to firmly grasp favorable window of opportunity to swiftly overcome the difficulties.

We are more than confident in our future development. The Company will persist in its strategic focus and further deepen implementation of Focus Strategy, step up the improvement of capabilities in marketing, network support, operations and management. The Company aims to drive continuous improvement in operational performance with continuous enhancement in its basic capabilities, and speed up the turnaround in financial performance. The Company will deploy premium network with craftsmanship spirit, accelerate the development of selective advantages for its mobile network in key areas, proceed with fibre upgrade of its fixed-line broadband network steadily, and fully enhance its service support capability. The Company will pragmatically lay a solid foundation for its operation, expedite 4G development to drive mobile service growth, enhance the value of broadband products with high-quality applications to drive stable growth in fixed-line service, and create new growth engines with scale development in key innovative service. The Company will speed up implementation of cooperation projects, extend the width and depth of cooperation, expand the scale of social cooperation to realise solid achievement in cooperation. We will also deepen reform in systems and mechanisms, strengthen corporate culture establishment, lift corporate vibrancy, deepen quality and efficiency improvement, and enhance refined management capability of the Company to continuously enhance shareholder value.



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Lastly, on behalf of the Board of Directors of the Company, I would like to express my sincere gratitude to all shareholders, customers and friends across the society for their support to the Company, and to all employees for their dedication and contribution along the way!

Wang Xiaochu

Chairman and Chief Executive Officer

Hong Kong, 17 August 2016

Note 1: EBITDA represents profit for the period before finance costs, interest income, share of net losses of associates, share of net profit/(loss) of joint ventures, other income-net, income tax, depreciation and amortisation. As the telecommunications business is a capital intensive industry, capital expenditure and finance costs may have a significant impact on the net profit of the companies with similar operating results. Therefore, the Company believes that EBITDA may be helpful in analysing the operating results of a telecommunications service operator like the Group.

