

Chairman's Statement



Wang Xiaochu
Chairman and Chief Executive Officer



“ In the first half of this year, we grasped the opportunity and successfully promoted the fast development of our mobile business by expanding initiatives. We also actively explored and enhanced our integrated operation capability. Although these brought short term pressure to our profitability, remarkable benefits have been achieved. Next, we shall actively leverage our 3G and full services integrated operation edge to enhance our customers' experience and value with innovative differentiated services, while persisting in avoiding single product price competition. I firmly believe, we would reap the handsome rewards of the initiatives we put in this year with sustainable development in future and enhance value for you, as our shareholders! ”

Chairman's Statement (Continued)

In the first half of 2009, we continued to advocate the "Customer-focused Innovative Informatisation Strategy" in the new era of full services integrated operation with firm confidence. We actively explored the integration synergy of mobile, wireline and Internet services, accumulating and expanding the competitive edge through differentiated offering to achieve a good start of full services operation. The launch of the "e surfing" brand for our mobile services was well received in the market and drove up the customer scale and the mobile revenue with increasing market share. The scale of brand customer base expanded persistently and the broadband as well as value-added and integrated information services continued to grow rapidly. The strength of full services offering has been enhanced and the customers' satisfaction has noticeably improved. The strategic transformation achieved substantial and remarkable breakthroughs, laying a solid foundation for the long-term sustainable development of the Company.

Business Performance

In the first half of 2009, the Company's operation was on track as planned. The operating revenues reached RMB103,146 million. Excluding the amortisation of upfront connection fees, the operating revenues were RMB102,554 million, representing a growth of 14.8% over the same period of last year, of which the mobile service revenue amounted to RMB12,814 million. Revenue from non-voice services exceeded 50%, amongst which the revenues from wireline broadband access as well as wireline value-added and integrated information services increased by 18.2% and 15.6% respectively. EBITDA^{1,2} was RMB43,339 million, and the EBITDA margin was 42.3%. Profit attributable to equity holders of the Company² was RMB8,412 million, representing a decline of 27.5% over the same period of last year. Basic earnings per share² was RMB0.10. In the first half of the year, the capital expenditure was RMB17,033 million, a decline of 9.3% compared with the same period of last year. Free cash flow³ was RMB19,652 million. The Company believes that, despite its short term pressure on the Company's profitability, the increase in marketing initiatives for the profitable scale development of our mobile services will significantly enhance future sustainable development and value creation of the Company.

Taking into consideration the Company's business development needs and the cash flow position, the Board of Directors has decided 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.

Deepening Transformation to Create Integrated Operation Edge

With determination, we adhered to the development of full services integrated operation of mobile, wireline and Internet services. We proactively promoted and executed the strategy of focusing on mid-to-high-end customers with differentiated service offering to avoid single product price competition and endeavoured to maintain the value of the overall industry.

In the first half of the year, the promotion of 'e surfing' brand was well received by the market with the 'Internet handset' applications being introduced. Leveraging the competitive advantage of our 3G platform, we focused on the promotion of information application products such as '189 email', 'e surfing LIVE', 'imusic' and 'Mobile Best Tone' to enable customers to easily enjoy and experience the enriched full services offering via mobile terminals. A wide range of personalised products were introduced to target at the mid-to-high-end customers. At the same time, we actively pushed forward the integrated packaging of mobile and wireline services, leading to the rapid expansion of mobile subscriber base. The number of mobile subscribers has increased by 11.37 million in the first half of the year, with a total number of 39.28 million mobile subscribers at the end of June 2009. The net addition market share rose from 12.0% in January 2009 to 28.7% in June 2009, demonstrating a gradual improvement on monthly basis, while the ARPU primarily remained stable.

¹ For convenience of the investors' analysis, EBITDA is calculated before CDMA network capacity lease fee.

² Including the amortisation of the upfront connection fees, EBITDA was RMB43,931 million, profit attributable to equity holders of the Company was RMB9,004 million and basic earnings per share was RMB0.11.

³ Free cash flow is calculated from EBITDA (excluding amortisation of upfront connection fees) minus CDMA network capacity lease fee, capital expenditure and income tax.

Chairman's Statement (Continued)

For government and enterprise customers, we actively promoted a wide range of integrated services including 'wireless Mega-eye' (remote monitoring), 'Office General Line', 'Integrated Communication' and 'Push-mail', and promptly accomplished the synergy of existing wireline products and new mobile products. For household customers, we adopted integrated strategy to expand new addition market by leveraging the upgraded bandwidth to increase the market penetration of broadband products. Through customer account number operation, we realised the integrated development and seamless coverage of wireline broadband and wireless Internet, further consolidating our leading position in the market. In the first half of the year, the total numbers of wireline broadband customers and wireless Internet access customers have increased by 4.78 million and 1.61 million on a net basis, reaching a total of 49.05 million and 3.95 million respectively. Revenue from wireline broadband access services reached RMB22,745 million, an increase of 18.2% compared with the same period last year. Through integrated development, the subscriber scale of the two major customer segments expanded continuously. As of the end of June, the subscribers of 'BizNavigator' and 'One Home' service reached 3.01 million and 30.11 million respectively, representing an increase of 19.1% and 25.8% respectively from the beginning of the year.

Facing the challenges from the global financial crisis and the increasing mobile substitution in the first half of the year, there was a net decrease of 8.99 million of access lines in service. The total number of access lines in service was 199 million at the end of June 2009. Revenue from wireline voice service was RMB41,060 million, a decrease of 18.7% compared with the same period last year. In response thereto, we will further reinforce the development of transformation business such as 'Best Tone', system integration and Internet services and promote the value transfer from wireline voice to our non-voice and mobile services by leveraging our transformation business edge and integrated service packaging. In addition, we will also accelerate the migration of our mid-to-high-end PHS customers to our mobile service, endeavouring to mitigate the revenue decline of our voice service.

Proactive Exploration to Promote Comprehensive Full Services Development

In the first half of the year, we continuously enhanced the competitiveness of the network quality, customer service, business functionality and terminal selection to proactively prepare for the full implementation of mid-to-high-end customer-focused differentiated service strategy, striving to create a new phase of full services integrated operation.

With the fastest pace, we have constructed the largest scale 3G network for the earliest commercial use in mainland China. By the end of July, we accomplished 3G network coverage of 342 cities and more than 2,000 counties, laying a solid foundation for seizing market opportunities. Simultaneously, with regard to customer experience, we continued to strengthen the network coverage and optimisation, leading to a rapid improvement in the network quality.

In order to meet the new requirement of full services integrated operation, we implemented innovative mechanisms and optimised processes to ensure efficient operation of our full services organisation structure and product development system. We persisted in the organisation deployment according to three major customer segments of government and enterprise, household, and individual customers, with strengthened accountability to ensure coordinated development. We established a product centre to focus on coordinating product development and deployment for the nationwide network. In addition, we set up a customer service monitoring centre to improve the quality of customer service and improve customers' experience. Based on customer segmentation, we carried out "targeted" marketing, sales support, customer service and product research and development. We also continued to optimise the value-added service operation system and the sales process of integrated services to enhance the operational efficiency of our front-end business units.

Chairman's Statement (Continued)

In order to promptly and comprehensively improve the fundamental service quality, the Company launched the 'Tackle-the-Deficiency' campaign for customer service in the first half of the year to swiftly remedy the shortcomings of mobile service during the initial stage of operation. We strengthened the customer service accountability system and improved the customers' experience to effectively enhance customer satisfaction. We steadily advanced the sales and servicing capability of our distribution channels in addition to launching our on-line 'Mobile Palm Service Centre'. We also strengthened our electronic channels such as on-line Service Centre and 'Hotline 10000'. The scale and sales capability of the open channels have been significantly improved with the proportion of mobile subscribers acquired through open channels exceeding one-third in June. Meanwhile, we further perfected the IT system to reinforce the support for the real-time and nationwide network operation of the mobile services, significantly upgrading the Company's capability of customer service and data analysis.

Having a mobile handset terminal market which could satisfy the customers' needs is a key condition for our mobile service development. We proactively promoted the cooperation with each party of the industry chain and enhanced centralised scale procurement and terminal customisation. We also bolstered the cooperation with upstream handset chip manufacturers and actively supported the sales channel of the industry chain to motivate our business partners and strengthen their confidence. In the first half of 2009, there were about 300 models of handset terminals on sale in the market and the volume of terminal supply was nearly three times over the same period last year, achieving an overall balance of supply and demand in the market. Moving forward, we will further strengthen the cooperation with mobile handset designers and manufacturers to further promote research, development and production of mobile handsets. We will effectively promote the open channel procurement and sale of terminals, optimise the terminal subsidy model and vigorously push forward the penetration of 3G mobile handsets.

We adhered to the value-oriented approach with continuous optimisation of resource allocation. The Company continuously improved the control of resource utilisation, tilting towards the development of broadband, transformation and mobile services, while at the same time gradually reinforcing the integration of mobile and wireline resources to enhance the Company's operational efficiency. We will further strengthen the centralised treasury management, improving capital operational effectiveness while progressively lowering the average borrowing cost. With a strict control on the scale of capital expenditure and further optimisation of its structure, the Company has maintained a strong free cash flow.

Continuous Enhancement of Corporate Governance

We strived to maintain and strengthen the high level of corporate governance, continuously improving the corporate transparency, ensuring the healthy development of the Company and endeavouring to enhance the corporate value. Our continuous efforts in corporate governance are widely recognised by the capital market. We were accredited with a number of awards in the first half of the year, including "The CAPITAL Outstanding China Enterprise Awards-Telecommunications" by *The Capital* for four consecutive years, "Asia's Best Companies in Corporate Governance in China" for the year 2009 by *Corporate Governance Asia*, and "Best Corporate Governance" as well as "Best Managed Company" by *Finance Asia* in the Asia's Best Companies Poll.

Chairman's Statement (Continued)

Future Outlook

The second half of this year will be a critical period for the Company to embark a new phase of full services integrated operation. With an improved market environment resulting from the gradual recovery of the economy, and leveraging the valuable practical experience in full services integrated operation accumulated in the past half year and beyond, we are more confident in accelerating our development. However, we are also fully aware of the increasingly intense market competition and the various challenges to be faced by the Company, including increasing difficulties in consolidating traditional voice business, intensified competition in the mid-to-high-end market and lack of competitiveness of mobile terminals.

In response thereto, we will take the integrated operation as a new kick-off of our transformation, leveraging the foundation of various preparation works previously accomplished. We will strengthen our focus on our wireline core value services and take full advantage of the experiences we have accumulated in Internet and informatisation application services in the past few years. We will innovate effective integrated development of wireline and mobile services to enhance our differentiation edge and endeavour to accomplish the key breakthroughs in mid-to-high-end market. We believe, following the further enhancement of our basic service quality and the progressive rollout of 3G products with enriched mobile Internet applications, our 3G service and full services offering will have remarkable development in future, leading to further value creation for our shareholders.



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Beijing, PRC
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