

household customers

↑ **7.33** million

Broadband subscribers reached 35.65 million, a net add of 7.33 million in 2007



Bringing You  
Closer to Your Family &  
Your Loved Ones



driving transformation,

driving value



driving transformation,

driving value

Making our customers' life richer, easier and happier



# Business Review

The following table sets out key operating data in 2005, 2006 and 2007:

|   | Unit             | 2005    | 2006    | 2007           | Rate of Change<br>(2007<br>over 2006) |
|---|------------------|---------|---------|----------------|---------------------------------------|
| Local wireline access lines in service                            | Million          | 210.09  | 223.04  | <b>220.33</b>  | (1.2%)                                |
| Local voice usage   | Million pulses   | 449,404 | 422,562 | <b>406,268</b> | (3.9%)                                |
| Domestic long distance usage                                      | Million minutes  | 93,817  | 95,567  | <b>98,251</b>  | 2.8%                                  |
| International, Hong Kong, Macau<br>and Taiwan long distance usage | Million minutes  | 1,711   | 1,601   | <b>1,588</b>   | (0.8%)                                |
| Broadband subscribers   | Million          | 21.02   | 28.32   | <b>35.65</b>   | 25.9%                                 |
| Volume of Inbound local calls                                     | Million minutes  | 102,670 | 124,452 | <b>135,447</b> | 8.8%                                  |
| Caller ID service subscribers                                     | Million          | 131.46  | 145.73  | <b>146.74</b>  | 0.7%                                  |
| SMS usage volume  | Million messages | 17,254  | 23,277  | <b>23,346</b>  | 0.3%                                  |
| Colour Ring Tone subscribers                                      | Million          | 18.16   | 36.68   | <b>63.19</b>   | 72.2%                                 |

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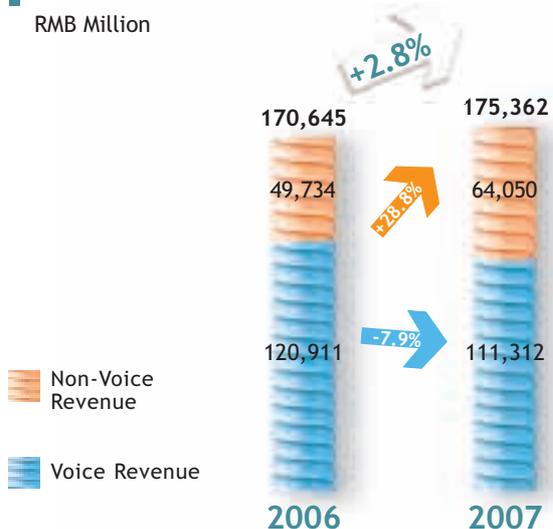
In 2007, the Company continued to implement business transformation strategy. By proactively innovating development models and vigorously promoting customer branding management, the Company gradually shifted its operation focus from voice services to integrated information services. The Company gained momentum in its business transformation.

In 2007, total operating revenues were RMB178,656 million, representing an increase of 1.7% from 2006. Excluding amortisation of the upfront connection fees, the Company's operating revenues were RMB175,362 million, representing an annual growth of 2.8%. The increase in operating revenues was mainly attributed to Internet access services and value-added and integrated information application services, which increased by 32.1% and 35.4% respectively. These increases have further optimised the income structure of the Company and raised its risk management capability.

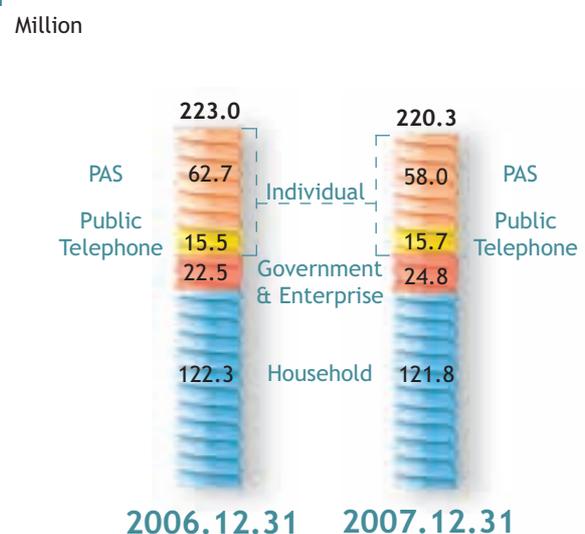
### Voice Services

In 2007, the total number of wireline telephone subscribers recorded an unprecedented negative growth. Such decrease was attributable to the reduction in domestic mobile tariffs and the popularisation of mobile voice communication. The total number of wireline telephone subscribers decreased by 2.71 million to 220.33 million while the number of wireless local access subscribers decreased by 4.68 million to 58.04 million. Due to the reduction in the number of subscribers and the consistent decline in the value of the wireline voice service, revenue from voice services continued to decrease. In 2007, the revenue from voice services<sup>1</sup> was RMB111,312 million, a decrease of 7.9% from 2006, accounting for 63.5% of operating revenues, representing a decrease of 7.4 percentage points from 2006.

### Operating Revenues



### Access Lines in Services



<sup>1</sup> Revenues from voice services include, monthly fees, local usage fees, domestic long distance usage fees, international, Hong Kong, Macau and Taiwan long distance usage fees, interconnection service fees, and amortization of the upfront installation fees.

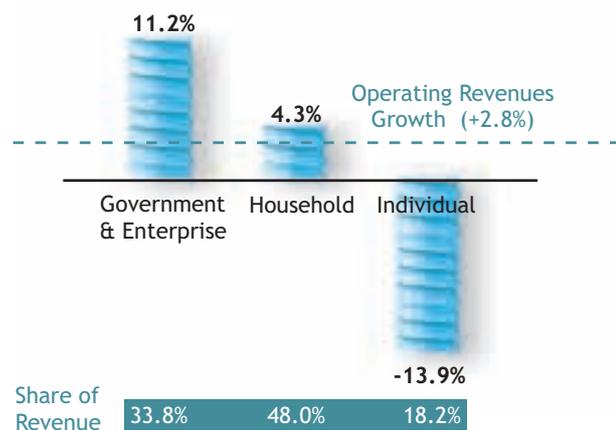
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In 2007, the Company's revenues from various voice services showed trends of decline. The revenue from local telephone services was RMB70,424 million, representing a decrease of 9.8% from 2006. The revenue from domestic long distance services amounted to RMB24,127 million, representing a decrease of 5.4% from 2006. Revenue from international, Hong Kong, Macau and Taiwan long distance telephone services totalled RMB2,882 million, representing a decrease of 10.6% from 2006. Due to significant influence from Calling-Party-Pay scheme offered by mobile operators and the increasing diversion of voice usage volume to growing mobile networks, the revenue from interconnection recorded an unprecedented negative growth, with a decrease of 1.5% to RMB13,879 million.

In 2007, to slow down the decrease in revenue from voice services, the Company adopted a number of measures and introduced tailored packaged services targeting at the three major client markets, namely the government and enterprises, households and rural areas. In respect of government and enterprises, the Company mainly introduced packaged sales for voice, broadband, and value-added and integrated information application services. In respect of household customers, the Company mainly launched the packaged sales of voice and broadband services. In respect of rural

areas, the Company focused on the packaged sales of voice and value-added services. Meanwhile, to avoid simple price cutting in the highly competitive long-distance services market, the Company emphasized its packaged sales of local telephone services and broadband services so as to offer additional values, increase attractiveness of such services and improve the stickiness of customers.

### Revenue Growth by Customer Groups in 2007



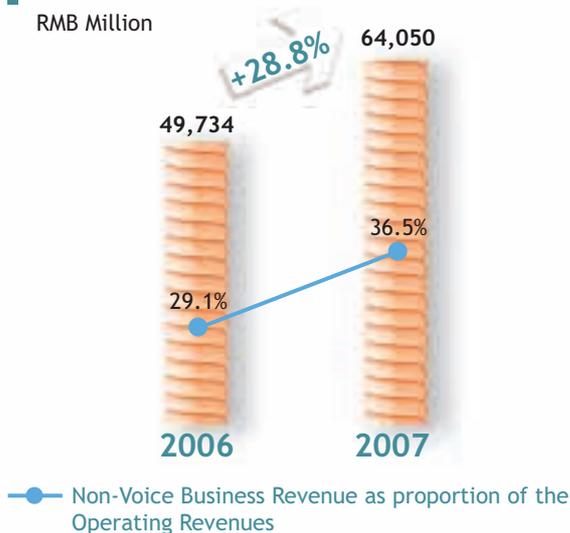
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### Non-Voice Service

In 2007, the Company fully leveraged its first-mover advantage in business transformation. The Company retained the traditional business volume by developing transformation businesses while drove the scale development of transforming businesses by further strengthening traditional businesses. With customised service packages to meet the demands of different customers, the Company has raised the profile of these services amongst customers. In 2007, the Company's revenues from non-voice services<sup>2</sup> were RMB64,050 million. The proportion of revenues from non-voice services to operating revenues increased by 7.4 percentage points to 36.5% from 2006.

In 2007, emphasizing on both scale and profitability as well as differentiation in products, applications and services for broadband business, the Company achieved revenue of RMB31,340 million from Internet access services, representing an annual growth of 32.1%. The proportion of revenues from Internet access services to operating revenues increased by 4.0 percentage points to 17.9% from 2006. In 2007, as the Company insisted on the strategy of scale development of broadband subscribers, the total number of broadband subscribers increased by 7.33 million to 35.65 million. At the same time, driven by the scale of broadband customer base, the Internet value-added services, including ChinaVNet and IDC, developed rapidly with a revenue growth rate of 56.0% from 2006. With Internet VAS, the Company increased the attractiveness of broadband services and maintained the stability of broadband subscriber ARPU. In 2007, broadband subscriber ARPU rose steadily to RMB80 per month per subscriber. To maintain the competitive edge of broadband services, the Company will continue to innovate the development approach of broadband services, while it has already started enhancement of broadband account number-based operations and standardisation of customer-end terminals.

### Non-Voice Business Revenue



<sup>2</sup> Revenues from non-voice services include revenues from Internet access services, value-added and integrated information application services, managed data services, leased line service and others.

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The consistent and rapid growth of value-added and integrated information application services has become a major driver for stabilising wireline voice usage volume and revenue growth. In 2007, the Company focused on expanding three major customer markets, namely the government and enterprises, households and rural areas. Through various marketing approaches, such as customer experience, SMS and telesales, packaged sales and joint promotion, the Company promoted the scale development for value-added business. Revenues from value-added and integrated information application services were RMB19,231 million, representing an annual growth of 35.4%. The proportion of revenues from value-added and integrated information application services to operating revenues increased by 2.6 percentage points from 2006 to 11.0%.



Best Tone - Information Search Engine and Booking Services

In 2007, the Company's penetration rate of wireline value added services consistently increased. The revenue growth rate of Caller ID was 8.3% with a penetration rate of 66.6%, while the revenue growth rate of "Colour Ring

Tone" was 79.1% with a penetration rate of 28.7%. In addition, the Company consistently enriched and expanded the variety of wireline value added services. Telephone radio services achieved breakthrough, wireline telephone payment grew steadily in 2007.

The Company continued to promote the development of integrated information application services, including "Best Tone", IT services and application, enterprise informatisation applications, and video applications. In 2007, the revenue from "Best Tone" services increased by 155.5% from 2006. The Company launched a nationwide campaign for the promotion of whole-packaged "Best Tone BizTravel" services, which comprises a series of services in relation to ticket booking and hotel reservation, making "Best Tone BizTravel" and "Communication Assistant" highly-competitive products of the "Best Tone" services. Revenues from IT services and applications, and enterprise informatisation applications rapidly increased by 108.1% and 90.1% from 2006, respectively. In addition, the Company insisted on seeking broad cooperation, explored development approaches in respect to IT services and applications, and enterprise information application services, integrated its resources and established professional teams for planning and promoting of key products. Besides, the Company paid attention to the development of video applications, of which security monitoring services grew rapidly and commercial testing of IPTV progressed smoothly.

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In 2007, resources leasing services of the Company sustained a steady growth. Revenue from resources leasing services was RMB8,334 million, representing an annual growth rate of 9.3%, in which revenue from managed data services was RMB3,013 million and revenue from leased line services was RMB5,321 million.

### Customer Service and Channel Development

In 2007, in line with the shift of business focus, the Company constantly adjusted its distribution channels by covering major customer groups and products with core channels and developing e-channels in full swing. As a result, costs were reduced and efficiency was enhanced. With the assistance of sales offices and "Hotline 10000", direct channel account managers provided services to government and enterprise customers in accordance with the industry and consumption characteristics of the customers while allocating adequate resources to key products. Additionally, the Company capitalised on various forms of collaboration to improve its coverage for SME clients and other business customers. With physical and electronic distribution channels, the Company provided services to the household customers. In order to reinforce the basic services for the public and the differentiated services for the brand customers through physical channels, the Company set up exclusive service zones for brand customers in both first-tier and second-tier sales offices, and offered "all-in-one-form" and "no-form" services in some of the sales

offices. Moreover, electronic channels, including online customer service and "Hotline 10000", are capable of dealing with subscription of brand customers services. In 2007, upon the opening of subscription of e8 and e6 over "Hotline 10000", this channel accounted for 26.7% of total subscriptions, resulting in significant enhancement of channel efficiency. Constantly improved by the diversified service channels, the level of customer satisfaction remained leading in the industry.



BizNavigator - ICT services for government & enterprise customers

### Brand Operation

In 2007, the Company implemented a customer brand-oriented management strategy for business transformation. Through in-depth promotion, the Company has raised the recognition of "BizNavigator" and "One Home" brands and built up good brand images in the enterprises and household customers markets.

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To drive the sales to enterprise customers with "BizNavigator", the Company introduced three versions of "BizNavigator", which are communication, information and industry versions respectively. In 2007, revenue from government and enterprises customers increased 11.2% from 2006. Incorporated with label products, such as Super Cordless, enterprise switchboard and corporate "Colour Ring Tone", the Company introduced the communication version. In addition, with wireless modems and routers as customised terminals, and corporate mailbox and network hard disks as key applications, the Company introduced the information version. The total number of "BizNavigator" customers was 1.88 million. Aiming at the development of industry applications in relation to electronic government administration, Hotel Perfection Alliance, e-Campus, e-commercial buildings, conference and exhibition applications, "Mega Eye" and electronic tax filings, the Company organised and implemented the so-called "Hundred – Thousand – Ten Thousand" program, through which the number of customers in Hotel Perfection Alliance reached 5,843 while the number of "Mega Eye" monitoring spots reached 84 thousand.

With "One Home" as the core product, the Company proactively developed mid- and high-end households market. In 2007, focusing on the household customers, the Company



Colour Ring Tone - Fixed-line value added service

successfully organised the promotion activities for the launch of "One Home" brand and optimised the e8 and e6 packaged product series. Through nationwide marketing measures, including targeted brand promotion and improvement of customised terminals, the Company has promoted the scale development of "One Home". In 2007, the number of "One Home" customers was 10.54 million, with e8 customers accounting for 76% of "One Home" customers and 28% of total residential broadband subscribers, while the customised terminals of "One Home" were widely adopted by e8 customers. As a result, "One Home" has successfully strengthened its position in the households market, with revenues from household customers increasing steadily at 4.3% from 2006.

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As rural areas still have increasing demands for communication information services, they have



One Home – Integrated information services for household customers

become one of the major target markets of the Company. In line with informatisation strategy, the Company expanded the rural market and strengthened the customer base in rural areas by introducing a standardised integrated service brand – “Info Farm”, which provides services in relation to voice, broadband and distance education. In addition, the Company put great efforts in the development of “Countryside Network”. In 2007, most of the increase in number of telephone subscribers and about one-third of the increase in broadband subscribers were from the rural market.

### Construction of Network and Support Systems

By adjusting the focus and structure of investment, the Company has effectively controlled total investments. In 2007, capital expenditure of the Company totalled RMB45,558 million, representing a decrease of 7.2% from 2006. The ratio of capital expenditure to operating revenues decreased by 2.8 percentage points to 26.0% from 2006. In respect of the investment structure, the Company continued to increase investments into core products and transformation businesses. As a result, in 2007, the investment in the Internet and data service equipment increased by 37.4% from 2006. Meanwhile, the investment in fixed-line network switch equipment, local telephone transmission and access, and wireless local access decreased by 31.9%, 22.2% and 63.4% from 2006, respectively. In addition, the investment in telecommunications infrastructure and others dropped by 24.8%.

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The Company reinforced the support for business transformation through the promotion of network optimisation and renovation. In 2007, to ensure the service quality for key customers, the Company significantly increased IP backbone bandwidth, completed the optimisation and renovation of Metropolitan Area Network and its interconnection with CN2, and improved the support for the tailored end-to-end services over IP network as well as the network management capability. With the broad implementation of “replacing the old copper wire with optical fiber”, the Company promoted the deployment of optical fibre access network, which effectively increased the bandwidth for broadband access. At the end of 2007, 85% of our broadband Internet network will support 2M Broadband accesses, 65% of the network will support 8M broadband accesses, representing an increase of 7 percentage points and 12 percentage points from 2006, respectively. In 2007, the Company increased its wireless broadband (WLAN) hotspot coverage and roaming test spots. In addition, the Company actively promoted customised terminals of “One Home” to support its promotion. To supplement its brand value, the Company enhanced platform capacity and level of differentiated services for “BizNavigator”. Furthermore, to support the business development and nationwide standardised management of “Best Tone”, the Company standardised the search engine, data model and call centers.

To enhance the customer service level, the Company significantly upgraded and optimised its IT system. In 2007, the Company further improved the functions of Business Supporting System (BSS) to enhance the customer base management. Through the full implementation of Customer Relations Management (CRM) system, the Company has basically built a standardised customer database and profile, speeding up the implementation of “all-in-one form” function and further strengthening the capability of customer relationship management. Besides, the Company also established an integrated multi-service billing system and completed the development of corporate data application portals so as to provide strong support to precision marketing and sales.

### Outlook for 2008

In 2008, as the Company continues to deepen its strategic transformation and prepares for the upcoming full services offering, the Company will enjoy an excellent development prospect. However, due to constant changes of the pricing policy of mobile communication and the rapid diversion of traditional services attributable to emerging telecommunication methods, the Company will encounter more challenging issues in the course of development.

## Business Review

In 2008, the Company will actively implement its Customer-oriented Innovative Informatisation strategy. By putting focus on core customers, concentrating resources to the core customer groups and strategically allocating resources according to the strategic customer grouping, the Company strives to explore, direct and satisfy customers' demands for information services. In addition, the Company puts more emphasis on brand management by making greater efforts in brand promotion. In this way, brand image will be rapidly raised, forming differentiated competitive edge. The Company will continue to develop in the information services arena and insist on driving business development with applications. Through the development and promotion of information service applications and emphasis on information content operation, the Company will proactively extend its services in both the upper stream and lower stream of the industry chain so as to facilitate the scale development of integrated information services. By speeding up the innovation of technology, products and services, the Company will vigorously develop services in relation to IT services and applications, "Best Tone" and Internet applications. Attaching great importance to the strategic transformation as well as the R&D of future core products, we will implement the convergence of multi-communication means and multi-products in a broader perspective and strengthen our execution capabilities in providing integrated information services to our customers.