

Chairman's Statement

Driving Transformation
Driving Change



Dear Shareholders,

In order to speed up the full services offering process, the Company has entered into an agreement with China Unicom on the acquisition of CDMA business, which would allow the Company to quickly enter into the mobile communications market and attain enormous development potential. This will also enhance the incorporation of mobile elements into our integrated information services, strengthening our core competitiveness. In the first half of this year, the unexpected serious natural disasters such as snowstorms and earthquake together with the intensified market competition, have given us unprecedented harsh challenges. However, with the unwavering dedication and exceptional endurance of the Company's management and all our people, the Company achieved encouraging results. In our fight against the disasters and the subsequent reconstruction works, China Telecom well-demonstrated not only its outstanding capability for ensuring communications, but also its high regards of responsibility towards the society and its shareholders. Facing intense market competition, we continuously expanded the market with customer focused to maintain the stability of the Company's fundamentals and lay a solid foundation for the full services offering in the future.

FINANCIAL RESULTS

In the first half of 2008, the Company's financial performance remained stable. Operating revenues reached RMB90,434 million, up by 0.8% from the same period last year, of which RMB1,028 million was accounted for by the amortisation of upfront connection fees. Excluding the upfront connection fees, the operating revenues were RMB89,406 million, a 1.5% growth from the same period last year. Revenue from wireline voice service was RMB50,510 million, a 11.8% decrease from the same period last year. Revenues from Internet and data services as well as value-added and integrated information application services reached RMB24,534 million and RMB11,987 million respectively, representing 27.3% and 31.6% growth from the same period last year. EBITDA^{1,2} was RMB44,268 million, a 1.9% decrease from the same period last year, and the EBITDA margin was 49.5%. Profit attributable to equity holders^{1,2} of the Company was RMB11,606 million, a 4.0% decrease from the same period last year, and basic earnings per share^{1,2} was RMB0.14. Capital expenditure was RMB18,783 million, a 9.5% decrease from the same period last year. Free cash flow³ reached RMB21,669 million, a 11.3% increase from the same period last year.

Taking into consideration the Company's business development needs and its cash flow position, the Board of Directors has resolved not to pay any interim dividend for the year in order to maintain adequate funding flexibility. The Board of Directors will proactively consider the final dividend proposal at the time of reviewing the full year results and propose to the shareholders' general meeting accordingly.

BUSINESS PERFORMANCE

In the first half of 2008, the Company continued to proactively and effectively implement strategic transformation. Focused on providing integrated information services to customers, we keep on innovating business model, expanding business services, and advancing customer brand management to continuously optimise subscriber base and revenue structure.

With regard to government and enterprise customers, we strengthened the specialised marketing of "BizNavigator" and promoted the Internet-oriented integrated information services and applications services, enhancing the penetration of businesses such as information security products, video application products and enterprise switchboard while effectively consolidating the traditional voice services. With respect to our service approach, we continued to strengthen the coordination mechanism for cross-region services. Back-end network maintenance support personnel were embedded in the front-end sales force to provide differentiated network support services and to further improve responsiveness to customers' needs. Being the Company's core value customers, the government and enterprise customer base continued to expand in the first half of 2008, resulting in a significant increase in revenue with a 13.5% growth from the same period last year.

¹ Including the amortisation of the upfront connection fees, EBITDA was RMB45,296 million, profit attributable to equity holders of the Company was RMB12,634 million and basic earnings per share was RMB0.16.

² The natural disasters such as snowstorms and earthquake cost approximately additional RMB1,700 million to the network operation costs with an after tax effect of approximately RMB1,281 million in the first half of 2008. The implementation of new income tax law resulted in a tax saving of approximately RMB706 million. Excluding the amortisation of the upfront connection fees, the impact of natural disasters such as snowstorms and earthquake and of the variation in income tax rate, EBITDA was RMB45,968 million, a 1.9% growth from the same period last year, profit attributable to equity holders of the Company was RMB12,181 million, a 0.8% growth from the same period last year and basic earnings per share was RMB0.15.

³ Free cash flow is calculated from EBITDA (excluding amortisation of the upfront connection fees) minus capital expenditure and income tax.



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With regard to household customers, we continued to increase our marketing efforts for broadband access products. In accordance with customers' demand, we also integrated various services and products to enrich the "One Home" brand contents to provide one-stop communications, wealth management, live broadcasting, information and entertainment services to household customers. By the end of June 2008, the household penetration rate of "One Home" reached 14.4%, a 5.8 percentage point growth from the beginning of the year. In the first half of the year, revenue from household customers maintained steady growth of 2.9% from the same period last year.

Due to its rapid development, the non-voice service has become the consistent driver for the revenue growth of the Company. In the first half of 2008, revenue from the non-voice service as a percentage of operating revenues reached 43.5%, a 8.5 percentage point growth from the same period last year. The Company further explored the broadband access subscribers market and maintained the rapid growth of subscriber base and service revenue. The broadband subscribers in the first half of the year increased by 4.30 million to a total number of 39.95 million. Revenue from broadband access reached RMB19,279 million, a 31.3% growth from the same period last year. At the same time, the Company adhered to the strategy of leveraging informatisation applications to drive business development and continued to promote the rapid development of "Best Tone" and ICT services (including IT services and applications as well as video applications such as "Mega Eye"). In the first half of the year, revenues from "Best Tone" and ICT services grew by 56.7% and 101.8% respectively, contributing 0.87 and 1.19 percentage point growth to the total revenue.

In the first half of 2008, there was a significant decline in the Company's wireline voice service. Revenues from local telephone services and long distance services fell 13.9% and 9.4% respectively from the same period last year. There was a net decrease of 5.44 million access lines in service in the first half of the year, mainly of low-end subscribers. As a result of continuing significant reduction in mobile tariff, the imbalanced competitive landscape has worsened with immense pressure on expanding new market shares of wireline voice service. In response, we insisted on profitable development of voice service and controlled marketing expenditure of low return. We also insisted on driving the voice services through integrated development with transformation services, and continuously enriched informatisation applications to provide differentiated services for different customers with a view to consolidating our traditional voice services.

OPERATING MODEL

In line with the Company's strategic transformation, we continued to adjust and optimise our organisational structure, innovate operating model, and strengthen vertically-integrated operation to cater to the needs of the full services offering. We completed the organisational structure reform from headquarter with provincial subsidiaries to headquarter with provincial branches in the first half of the year to improve the execution efficiency and set a solid foundation for our upcoming full services offering. Leveraging the characteristics of the Company's resources, and our competitive edge of providing total solutions to customers while avoiding the disadvantages of single business offering, we optimised the front- and back-end structures with the front-end operation focusing on customer segments and the back-end support to consolidate. These allowed us to bring the advantages of full services offering and focus on our target customers to enhance customer segment oriented marketing and product development. We also integrated the mobile operation management into the Company's organisational structure to establish a vertically-integrated full services operating structure. In addition, the successful acquisition of the Beijing Telecom in the first half of the year expanded the Company's geographical scope of operation. This is beneficial to providing national or transnational networking services for government and enterprise customers and further consolidates the Company's competitive edge in the high-end government and enterprise market.

CORPORATE GOVERNANCE

To protect the interest of our shareholders, customers and staff, we have strived to increase our corporate value by maintaining and strengthening high standards of corporate governance, continuously increasing transparency and ensuring the healthy development of the Company. Our efforts in corporate governance have been widely recognised by the capital market. In the first half of the year, we were awarded "Asia's Best Managed Fixed Telecom Company" by *Euromoney*. In accrediting Asia's Best Companies for the year of 2008 by *FinanceAsia*, the Company was awarded the "Best Managed Company – China". In addition, the Company was accredited with "CAPITAL Outstanding China Enterprise Awards – Telecommunications" by *CAPITAL* for three consecutive years. Further, our website (www.chinatelecom-h.com) was accredited in "IR Global Rankings 2008" as the "Best Investor Relations Website" in China.

ACQUISITION OF MOBILE BUSINESSES

The Company has entered into a detailed agreement with China Unicom based on the CDMA business acquisition framework agreement. We will launch mobile services operation by leasing the CDMA network assets to be acquired by our parent company. The lease agreement is subject to our independent shareholders' approval. We will endeavour to achieve smooth transition of CDMA network operation and its earliest independent operation. The aforesaid arrangements will enable the Company to obtain on taking over the CDMA business, relatively complete mobile network resources and customer service system with stand-alone operation and continuous service capability. This is beneficial for the Company to quickly enter into the fast-growing mobile telecommunications market in China and achieve full services offering. The Company's core competitiveness can also be strengthened continuously by proactively implementing customer-focused differentiation operation strategy.



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FUTURE OUTLOOK

Despite the various challenges for the Company, the full services offering would bring us development opportunities. The severely imbalanced competition landscape in China's telecommunications market will be gradually improved as the telecommunications sector reform and restructuring continues to deepen. However, there will be short-term downward pressure on our profit as the market share of wireline subscribers will continue to shrink in the near term while our forthcoming mobile services operation will need significant investment at the initial stage.

The Company will leverage transformation to drive full services offering. We aim to effectively converge the mobile elements with the integrated information services and implement differentiation development strategy with a focus on mid-to-high-end urban customers. Taking advantage of our customer resources, direct sales channels and multi-service operations, we will incorporate mobile elements into the brand operations of "BizNavigator" and "One Home" to provide our customers with differentiated integrated information services based on Mobile Internet and Fixed-Mobile Convergence (FMC), enhancing the brand influence and penetration. At the same time, with regards to customers' demand and experience, we will improve our network coverage and optimise our network quality. We will also coordinate the existing wireline and mobile network resources to drive synergy and improve network utilisation and economise network construction and operating costs, striving to achieve the profitable scale development of the mobile business.

We are full of passion about the future. We firmly believe that the full services offering will greatly enhance our core competitiveness. The Company's business development is going to reach a new stage of growth and together we will strive for the success to make our long time dream come true. China Telecom would thrive again and create more value for our shareholders.

Wang Xiaochu

Chairman and Chief Executive Officer

Beijing, PRC

28 August 2008