



CHAIRMAN'S
STATEMENT

“ We always believe everyone has a dream of having their own stage to perform on and shine. In the past two years, we vigorously sub-divided our performance evaluation units of operation, coupled with ancillary individual performance contracts and service support system. I am so pleased to see the standing out of tens of thousands of “unit CEOs”. Their passion and full dedication on chasing their dreams have fuelled China Telecom of 100 years’ legacy with vibrancy and vigor. I strongly believe that our “unit CEOs” will build a more promising future for our Company as they strive to realize their potential and personal value! ”



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In 2014, in the face of a number of prominent changes in the external environment, the Company rose to the challenges. While persisting in our established strategic direction, we proactively and flexibly adjusted our operation plans. We accelerated the transformation of our development model, achieving a stable growth in our operating results. By seizing the 4G development opportunities, the Company advanced the sound development of its 4G service in 56 trial cities with the strength of its hybrid network. The Company pragmatically promoted its comprehensive deepening reform to further liberate its productivity and continually generate development vitality. The Company proactively promoted an Internet-oriented transformation and accelerated the upgrade of its fundamental services and the “market-driven” development of its emerging businesses. The Company persisted in reform and innovation and strengthened open cooperation, enhancing its quality and efficiency. Moreover, we participated in the investment and establishment of the Tower Company and recently we were granted the 4G (LTE FDD) licence, which brought us brand new opportunities for our development.

Operating Results

In 2014, the Company accelerated its reform and transformation. Despite the impact of the value-added tax (VAT) reform and the geographical limitations on the trial of its 4G hybrid network, the Company still managed to achieve a stable growth in its revenue and profit. Operating revenues amounted to RMB324.4 billion, representing an increase of 0.9% over last year. Service revenues¹ amounted to RMB287.4 billion, representing an increase of 3% over last year, ranking first in the industry for the first time in respect of the growth rate of the revenues since the restructuring of the telecommunications industry in 2008. Emerging businesses accounted for 29% of service revenues, representing an increase of 5 percentage points over last year. Our business structure continued to be fast optimised. EBITDA² was RMB94.9 billion, while EBITDA margin³ was 33%. Profit attributable to the equity holders of the Company was RMB17.7 billion, representing an increase of 0.8% over last year. Basic earnings per share were RMB0.22. Capital expenditure was RMB76.9 billion while free cash flow⁴ was RMB12.5 billion.

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.

³ EBITDA margin was calculated based on EBITDA divided by service revenues.

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

GROWTH RATE OF SERVICE REVENUES in the industry

No. 1

The pilot programme of VAT reform commenced in the telecommunications industry in June 2014. Although it has an adverse impact on the Company in the short term, we expect that it will be beneficial for the sustainable development of the Company in the long term. The Company strived to optimise its development and sales models, implemented enhanced management over cost, procurement and vendors' tax qualifications. The relevant adverse impact has been moderated. In the future, with the continual expansion of the VAT reform to other industries, it is expected that the Company will be entitled to more input VAT credits. Together with the continuously optimising revenue structure of the Company, it will be beneficial for the enhancement of its profitability in the long term.

Taking into account the return to shareholders, the Company's profitability, free cash flow and capital requirements for its future development, the Board of Directors has decided to recommend at the

forthcoming shareholders' general meeting that a dividend equivalent to HK\$0.095 per share be declared for the year 2014, maintaining the same level of dividends as last year. Going forward, the Company will strive to enhance its profit while paving the way for an increase in future dividends.

Rising to the challenges and persisting in innovation to achieve stable growth

Accelerating transformation and upgrade of fundamental services

In 2014, the Company efficiently leveraged the synergy of the networks and target markets between 4G and 3G, with the splendid launch of 4G driving the sustainable development of its mobile services. With a focus on cities with high data traffic, the Company accelerated the establishment of 4G network and continued to strengthen the advantage of its network quality. The Company actively nurtured the 4G terminal value chain and introduced fashionable brands, resulting in a continual increase in the varieties of terminals. With the introduction of innovative products such as customised service plans and dual-number sim cards, and the enhanced package design of low-entry barrier, heavy data, sharable and do-it-yourself plans, customer experience was continuously enhanced. Our efficiently-centralised 4G operations further accelerated the pace of market responses and became an important milestone in the transformation of the operating model of mobile services. Mobile service revenues reached RMB120.3 billion for the year, representing an increase of 6% over last year, ranking first in the industry. Amid intensified market competition driven by the launch of 4G services and strengthened marketing promotions by the peers, the Company

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recorded a stable subscriber base of 186 million, with a net addition of 40,000 subscribers. Among these subscribers, the net increase of 3G/4G subscribers was approximately 15.52 million, achieving a subscriber base of 119 million and representing 64% of its total mobile subscribers. The subscriber structure was further optimised.

In 2014, along with the increasingly intensified competition in the wireline broadband market, the Company accelerated its innovation and transformed its business development model to continuously explore new business growth drivers. By continually leveraging the strength of its fibre network, the Company promoted comprehensive bandwidth upgrades for subscribers, with 50Mbps and 100Mbps bandwidth as its mainstream products and will also accelerate the promotion of end-to-end bandwidth speed upgrade, creating a comparative advantage throughout the entire network. The Company leveraged the integrated product, "Joy me", to create "Smart Family" portals, embodying smart terminals and applications to achieve an evolutionary upgrade from a single-function service to an all-in-one integrated product. The Company also launched standardised fast selling products such as "Speedy Connect" cards and prepaid cards to achieve the open channel sales of broadband services. Wireline broadband revenues amounted to RMB73.5 billion for the year, representing an increase of 4% over last year. The number of wireline broadband subscribers reached 107 million, representing a net increase of 6.85 million. Among these subscribers, Fibre-to-the-Home (FTTH) subscribers reached 42.61 million, accounting for approximately 40% of the total wireline broadband subscribers, representing an increase of 13 percentage points over last year.

Achieving significant breakthroughs in emerging businesses

The innovative business model of data traffic operations continued to enhance the value of data traffic. The Company continually expanded its scale of data traffic by optimising the sales and marketing model with an emphasis on management of data traffic value and the sharing of resources with mainstream Internet companies. Leveraging its integrated platform, the Company launched innovative data traffic backward monetisation products such as "Data Traffic 800" and "Liuliangbao", which established a data traffic resource exchange platform to further enrich the product mode and transaction method of data traffic products. To satisfy the personalised demands of users, the Company launched 4G dedicated-data traffic products focusing on videos, music and games, by deepening the optimisation of its intelligent pipelines and enhancing the core capabilities of its data traffic operations such as specific data identification. Mobile handset Internet access revenues amounted to RMB34.1 billion for the year, representing an increase of nearly 50% over last year. Aggregate 3G/4G handset Internet data traffic increased by 56% over last year, and the monthly average data traffic per 3G/4G handset subscriber reached 227MB, representing an increase of 19% over last year. The 3G/4G handset internet access ARPU accounted for 40% of the 3G/4G handset ARPU.

The Company continually enhanced the Internet application development model which comprised of portals, content and capabilities. Fully leveraging the data-attracting feature of portal-type applications to accelerate scale expansion, YiChat has become an important portal of mobile Internet services for the Company, creating a new independently operating model for the Company's Internet businesses. The rapidly growing "Best Pay" business became the most extensively covered daily-life payment platform in the country. The Company also leveraged products such as "Tianyibao" and "e-Surfing Credit" to promote the exploration of the Internet finance market and continually expanded its business scope. In 2014, the number of "Best Pay" users exceeded 100 million, ranking in the top five in the industry with a gross merchandise value exceeding RMB350 billion for the year, representing an increase of 1.6 times over last year. Relying on the integrated platform for the convergence of various quality application developers and Internet companies, the Company served as a linking bridge among developers, enterprises and subscribers by providing a vertically integrated service of network, capabilities and applications to build a new ecosystem for the mobile Internet business.

The Company focused on informatisation applications to further enhance its competitive strength in the Information and Communications Technology (ICT) services. Led by the "Smart Cities" project, the Company fully leveraged the advantage of its longstanding cooperation with the government and enterprises and continued to strengthen the informatisation development in areas such as urban safety, transportation and government administrative services. The Company also accelerated the promotion of scale replication of benchmarking industry applications, and achieved significant breakthroughs in targeted markets such as campuses, business customers and the rural market. The Company promoted the efficiently-centralised management and operation of the Internet Data Centre (IDC) business and the cloud computing services to reduce costs and enhance efficiency. The Company also accelerated the data aggregation and resource integration of Big Data across the whole network. It also rapidly promoted the transformation of its own data capabilities into products and established the China Big Data Union together with 44 enterprises. In 2014, the Company's revenues from ICT services amounted to RMB23.9 billion, representing an increase of 18% over last year.

**EMERGING
BUSINESS
revenues**
↑ 24%

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Fully deepening strategic transformation to develop differentiated edges

Solid progress in comprehensive deepening reform

In the area of fundamental services, the Company fully promoted the sub-division of performance evaluation units and commenced authorities delegation operations with performance contracts. Through delegating operation authorities and delineating clearly on responsibilities, authorities and interests, the Company continually enhanced the autonomy of frontline staff in operations to stimulate their vitality. By trial-running the "top down" service support system and implementing the cross-profession collaborative operations, the Company enhanced the speed of market responses and improved the efficiency of resource allocation, creating a flatter and highly efficient operating system. In the area of emerging services, the Company respected the mobile Internet development pattern and established segregated zones for innovations. In accordance with the principle of relatively segregating from fundamental services, the Company continued to improve its market-driven talent management mechanism, Internet-oriented resource allocation and financial management mechanism. To facilitate the rapid growth of emerging businesses, the Company strengthened its efficiently-centralised operations and established as well as enhanced its internal competition mechanism.

Fully commencing the Internet-oriented transformation

Leveraging its existing advantages, the Company further enhanced its market competitiveness through Internet-oriented operations. The Company coordinated its leading resources in an extensive efficiently-centralised manner and promptly launched differentiated products such as "cloud dam" (Distributed Denial of Service (DDoS) protection product) and security handsets. Fully leveraging Yichat, Wechat and other new mobile social media, the Company adopted new marketing initiatives such as event marketing and experience marketing to accelerate the transformation towards Internet-oriented marketing. By strengthening the efficiently-centralised e-channels and vigorously promoting the cooperation between online stores and social e-commerce merchants, the Company achieved a unified national operation of online stores in 2014, with online sales in 4G services amounting to 11%. With a view to promoting the Internet-oriented transformation of customer services, the Company made extensive use of new media for customer services such as Weibo and Wechat to promote online services, resulting in cost reduction and efficiency enhancement.

cooperate
with
44 ENTERPRISES
to form
**CHINA BIG DATA
UNION**

Open cooperation to strengthen competitive advantages of the ecosystem

Persisting in strengthening open cooperation, the Company created competitive advantages of the ecosystem. Through extensive collaboration with upstream and downstream partners along the value chain, including chipsets, terminals and Internet applications, the Company aggregated the strength of each party in all aspects to enhance its competitiveness. By vigorously promoting cooperation with open channels to accelerate the penetration of channels, the Company continually enhanced its market presence in rural areas and campuses and increased its market share of terminal sales through open channels. To foster the development of its wireline broadband services, the Company tried to introduce private capital and a more flexible mechanism in the construction of its local access network. The Company proactively launched the resale of mobile services (MVNO) and partnered with 26 resellers throughout the year. By taking the advantage of the resellers' competitive edges in areas such as business, services, channels and innovation, the Company further enhanced its network resource utilisation rate and investment return. Through the investment in establishing the Tower Company, the Company promoted the joint construction and sharing of telecommunications infrastructure facilities, with a view to further increasing its operating efficiency and corporate value.

Quality and efficiency enhancement to strengthen highly efficient operations

The Company continued to deepen its precision management, strengthen the overall coordination and optimal allocation of existing resources to further enhance the Company's operating efficiency and return. By optimising its sales and marketing model and enhancing its efficient use of marketing resources, in 2014, the Company reduced its sales and marketing expenses by more than RMB7 billion when compared to the previous year. By fully implementing the O2O collaborative operations, the Company conducted efficiently-centralised promotions of its online platform to strengthen the aggregation of customer flow, while, on the other hand, consolidating physical stores to enhance overall effectiveness. The Company continued to optimise its network deployment and resource allocation, and carried out cross-regional resource re-allocation to activate existing network assets, and thereby further promoting investment return and network resource utilisation. The Company also accelerated its reform in IT support, continued optimising the procurement process, and set up a VAT system to achieve a smooth transition upon the implementation of the VAT reform.

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Corporate Governance and Social Responsibility

We continue to strive to maintain 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 and orderly 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 in 2014, including being voted the “No. 1 Most Honoured Company in Asia” by *Institutional Investor* for two consecutive years, “No. 1 Best Managed Company in Asia” by *FinanceAsia* for four consecutive years and also “Overall Best Managed Company in Asia” by *Euromoney* for five years in a row.

We persisted in operating with integrity and proactively fulfilled our corporate social responsibility, while maintaining a fair and orderly environment for market competition and facilitating the healthy development of the entire value chain. We actively promoted green operations, further strengthened energy conservation and emission reduction, and improved utilisation efficiency of resources. We received high recognition and appreciation from the society by accomplishing telecommunications assurance services for significant events such as the APEC Summit and Youth Olympics, and contributing in the rescue and relief mission in earthquakes and other natural disasters.

Outlook

At present, China's economy has entered into the “new normal” of medium-high-level growth, and innovation will be the key driver for future development. The booming development of the “Consumption Internet” market along with the emerging “Industrial Internet” market in China will provide us with vast market potential. The issuance of the 4G licence will bring new opportunities for the industry development, and our corporate transformation development will generate new opportunities. At the same time, the domestic telecommunications industry is increasingly saturated, and market competition will gradually lead to an era of competition for existing customers. Under the new industry ecology, cross-industry competition and cooperation become a main trend, which brings severe challenges to the current operating model. Although the VAT reform is expected to be beneficial for the Company's development in the long term, it will still impose a significant impact on its profitability in the short term. Tackling various challenges will also become a new norm for the Company for some time in the future.

Looking ahead, we have full confidence. We will seize the crucial opportunities from the issuance of 4G licence and the sharing of tower resources. We will increase our investment and promote the rapid development of our mobile services in full strengths, especially the profitable scale development of our 4G services. We will proactively promote our comprehensive deepening reform, accelerate the transformation of our operation and management models to further stimulate the corporate vitality. We will speed up our Internet-oriented transformation and fully leverage our existing strengths in telecommunications. We will engage in open cooperation and strengthen our competitive advantages of the ecosystem to enhance our differentiated operational capabilities. We will rapidly establish a new China Telecom so as to create values for shareholders.

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 Madam Wu Andi, Mr. Shao Chunbao and Mr. Du Zuguo for their valuable contribution during their tenure of offices as executive director, Chairman of the Supervisory Committee and supervisor of the Company, respectively.



Wang Xiaochu
Chairman and Chief Executive Officer
Beijing, China

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