

## Chairman's Statement



**Wang Xiaochu**

*Chairman and Chief Executive Officer*



In the first half of 2010, we deepened the promotion of our “Customer-focused Innovative Informatisation” Strategy, leveraging our full services integrated operation to expand the market and riding on the differentiated operations to create competitive edges. The Company achieved invigorated results: Our mobile service continued to maintain robust development with expanding scale, while mobile terminal supply also showed significant improvement. We strengthened our market leading position in wireline broadband and integrated information services. Our overall business structure was further optimised with remarkable earnings recovery. The sustainable development of the Company’s full services operation is gaining momentum.



## Chairman's Statement (Continued)

### Business Performance

In the first half of 2010, the Company's operation was on track as planned. The operating revenues reached RMB107,817 million. Excluding the amortisation of upfront connection fees, the operating revenues were RMB107,552 million, representing a growth of 4.9% over the same period of last year, of which mobile service revenue amounted to RMB22,770 million, up 77.7% from the same period last year. Revenue from non-voice services as a percentage of the operating revenues further increased to 56.3%, amongst which wireline broadband access revenue attributed to 24.5% of the operating revenues. This further optimised our overall business structure as well as our ability to mitigate risks. EBITDA<sup>1,2</sup> was RMB45,759 million, a 5.6% increase from the same period of last year, while the EBITDA margin was 42.5%. Profit attributable to equity holders of the Company<sup>2</sup> was RMB8,811 million, representing an increase of 4.7% from the same period of last year and growth of 81.3% over the second half of last year. Robust earnings trajectory marked a good start of our result improvement. Basic earnings per share<sup>2</sup> was RMB0.109. Capital expenditure was RMB17,918 million, an increase of 5.2% over the same period of last year. Free cash flow<sup>3</sup> reached RMB18,591 million.

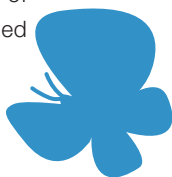
Taking into consideration the Company's business development needs, the Board of Directors has decided not to pay any interim dividend for the period in order to maintain adequate funding flexibility. The Board of Directors will proactively consider the final dividend proposal when reviewing the full year results and will propose to the shareholders' general meeting accordingly.

### Expanding Integrated Operation and Optimising Business Structure

In order to innovate business development model and achieve scientific development in the new landscape, we pooled our resources to actively promote the development model of full services integrated operation. We are committed to building a system for multi-services integrated packages of products and services as well as marketing and sales, accelerating product development, initiating cooperation on developing applications, and continuously enriching the content of our integrated operation by leveraging our comprehensive range of products. We also established a network structure and IT support capabilities to support our full services operation, while at the same time further deepened precision management and optimised resource allocation. With unwavering efforts, our integrated operation model has effectively driven the rapid growth of our mobile and broadband services. There was a significant increase in revenue proportion from our mobile, broadband and integrated information services, while the risk to our wireline voice service was further alleviated.

We have fully leveraged our advantages in the integrated bundling operations and our mobile services gained traction. The number of mobile subscribers increased by 18.43 million in the first half of the year to a total number of 74.52 million, of which 7.18 million were 3G subscribers. The mobile subscriber packaging penetration rate was over 50%. Our market share of mobile subscribers was close to 10%, an increase of 5 percentage points from the end of 2008. Our mobile voice usage showed a trend of continual improvement on a monthly basis, doubling the level of the same period of previous year, while the ARPU of subscribers remained relatively stable compared to last year.

- 1 For convenience of investors' analysis, EBITDA is calculated before CDMA network capacity lease fee.
- 2 Including the amortisation of upfront connection fees, EBITDA was RMB46,024 million, profit attributable to equity holders of the Company was RMB9,076 million and basic earnings per share was RMB0.112.
- 3 Free cash flow was calculated from EBITDA (excluding amortisation of upfront connection fees) minus the CDMA network capacity lease fee, capital expenditure and income tax.



## Chairman's Statement (Continued)

With the wireline broadband services as the foundation for deepening the integrated operation and expanding the mobile Internet service, we established the brand of "eSurfing Broadband" in the first half of the year and integrated our wireline and wireless broadband services. We proactively expanded our subscriber base by investing more than 60% of our capital expenditure on broadband network infrastructure to accelerate bandwidth upgrade, enhancing the quality of our broadband services and promoting our differentiated applications. In the first half of the year, the net addition of wireline broadband subscribers was 4.87 million, reaching a total of 58.33 million. Revenue from wireline broadband access services reached RMB26,302 million, an increase of 15.6% compared to the same period of last year.

We always focus on the development of integrated information services as the highlight of our strategic transformation, and endeavour to provide comprehensive industry applications and public applications to customers and meet the ever growing demand of the market. In the first half of the year, revenue from wireline value-added and integrated information services reached RMB13,713 million.

With mobile, broadband and information application services marking the rapid development of the modern telecommunications, traditional wireline voice services face more challenges. Therefore, we strived to mitigate the decline in revenue from our wireline voice services by providing targeted packages to customers. Through the proactive and orderly migration of the PAS services to effectively alleviate operating risk, we endeavoured to maintain the Company's overall operational profitability with stringent control on related investment and other measures. In the first half of the year, there was a net loss of 7.61 million PAS subscribers. The total number of access lines in service was 181 million as at the end of June this year.

## Creating New Competitive Edges through Differentiated Operations

We persist in differentiated operation, targeting government and enterprise and public customers to take differentiated marketing initiatives, and proactively expand subscriber base to facilitate revenue growth.

For the government and enterprise customer market, we fully utilised the edge we have accumulated over the years to expand into the mid-to-high end market with differentiated service offerings and form extensive strategic partnership with government entities and large corporations. We focused on areas such as government affairs, transportation and logistics, "All-in-one eSurfing handset" and digital hospitals, while strengthening the development of new industry applications and showcasing by creating pilot customers so as to accelerate the scale replication and promotion of ICT services. By the end of June this year, the number of "BizNavigator" subscribers reached 4.85 million, representing an increase of 11.2% from the end of last year.

For the public customer market, our primary strategy is to strengthen the collaboration with partners in content and applications. Leveraging the core product values of our partners, we provide a more comprehensive range of mobile Internet applications. In the first half of the year, we progressively launched new products such as mobile payment, "eSurfing reader" and mobile positioning services. The numbers of subscribers to services such as "189 mailbox", "eSurfing LIVE", and "eSurfing Video" have more than doubled. We will take further steps to highlight the concept of mobile Internet handset while focusing on traffic-centric operation, opening up intelligent channels and platforms, and deepening our collaboration with various reputable Internet content providers and integrators of core industry applications. We will endeavour to provide enriched content and applications for our customers, as well as to promote the transition of the Company towards a higher-value mobile Internet application services provider.

## Chairman's Statement (Continued)

### Strengthening Infrastructure to Promote Full Services Development

We are committed to building a superior network. We have further accelerated the broadband transmission speed upgrade. In city areas, the network basically featured 4M or above broadband access capability with 44% coverage of 20M or above. In order to seize the market opportunities, our next step will be to further invest in fibre broadband network, particularly "Fibre-to-the-Home" (FTTH). This will facilitate broadband subscriber development and help us to consolidate and strengthen our core competitiveness continuously. We continued to optimise our EVDO network which covers all cities above county-level and over 20,000 towns, while accelerating Wi-Fi hotspots construction and optimisation. This will sustain our leading position in network coverage and quality transmission support for mobile Internet traffic-centric operation.

We also further strengthened collaborations. We strengthened the cooperation with handset manufacturers in order to improve the handset supply to meet market demand and efficiently alleviate the bottlenecks. We also enhanced the development of distribution channels and promoted the scale development of open channel. Mobile subscribers developed and handset sales by open channel accounted for more than 50%.

We continued to promote precision management and further optimise resource allocation. We expanded our investment in broadband and fibre access, persisted in resource allocation tilting towards high-growth and high-value services, enhanced capital utilisation by actively redeploying inactive assets and deepened centralised capital management to save finance costs and thus enhance profitability.

### Corporate Governance and Social Responsibility

We strived to maintain our high standards of corporate governance by continuously improving corporate transparency, ensuring the healthy development of the Company, and enhancing corporate values. Our continuous efforts in corporate governance are widely recognised by the capital market and we were accredited with a number of awards in the first half of the year, including recognition as "Asia's Best Companies in Corporate Governance" by *Corporate Governance Asia*, and "Best Managed Company in China" and "Best Managed Company in Asian Telecom Sector" by *FinanceAsia* in the Asia's Best Companies Poll. The Company's stock was also selected as constituent of Hang Seng Corporate Sustainability Index.

As one of the leading telecommunications operators in China, we serve as a role model for fulfilling social responsibilities. We actively contributed to the rescue efforts during the Yushu earthquake in Qinghai Province and the flooding in the southern provinces. Our emergency rescue teams hustled off the disaster areas and quickly restored wireline and mobile communications services, ensuring undisrupted communications during the rescue operations. As an integrated information service partner, we also fully supported the Shanghai World Expo. Our capability in providing quality communications was highly appreciated by participants at the Shanghai World Expo.

## Chairman's Statement (Continued)

### Future Outlook

With the advent of mobile Internet and the three-network convergence era, the Company is embracing another major period of strategic opportunities and huge development potential. At the same time, the Company is also facing the challenges of intensifying competition in the telecommunications sector. We will continue to deepen our integrated operation by focusing on the development and retention. On one hand, we will focus on fulfilling our customers' needs and accelerating the promotion of broadband access and mobile services, particularly in the 3G development. On the other hand, we will also work to retain our existing subscribers and maintain our traditional services and coordinate the sustainable development of the four pillars of our business – mobile, broadband, wireline voice and valued-added and integrated information services.

On this foundation, we will fully utilise our leading edges in the largest Internet broadband subscriber base, the most reputable 3G brand and the widest 3G network coverage. While improving the superiority of our network infrastructure, we will also focus on mobile Internet traffic-centric operation and open our service platforms to strengthen the cooperation in the application and handset terminals. By establishing new differentiated competitive edges, we will strive to break new ground for our full services integrated operation and continue to create more value for our shareholders.



**Wang Xiaochu**

*Chairman and Chief Executive Officer*

Beijing, PRC

25 August 2010