

NETWORK INTELLIGENTISATION

RECONSTITUTION of

NETWORK



Chairman's Statement



Yang Jie

Chairman and Chief Executive Officer

Intelligent service era is coming soon! As a leading telecommunications service provider, we take the lead to step up in transformation and upgrades introduced by intelligence. We shall seize the opportunities brought about by the new era. We shall build a flexible and simplified intelligent network, nurture service ecology satisfying different customer needs, and at the same time inject intelligence into operation & management, to enhance efficiency and return. We shall dedicate to innovation and advance ourselves timely for creation of more shareholders' value!

In 2016, with a coherent goal to step forward with keen determination, the Company strived to devote all efforts to firmly seize the favorable opportunity of information consumption upgrade and proactively responded to the complicated environments and circumstances, effectively tackling various pressures and challenges and successfully embarking on a new stage of corporate development. Adhering to explore for new development with cohesive efforts, scale and effectiveness were remarkably enhanced while development capabilities were continuously accumulated. With our unwavering perseverance in promoting reforms, the vitality of our employees was comprehensively exploded and intrinsic momentum was consistently reinforced. With detailed analysis in strategies planning for future vision, the Company promptly deployed the new direction to become the pioneer and embraced the new intellectual era in full strengths.

Overall results

In 2016, the Company achieved impressive results. Operating revenues amounted to RMB352.3 billion, representing an increase of 6.4% over last year. Service revenues¹ amounted to RMB309.6 billion, representing an increase of 5.6% over last year, achieving continuous improvement in growth rate. Emerging businesses accounted for 40% of service revenues, representing an increase of over 5 percentage points over last year with continual rapid optimisation in business structure. EBITDA² was RMB95.1 billion while EBITDA margin² was 30.7%. Net profit³ was RMB18.0 billion, representing an increase of 11.7% as compared to the net profit³ for the year 2015 excluding the one-off gain from the disposal of tower assets. Basic earnings per share were RMB0.22. Capital expenditure was RMB96.8 billion, representing a decrease of 11.3% over last year while free cash flow⁴ was -RMB7.7 billion with remarkable improvement over last year.

Taking into consideration the return to shareholders, the Company's profitability, cash flow level and capital requirements for its future development, the Board of Directors has decided to recommend at the forthcoming shareholders' meeting to appropriately increase the dividend level, that a dividend equivalent to HK\$0.105 per share for the year 2016 to be declared.

Raise
OPS 
by
10.5%
to
HK\$ **0.105**

¹ Service revenues were calculated based on operating revenues minus sales of mobile terminals, sales of wireline equipment and other non-service revenues.

² EBITDA was calculated based on operating revenues minus operating expenses plus depreciation and amortisation while EBITDA margin was calculated based on EBITDA divided by service revenues.

³ Net profit refers to the profit attributable to equity holders of the Company. Excluding the one-off gain from the disposal of tower assets amounted to approximately RMB3.9 billion, the net profit for the year 2015 was RMB16.1 billion.

⁴ Free cash flow was calculated based on EBITDA minus capital expenditure and income tax.

Rising to the challenges, operational development leaped forward to a new landmark

In 2016, facing intensified market competition, the Company adopted a proactive marketing strategy and placed emphasis on two fundamental businesses namely 4G and fibre broadband as well as five emerging areas namely e-Surfing HD, BestPay, Internet of Things, cloud and Big Data and "Internet+" ("2+5"). With perseverance in integration and innovation as well as comprehensive products upgrade, we maintained our leading position in services and accelerated scale breakthrough. Operational development leaped forward to a new landmark.

Strong growth in 4G business to enhance the strengths of mobile business

Persevering with optimisation of existing customers, the Company comprehensively accelerated the users to upgrade their service from 3G to 4G. Through proactive expansion of customer acquisition, we strengthened integration to explore new markets. Aiming at all-round reinforcing business capabilities, we firmly seized the terminal benefits from "multi-mode" handsets, enhanced the sales capabilities of the entire channel and optimised the data traffic operation strategies. As a result, mobile business achieved rapid upgrade while scale and values were remarkably enhanced. The net increase of mobile subscribers for the year was 17.10 million, reaching a total of 215 million and accounting for 16.2% market share, representing an increase of 0.7 percentage points from the end of last year. The total number of 4G users doubled and reached a total of 122 million while the penetration rate reached 57%, accounting for 16.0% market share and representing

an increase of 1.9 percentage points from the end of last year. The sales volume of 4G handsets for the year exceeded 100 million, of which more than 80% represented sales of "multi-mode" handsets. The aggregate handset Internet data traffic for the year increased by 130% over last year, of which the aggregate 4G handset Internet data traffic increased nearly 3 times. The monthly average data traffic per 4G user entered a GB era. The mobile handset Internet access revenues for the year increased by 43% over last year, promoting steady improvement in mobile ARPU while the mobile service revenues increased by 10.5% over last year, outperforming the industry growth.

Accelerated penetration of fibre broadband to promote intelligent upgrade in broadband

The Company persisted to adhere to differentiated competitive strategies. Driven by Hundred-Mbps products with trial run of Gbps products, the Company accelerated the transformation of network edges into market competitive capabilities. Through persistent promotion of end-to-end bandwidth upgrade and provision of premier service throughout the entire services process, we established high-quality brand image of broadband services. With deepened integration of Fibre-to-the-Home (FTTH) and "Smart Family" products, we offered all-in-one home entertainment and intelligent applications services to enhance the overall business values. The subscribers scale achieved rapid breakthrough for the year and the Company continued to maintain a leading position in the market. The net increase of wireline broadband subscribers was 10.06 million, reaching a total of 123 million. Of which the total number of FTTH subscribers was 106 million, representing a net increase of 35 million and the penetration rate reached 86%. The wireline broadband access revenues for the year increased by 3.3% over last year with good momentum in business development.

Rapid development in emerging businesses to construct future growth engines

With persistent and unwavering determination in innovation and integration and leveraging the advantages of its own strengths and resources endowment, the Company internally strengthened efficiently-centralised integration while externally expanded open cooperation, resulting in accelerated expansion in growth potential of new emerging businesses. With rapid breakthrough in the scale of e-Surfing HD, the revenues for the year increased by 24% over last year. The net increase of e-Surfing HD subscribers was 20.95 million, reaching a total of 61.33 million. The number of average monthly active users of "BestPay" increased more than 3 times over last year. The gross merchandise value of "BestPay" for the year increased by approximately 30% over last year, exceeding RMB1 trillion. Internet of Things (IoT) business was rapidly developed, achieving efficient centralisation for the entire network. The net increase of IoT connected devices for the year was 13.21 million. Cloud and Big Data business maintained rapid development momentum. The revenues of cloud and Big Data business for the year increased by 55% over last year. The "Internet+" business achieved scale expansion with remarkable strengthening of the influences in the areas including government administration, education, health and medical care and industrial Internet.

Continual deepening in reforms and innovation to stimulate corporate intrinsic momentum

Promoting comprehensive innovation is the assurance to accomplish corporate everlasting vibrant fundamentals. The Company insisted on market-oriented focus as the core to intensify efforts in resources allocation tilted frontline and authority delegation as well as optimisation of "top down" service support system. With in-depth promotion of sub-division of performance evaluation units, the frontline vitality was fully stimulated and operational efficiency was remarkably improved. The Company proactively responded to the theme of "entrepreneurship and innovation by the general public" and was selected as one of the first batch of the state's models in mass entrepreneurship and innovation, creating an innovative atmosphere for our employees. Through promoting the enhancement of quality and efficiency, optimisation of financial management mechanism and reinforcement in precision management, we successfully enhanced the capabilities of values management and risk management. With concurrent promotion of co-building and co-sharing of networks as well as strengthening in centralised procurement, we effectively reduced our investment costs and enhanced the efficiency of resources utilisation. We increased our efforts in new talents introduction programme, optimised the structure of talents team, focused on practical nurture of new talents team and established internal co-sharing mechanism for talents. Corporate vitality and efficiency were persistently improved.

Revenues of Cloud and Big Data Business



55%



Looking ahead into the future vision, transformation and upgrades entered into a new stage of journey

In 2016, the Company successfully grasped and embraced the intelligent trend of development era as well as comprehensively examined and assessed the industry environment and actual corporate circumstances. Meanwhile, with widespread convergence of intelligence and experience from the implementation of strategic transformation (Transformation 1.0)⁵ and in-depth transformation (Transformation 2.0)⁵, the Company established a comprehensive transformation and upgrades strategy (Transformation 3.0) and strived to be a leading integrated intelligent information services operator. Surrounding the overall strategies planning, we promptly determined and established the implementation path to pragmatically promote network intelligentisation, service ecologicalisation and operation intellectualisation. Transformation and upgrades entered into a new stage of journey.

Promotion of network intelligentisation

In 2016, the Company published the *China Telecom's CTNet2025 Network Structure White Paper* and completed the top-level design on network reconstitution, endeavouring to build an industry-leading new style network featuring intelligence, efficient centralisation and openness. On the one hand, the Company persisted in strengthening the fundamental network capabilities. With full exploitation of the strengths of international mainstream FDD technology and co-sharing of telecommunications towers resources, the Company seized favourable opportunities from the policy to reform 800MHz frequency and swiftly achieved basic full coverage of superior 4G network nationwide characterised with multi-frequency collaboration, maintaining industry-leading customers' experience. We simultaneously deployed VoLTE and NarrowBand IoT (NB-IoT) with 4G networks, laying robust network foundation for the upgrade of mobile voice and IoT business. Through comprehensive promotion of fibre broadband network upgrade, we primarily achieved all cities in service areas with fibre broadband access capability while the overall average bandwidth of wireline broadband subscribers exceeded 50Mbps.

⁵ For the years from 2004 to 2010, we implemented strategic transformation which defined the corporate as Telecom Full Service Provider, Internet Applications Aggregator and Leading Enterprise ICT Service Provider. For the years from 2011 to 2015, we implemented in-depth transformation which adjusted the corporate's positioning as the Leader of Intelligent Pipeline, the Provider of Integrated Platforms and the Participant of Content & Application Development.

On the another hand, the Company steadily promoted the intelligent evolution of networks. By introducing new technologies such as Software-Defined Networking (SDN) and Network Functions Virtualisation (NFV), the Company established open laboratory for network reconstitution and joint open laboratory for 5G. We actively engaged in a number of major projects including the research and development of 5G, fundamental scientific research, network engineering and product research and development. In addition, we also promoted the construction of Data Centre Interconnect (DCI) and optimised the cloud resources deployment embedded with the features of super massive volume, wide areas coverage and flexible adjustment so as to enhance the synergistic capabilities of cloud and network.

Promotion of service ecologicalisation

The Company emphasised on key businesses and implementation of service reconstitution to plan well for future development. Through proactive establishment of five key business ecosphere, namely Intelligent Connection, Smart Family, Internet Finance, IoT and new ICT applications forming a synergetic integral featuring mutual integration, mutual reliance, mutual promotion and mutual driven as a whole, we aimed to provide intelligent-connected and vertically-integrated intelligent applications services for users. As the next step, the Company will increase efforts in building an operating mechanism for unified account products and enhance Internet-oriented and professional channel capabilities, injecting capabilities for service ecologicalisation; apply Big Data

capabilities to accurately support scale development and the entire process of value operations, injecting intelligence for service ecologicalisation; facilitate convergence of external resources and devote intensified efforts in open cooperation, injecting strengths for service ecologicalisation.

Promotion of operation intellectualisation

The Company continued to expedite the promotion of efficient centralised and Internet-oriented operations to focus on the construction of a market-driven and frontline-driven intellectual operational system. With devoted efforts in deepened precision management, enhancement of operational efficiency and improvement in customer perception, evolution of network intelligentisation and service ecologicalisation were assisted and supported. We explicitly defined the key value of data in corporate's perspective and focused on Big Data applications, striving to create a "corporate core" with data-driven focus as the core. The Company commenced to implement various key measures including construction of corporate-level Big Data platform, enhancement of database management, reinforcement of IT system support and improvement of data applications capabilities. Core data convergence of the entire-network was basically completed. The end-to-end perception system covering the entire-network mobile business has been launched while end-to-end operation of fibre broadband was steadily promoted. In the future, the Company will persist to promote the reconstitution of operation and management, further collaborating the in-

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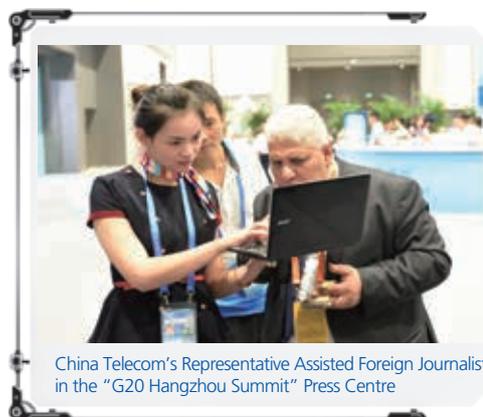
depth integration of smart operations with key areas including sales and marketing, service, network operations, corporate management and open cooperation as well as forming closed-loop management for the entire process so as to provide strengthened support and assurance for transformation and upgrades.

Corporate governance and social responsibility

We always commit to uphold high level of corporate governance and insist on governing the corporate in accordance with laws and regulations, attaching great importance to risk management and control. We continuously enhance corporate transparency to ensure corporate healthy and sustainable growth. Our persistent efforts in corporate governance have been widely recognised by the capital markets. In 2016, we were accredited with a number of awards and recognitions, including the "No. 1 Overall Best Managed Company in Asia" by *Euromoney* for seven years in a row, "Most Honored Company in Asia" by *Institutional Investor* for six consecutive years and two Platinum Awards namely "Best Telecommunications Company in Asia" and "Best Company in China" by *FinanceAsia*.

We persist to adhere to the collaboration of self-development and social responsibility. Adhering to ensure operation with integrity and maintain a fair and orderly environment for market competition, we strive to achieve win-win cooperation with respective stakeholders and facilitate healthy development for the entire ecosphere, proactively making contributions for the national economy. We also devoted to maintain network security

and information security, prevent and combat telecommunications information fraud to create a safe and green network environment and responded to the initiatives of "the Belt and Road" by enhancing the information infrastructure for the countries and regions along the path. With implementation of "Speed Upgrade and Tariff Reduction", we vigorously promoted the popularisation of broadband penetration in rural areas and proactively implemented alleviation of information poverty through provision of information, persistently fostering the informatisation evolution for the society. We further strengthened energy conservation and emissions reduction, emphasising on environment protection in engineering projects to promote green operations. We launched the initiatives for poverty alleviation and aid programme to Tibet and Xinjiang aiming at serving the society continuously. We received high recognition and appreciation from the society through our efforts in combating catastrophic flooding in Southern China and successfully accomplishing telecommunications assurance for "G20 Hangzhou Summit".



China Telecom's Representative Assisted Foreign Journalist in the "G20 Hangzhou Summit" Press Centre

Outlook

Year 2017 is a crucial year for the Company to implement the strategy of comprehensive transformation and upgrades as well as the construction of comprehensive competitive advantages. Despite facing more complicated external environment and more intensified market competition, we are even more confident looking into the future. The confidence is originated from the continuous improvement of macro environment — steady improvement of the national economy, progressive promotion of supply-side reforms, vitality released from the reforms of state-owned enterprises; from the prosperous and booming industry outlook — deepened promotion of a series of national strategies including “Cyberpower”, “Network and Information Country” and “Made in China 2025”, upgrade of information consumption, forming and creating vast market potentials; from the deepened endowment of the Company — robust development fundamentals and brilliant corporate culture established over many years. The strategy of transformation and upgrades catering for the development trends has comprehensively commenced.

In the future, with a unitary goal cohering as a whole, the Company will firmly seize the opportunities to step forward with unwavering determination and excellent execution. Driven by “Transformation 3.0” with reform and innovation as impetus, we strive to create superior and leading intelligent network in a more highly-efficient way, build a win-win business ecology in a more open way, promote flexible synergic smart operation and leverage the smart wisdom of our employees in a more comprehensive way so as to achieve concurrent development and enhancement of corporate values, customer values and employee values as a respectable corporate citizen.

Finally, on behalf of the Board of Directors, I would like to take this opportunity to express my sincere gratitude to all our shareholders, customers and all other parties in the community, and my grateful thanks to all our devoted colleagues who always work so hard and strive along with us for our common ideal and goal.



Yang Jie
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21 March 2017