

CHAIRMAN'S STATEMENT

“ Ready for next
MOVES
蓄勢待發 開拓未來 ”



Wang Xiaochu
Chairman and Chief Executive Officer

Dear Shareholders,

I am gratified by the results of the first half of the year 2007. Despite facing harsh challenges from intense market competition, we have successfully maintained our solid fundamentals, benefiting from the effective implementation of strategic transformation. The Company has continued to record growth in both revenue and profit. Through the transformation, our business structure was further optimised with our Internet access, value-added and integrated information services gaining momentum. This has also vigorously abated the pressure on the operation of our traditional voice business. What encourages me most is that, on implementation of the transformation during the past two years and beyond, our people at all levels have continued to liberalise their mindset and courageously faced the prevailing tough operating environment while executing the transformation strategy with passion. They keep on exploring and innovating products and services to satisfy the increasingly diverse communication and information needs of our customers, leveraging our rich resources and infrastructure. We firmly believe that as we further deepen our strategic transformation and capitalise on our multi-services convergence offering edge, we would drive greater value for our customers and for you as shareholders.

CHAIRMAN'S STATEMENT (Continued)

FINANCIAL RESULTS

In the first half of 2007, operating revenues reached RMB88,624 million, of which RMB1,666 million were accounted for by the amortisation of upfront connection fees. Excluding the upfront connection fees, operating revenues were RMB86,958 million, a 2.5% growth compared to the same period in 2006. EBITDA¹ was RMB44,551 million, and the EBITDA margin¹ maintained at a healthy level of 51.2%. Operating expenses were RMB68,340 million, an increase of 3.3% compared to the same period in 2006. Profit attributable to equity holders of the Company¹ was RMB11,816 million, an increase of 1.3% compared to the same period last year, and basic earnings per share¹ was RMB0.15. Capital expenditure was RMB20,435 million, 1.6% less than that of the same period last year. Free cash flow² was RMB19,356 million.

Taking into consideration of 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 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 2007, the Company's voice business was affected by the continuous decline in effective mobile tariff, the extensive implementation of mobile calling-party-pay packages and the increased diversity in communication methods. Our voice revenue recorded RMB56,997 million, a decrease of 6.9% from the same period last year. In face of the immense pressure of declining voice revenue caused by the aggressive expansion of mobile operators, the Company strengthened its customer brand operation to fully capitalise on branding premium value. Leveraging our two major customer brands, "BizNavigator" and "One Home", we further expanded our Internet access, value-added and integrated information services, so that our non-voice businesses emerged as the new revenue-drivers for the Company. In the first half of 2007, our non-voice businesses revenue reached RMB29,961 million, an increase of 26.9% compared to the same period last year, triggering 7.5 percentage points growth in revenue and accounting for 34.5% of operating revenue. The Company's revenue profile was thus further optimised. Additionally, our high-quality customer brands enhanced effective packaged sales of both voice and non-voice businesses, fostering customer loyalty and consolidating revenue. It also progressively transformed voice usage value to integrated information services, enhancing our multi-services convergence offering edge and making good the loss in voice revenue to a certain extent.

Starting from this year, the Company has further increased the marketing efforts of broadband access, in particular for the penetration of the government & enterprise customers as well as mid-to-high-end household customers, to achieve its high value and scale development. To reinforce our leading position in the broadband market, the Company has also persistently improved the quality of the Internet network as well as the user-ends' bandwidth to enhance customers' experience. The number of our broadband subscribers increased by 3.87 million to 32.19 million in the first half of the year. In order to accelerate the development of our Internet applications business, we strengthened the cooperation with renowned software and content providers, such as Microsoft, Google and Sina to improve our back-end operation. Revenue brought by our Internet value-added services grew by 54.2% in the first half of the year.

1 Including the amortisation of upfront connection fees, EBITDA was RMB46,217 million, EBITDA margin was 52.1%, profit attributable to equity holders of the Company was RMB13,482 million and basic earnings per share was RMB0.17.

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

CHAIRMAN'S STATEMENT (Continued)

For our value-added and integrated information services, the Company concentrated its efforts in promoting the development of services, such as “Best Tone” (information search engine), enterprise informatisation applications, IT services and applications. We also nurtured new value-added services such as media advertising and video applications, thus establishing an advantage over our peers in core competitiveness. These new services play an important role in consolidating the Company's traditional voice business and creating room for further business growth. The Company also established specialised subsidiaries to operate our “Best Tone” and system integration businesses respectively, introducing innovative management and incentive mechanisms to promote the rapid development of integrated information services at their growing phase and gradually establish a new operating model that would better suit their development.

Over the past two years and beyond, through transformation in our businesses, networks and human resources, we have developed a series of established products and services such as “Best Tone”, “Mega Eye” (remote monitoring) and ICT (Information, Communication and Technology), which laid a solid foundation for our customer brand operation. In the first half of the year, we transformed our operation model from product-oriented to customer-oriented to better cater to our customers' needs. We enriched the product combinations under our customer brands and aligned marketing resource allocation with customer value to enhance customers' perception and loyalty. Leveraging our two major customer brands, “BizNavigator” and “One Home”, we concentrated our marketing efforts and resources on the key customer segments of government and enterprise as well as mid-to-high-end household, providing them with our integrated information solutions which incorporated voice, broadband access and Internet applications, enhancing customers' value in a broader market. The success of “BizNavigator” and “One Home” brought our packaged multi-services strategy into a new stage. Consumers began to appreciate the value enhanced by the multi-services packaging under the customer brand oriented operation. Customer brand operations have driven the robust growth of our non-voice businesses and reduced the risk of our traditional voice business at the same time.

To tackle with the intense market competition, the Company has persistently improved its financial management. Leveraging comprehensive mechanisms, the Company allocated resource tilting towards business or operating units with high growth and high profitability to ensure the quality and growth of transformation businesses, and directed each level of the corporation to embrace long-term value creation. The Company also strived to ensure sustainable revenue growth, reinforce financial control and cost control with a view to enhancing its operating efficiency and value creation capability.

CORPORATE GOVERNANCE

We are firmly committed to continuously improving our corporate governance and transparency to ensure our healthy development and enhance our corporate value. With regard to the US Sarbanes-Oxley Act, the Company continuously strengthened its internal control systems while further improving its risk management system to effectively lower operating risk. Our efforts in corporate governance have been widely recognized by the capital market and honored with a number of awards, including the accreditation with “CAPITAL Outstanding China Enterprise Awards — Telecommunications” by CAPITAL magazine for two consecutive years. Furthermore, in the nomination of the Asia's Best Companies 2007 (China region) organised by FinanceAsia, we achieved top rankings in the “Best Managed Company”, “Best Corporate Governance” and “Best Investor Relations” categories.

CHAIRMAN'S STATEMENT (Continued)

FUTURE OUTLOOK

Our strategic transformation has gathered pace with brand building further strengthened and customer brand oriented operation progressively enhanced. Emerging integrated information business has grown rapidly, expanding new markets for the Company. Our revenue profile has been further enhanced, alleviating the risk of traditional voice business. In addition, we successfully acquired from our parent company, its subsidiaries in Hong Kong and US, as well as its system integration operating subsidiary. These acquisitions have afforded us with expanded markets for our development.

Looking ahead, we are fully confident. Rising demand in the domestic telecommunications market brings a great wealth of opportunities. The vast market potential in social informatization provides us with broader room for development. As we further deepen the strategic transformation, our roadmap is getting clearer. We have built our experience in integrated information operation with our people getting more suited to the requirements of strategic transformation. We are confident that the Company would achieve sustainable development and drive more value for its shareholders.

Finally, on behalf of the Board of Directors, I would like to thank our shareholders and customers for their continuous support to the Company. I would also like to take this opportunity to express my gratitude to our people for their considerable efforts in the corporate transformation.



Wang Xiaochu

Chairman and Chief Executive Officer

Beijing, PRC

28 August 2007