

Chairman's Statement



In the first half of 2014, the environment of the communications and information industry in the mainland China was complicated and tangled. The Company's operations faced unprecedented uncertainty upon the simultaneous emergence of numerous factors including the 4G regulatory policy, the implementation of the Value-Added Tax ("VAT") reform, the establishment of the Tower Company and the resale of mobile services (MVNO). The Company examined and assessed the situation, and timely refined the strategic plan to ensure that the operating results achieved a healthy growth. Embracing the overall landscape with a long term vision, the Company assumed responsibilities courageously and communicated pragmatically. With our dedicated efforts, we successfully obtained the approval of the 4G hybrid network operation and the VAT reform policy which is beneficial to the long term sustainable development. We took challenges as opportunities and proactively built cohesive

consensus, stepping forward to deepen reform and focusing on enhancement of corporate vitality and efficiency. Through accurately grasping the trends, the Company promoted the implementation of the "Three New Roles"¹ strategy and firmly established the roadmap of Internet-oriented corporate transformation to build a new China Telecom.

Operating Results

In the first half of the year, the Company persisted in rational competition and profitable development with appropriate controls over investments and costs, resulting in solid growth in both revenues and net profit. In the first half of the year, the operating revenues amounted to RMB166.0 billion, representing an increase of 5.3% over the same period last year. Excluding the mobile terminal sales, the operating revenues were RMB149.4 billion, representing an increase of 7.3% over the

¹ The "Three New Roles" refers to the Leader of Intelligent Pipeline, the Provider of Integrated Platforms and the Participant of Content & Application Development.

same period last year, with growth rate surpassing industry average. The proportion of revenues from emerging businesses accounted for 28% of total revenues excluding the mobile terminal sales, increased by 5 percentage points over the same period last year, driving continual fast optimisation in business structure. EBITDA² was RMB50.5 billion, while EBITDA margin³ was 33.8%. The profit attributable to the equity holders of the Company was RMB11.4 billion, representing an increase of 11.8% over the same period last year. Basic earnings per share were RMB0.14. Capital expenditure was RMB23.1 billion while free cash flow⁴ reached RMB23.9 billion.

Taking into consideration the cash flow of the Company and the capital requirements for future development, the Board of Directors has decided not to pay an interim dividend this year in order to maintain adequate funding flexibility. The Board of Directors will proactively consider a final dividend proposal when reviewing the full year results and will propose any such final dividend to the shareholders' general meeting accordingly.

Dual emphasis on scale and innovation to ensure steady growth of the Company

Perseverance in profitable development enhancing value of core services

In the first half of the year, the Company continued to leverage the competitive edges of the 3G network and services focusing on expansion of key markets and continuous enhancement of development quality. Persisting in the terminal-led approach, the Company continued to progressively develop the mid-to-high end handset models and accelerated the expansion into rural markets with the introduction of entry-level smartphones. Through promoting the synergic coordination of resources across the direct sales, physical and electronic channels, the Company further enhanced the overall effectiveness of sales channels. While strengthening the Internet applications-driven mode, the Company

conducted targeted marketing to continuously optimise the customer acquisition approach. In the first half of the year, amid intensified market competition driven by the launch of 4G services and strengthened marketing promotions by the peers, the number of mobile subscribers of the Company experienced a net decline of 5.34 million to 180 million. Of which, the net addition of 3G subscribers was 4.13 million, with 3G subscribers accounting for approximately 60% of the total number of mobile subscribers. The subscriber structure was further optimised while the ARPU of mobile subscribers was stable with slight increase with continual reinforcement in subscriber value.

In the first half of the year, the change in the regulatory policies in the wireline broadband market led to further intensified market competition. The Company achieved a steady and healthy growth in the wireline broadband service by fully leveraging the competitive strengths in optic fibre network and services edges. The Company vigorously promoted the bandwidth upgrade to further enhance network utilisation, leading to progressive increase in the proportion of high-bandwidth subscribers. The Company also continuously improved the market competitiveness by strengthening the scale development of broadband service as a single product and persistently optimising the design of packages. To promote high-bandwidth products and applications, the Company launched a new smart home product "Joy me" in July, embarking on a new type of integrated product combining the network, equipment and applications. Through the convergence of premium resources via the industry alliance, the Company stood at the forefront of the industry value chain. In the first half of the year, wireline broadband service revenues amounted to RMB36.4 billion, representing an increase of 3.4% over the same period last year. The number of wireline broadband subscribers reached 104 million with a net addition of 4.03 million. The number of Fibre-to-the-Home (FTTH) subscribers reached 33 million, accounting for approximately 32% of the total number of wireline

² EBITDA is calculated based on operating revenues minus operating expenses plus depreciation and amortisation.

³ EBITDA margin is calculated based on EBITDA divided by the operating revenues excluding mobile terminal sales.

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

broadband subscribers, representing an increase of 5 percentage points from the end of 2013, and leading to continuous optimisation of customer structure.

Innovative breakthroughs leading to rapid growth of emerging businesses

In the first half of the year, the Company strengthened innovation and cooperation, fully leveraging the competitive strengths of being a telecommunications operator to foster the rapid development of emerging businesses through promoting efficiently-centralised and market-driven operations. In the first half of the year, the revenues from emerging businesses amounted to RMB41.3 billion, representing an increase of 30% over the same period last year.

The Company expedited the promotion of data traffic operations model transformation leading to substantial enhancement in data traffic scale and value. By proactively promoting the data-centric packages and dedicated traffic packages, the Company continued to refine and optimise the product design with a primary focus on customers' demand. With the synergies of strengthened Internet applications cooperation, the Company stimulated the data usage habit through joint promotions and extended the data traffic operations from solely front-end billing to include data traffic backward operations. With our continuous efforts in expediting the construction of intelligent pipelines and optimising data traffic usage alerts and subscribers' tiered assurance, we persistently explored data traffic sharing and carry forward aiming to continuously improve the core competence of data traffic operations. The Company also strengthened the management and control over the marketing initiatives for data traffic operations focusing on preservation of data traffic value and effectively promoting profitable scale expansion. In the first half of the year, the total Internet access traffic of our 3G handset users increased by almost 80% over the same period last year. The average monthly data usage of our 3G handset users reached 218MB, representing an increase of 30% over the same period last year. 3G handset data ARPU accounted for 37% of the total 3G handsets ARPU.

The Internet applications developed rapidly with persistent reinforcement in development model comprising portal, business clusters and integrated platforms. The "YiChat" service accelerated the iterative optimisation with progressive enrichment in functions such as games and mobile payment. Total registered users exceeded 100 million in the first half of the year with consistent enhancement in product competitiveness. The service scope of "Best Pay" continued to expand. Leveraging the unique strengths as a telecommunications operator in terms of subscribers scale and transactions security assurance, we launched an Internet financial product, "Tianyibao". In the first half of the year, the trading volume of "Best Pay" almost reached RMB130 billion, representing an increase of 170% over the same period last year. The Company officially launched the integrated platform and opened up seven key capabilities such as unified account and location-based functions for cooperation, further strengthening the cohesive synergies of capabilities, data and resources with progressive accomplishment in platform values.

The Information and Communications Technology (ICT) services experienced rapid extension towards the high-end of the value chain. Focusing on key customers, the industry application services further stimulated its growth vitality by optimising resources allocation through a market-oriented approach. Through strengthening the efficiently-centralised operations of the Internet Data Centre (IDC) services, the Company fully leveraged the efficiently-centralised operations and economies of scale of six data centres including the centre in Inner Mongolia. In the first half of the year, revenues from the IDC service reached RMB4.8 billion, representing an increase of 30% over the same period last year. To accelerate the promotion of efficiently-centralised products of cloud computing, the Company persistently strengthened the operations of cloud resources and the collaborative capabilities of existing applications as well as deepened the exploration of Big Data applications based on data convergence and analysis capabilities, leading to a gradual perfection in the form of products.

Stepping forward to deepen reform to build future sustainable competitiveness

Deepen comprehensive reform to resolve the challenges in systems and mechanisms

In the area of fundamental services, the Company implemented and promoted the system reforms in management mechanisms, resources feedback and support mechanisms from bottom to top through sub-division of performance evaluation and authorities delegation of frontline units. These measures fully liberated the front-line productivity, effectively stimulating the vitality of the organisation, business and employees as well as enhancing corporate values. In the area of emerging businesses, the Company continued to strengthen the innovation in systems and mechanisms aiming at achieving the deepening of relative alienation among organisational decision-making, staff motivation and product development operations. In addition, the Company promoted the implementation of market-driven corporatisation operation model, implemented personnel management and incentive policies which are in line with market practice, and accelerated the promotion of technology and business innovation to further enhance market competitiveness.

Persistent in open cooperation to build competitive strengths in the ecosystem

The Company proactively commenced multi-field and multi-level cooperation which facilitated the capitalisation of complementary resources and established the competitive strengths in the ecosystem resulting in realisation and enhancement of the values of telecommunications resources. The Company also expedited the expansion of strategic cooperation with the Internet industry to integrate into the blue ocean of information and communications industry to seize the development opportunities. Furthermore, the Company explored the opening up of wireline broadband resources to private capital to embark on local network cooperation, aiming to enhance the operational capabilities and return. The Company also promoted the resale of mobile services (MVNO), fostered the cooperation with

wholesalers in various areas including customer development, channel agency and innovative business resulting in continual enhancement of the differentiated edges. Through the investment in establishing the Tower Company, the Company promoted the joint construction and sharing of telecommunications infrastructure facilities while activating its assets and utilisation to accelerate the corporate transformation and upgrade.

Persistent enhancement in quality and efficiency to achieve optimum cost development models

Adhering to the development models with low costs but high quality, the Company further optimised the customer acquisition approach resulting in persistent enhancement in effectiveness and efficiency of corporate development. With customer experience as the core, the Company consistently enriched the design of product functionalities and strengthened new multi-media customer services means such as handset user-ends, YiChat, effectively reducing the subscriber acquisition costs and improving the subscribers' loyalty and values. In addition, the Company also promoted the orderly disposal of equipment suffering with high energy consumption, resulting in remarkable savings in energy consumption. The Company also promoted the sub-division of performance evaluation units of investment to accelerate the improvement in the network utilisation rates such as FTTH. With continuous efforts in strengthening its management, the Company further enhanced the efficiently-centralised management in areas such as procurement, IT and finance.

Firmly establish the roadmap of Internet-oriented transformation to create a new China Telecom

In the first half of the year, we closely monitored the developments and trends in the Internet industry, objectively analysed our strengths and weaknesses, repeatedly carried out in-depth research and assessment and finally established the roadmap of Internet-oriented transformation. In the area of fundamental services, we adopted the Internet mindset and methodology to reform and upgrade, rapidly creating the differential

edges as an Internet-oriented operator. In the area of emerging businesses, we leveraged the competitive strengths as a telecommunications operator and promoted the process of marketisation in accordance with the Internet operating dynamics to quickly uplift the industry market position of emerging businesses through efficiently-centralised management. In the near term, the Company plans to focus on the Internet-oriented transformation and upgrade of several aspects including fundamental services, basic network resources, public Internet applications, government and enterprise informatisation applications, cloud and Big Data and enterprise IT operations, endeavouring to create a new China Telecom.

Corporate Governance and Social Responsibility

We are committed to maintaining a high level of corporate governance, attaching great importance to risk management and control. We strive to enhance corporate transparency and corporate value to ensure our healthy growth. Our persistent efforts in corporate governance have been widely recognised by the capital markets. We were accredited with a number of awards and recognition for the year to date, including “No. 1 Most Honored Company in Asia” by *Institutional Investor* for two consecutive years, “No. 1 Best Managed Company in Asia” by *FinanceAsia* for four consecutive years and “Overall Best Managed Company in Asia” by *Euromoney* for five consecutive years.

We persisted in operating with integrity and proactively fulfilled our corporate social responsibility to maintain a fair and orderly environment for market competition and facilitate healthy development of the entire value chain. Meanwhile, we actively promoted green operations, further strengthening energy conservation and emission reduction to improve utilisation efficiency of resources. We accomplished telecommunications assurance tasks for significant events such as the Conference on Interaction and Confidence – Building Measures in Asia (CICA) and disaster reliefs and were highly commended by the society.

Outlook

At present, the mobile Internet industry is increasingly prosperous while its business models are becoming progressively mature and its effect on the competition and transformation of the telecommunications industry has become more prominent. Despite its beneficial effect on the corporate long term sustainable development, the VAT reform policy will have significant adverse impact on the operating profits of the Company in the short term. Resale of mobile services (MVNO) and the establishment of the Tower Company, etc. will impact on the Company's existing operation model. The Company is facing new challenges as well as opportunities.

In the second half of the year, we will firmly seize the 4G development opportunities, fully leveraging the competitive strengths of hybrid network in full strengths and ensuring leadership in network quality of hybrid network trial to develop a good reputation amongst subscribers. We will actively cultivate the 4G terminal industry chain and build a mature, complete efficiently-centralised 4G operating system. We will also actively apply for the expansion of the LTE hybrid network trial footprint and LTE FDD licence so as to get fully prepared for the comprehensive commercial launch of 4G. At the same time, the Company will continue to focus on core services such as 3G and wireline broadband services, persisting in profitable scale development. We will promote the implementation of comprehensive in-depth reform to stimulate the inherent corporate vitality. The Company will leverage mixed ownership to extend open cooperation and strengthen the capitalisation of the complementary resources. The Company will grasp the wisdom of the Internet mindset to comprehensively promote the corporate Internet-oriented transformation and tackle the implementation of the VAT reform in full strengths so as to create values for shareholders.

Chairman's Statement (Continued)

Finally, on behalf of the Board of Directors, I would like to take this opportunity to express my sincere appreciation to all our shareholders and customers for their support. I would also like to express my sincere thanks to all our employees for their hard work and contribution as well as to Mr. Wu Jichuan, Mr. Qin Xiao, Mr. Xie Liang and Madam Zhu Lihao for their valuable contribution during their tenure of offices as directors and supervisor of the Company. Also, I would like to welcome Madam Wang Hsuehming and Mr. Zhu Wei to join our Board of Directors.



Wang Xiaochu

Chairman and Chief Executive Officer
Beijing, China

27 August 2014