

Chairman's Statement



Dear Shareholders,

In the first half of 2019, communications industry in domestic market faced challenges from various aspects, including traditional businesses becoming increasingly saturated, and diversified competition in emerging areas getting more intensified. However, information and communications technologies, such as cloud computing, 5G, and AI, become increasingly mature, creating new room and providing new growth impetus for the industry. Faced with this new situation, the Company adhered to the new development principles and implemented supply-side structural reforms. Moreover, the Company fully capitalised on the edges offered by its

network and talents, while pushing forward reform and innovation steadily. Our corporate capabilities and vitality were further enhanced, while preliminary results in high-quality development have been achieved. Our business performance remained healthy and solid while our capabilities for future sustainable development were continuously strengthened. In June, commercial licenses for operating 5G digital cellular mobile business were officially granted, marking the commencement of the highly anticipated new 5G era, and bringing forth a historic opportunity for the vibrant development of digital economy. In line with market-driven and customer-oriented principles, the Company will speed up its planning and preparation in all aspects ahead of 5G

scale commercialisation, accelerate the pace of 5G scale commercialisation proactively and pragmatically. The Company will also continuously push forward its corporate transformation and the conversion of its development model to drive high-quality development and endeavor to create new value for shareholders.

Overall Results

In the first half of the year, operating revenues of the Company amounted to RMB190.5 billion. Service revenues¹ amounted to RMB182.6 billion, representing an increase of 2.8% compared to the same period last year and continuing to maintain the leading position in the industry. Of which, mobile service revenues amounted to RMB88.2 billion, representing an increase of 5.6% over the same period last year; wireline service revenues amounted to RMB94.4 billion, representing an increase of 0.3% over the same period last year. Revenues from emerging businesses² accounted for 55.4% of service revenues, contributing 5.7 percentage points within service revenues growth, alongside a continual optimisation of the revenue structure and the continuous magnification of development impetus. EBITDA³ amounted to RMB63.3 billion, representing an increase of 13.3% over the same period last year. Net profit⁴ amounted to RMB13.9 billion, representing an increase of 2.5% over the same period last year while basic earnings per share were RMB0.172. Capital expenditure was RMB35.0 billion, representing an increase of 6.3% over the same period last year. Free cash flow⁵ remained strong at RMB18.3 billion.

Taking shareholders' returns into consideration, alongside the Company's profitability, cash flow level and capital needs for its future development, the Board of Directors has decided not to pay an interim dividend this year. The Board of Directors will proactively consider the demand for shareholders' returns and comprehensively evaluate the final dividend proposal when reviewing the Company's full year results and will propose to the shareholders' general meeting

accordingly. In the future, the Company will strive to create good returns for shareholders.

On-going enhancement of scale and development impetus

In the first half of the year, the Company grasped the precious time window of 4G business and continued to expand its subscriber scale. The Company spared no efforts to cultivate cloud-network integration to strengthen its competitive advantages. The Company also dedicated itself to building the Smart Family ecosystem and pushed forward the vigorous development of DICT⁶ and Internet of Things (IoT), further accelerating the conversion of development impetus.

Continuous subscriber scale expansion and elevated market position.

Insisting on strategies of large data traffic and convergence, the Company continued to promote scale expansion, and foster large data traffic usage habit as well as value opportunity. The Company created informatisation solutions for households and proactively responded to the fierce competition in the broadband market. In the first half of the year, the total number of mobile subscribers reached 323 million, representing a net addition of 20.48 million and maintained leadership position in market share of net addition. The Company's overall market share increased to 20.4%, representing an increase of 0.8 percentage point compared to the end of last year. In which, the number of 4G subscribers reached 266 million, representing a net addition of 23.71 million. 4G penetration rate reached 82% and continuously maintained industry-leading position. Aggregate handset Internet data traffic doubled, with 4G DOU reaching 7.3GB. Handset Internet access revenue grew by 11.5% compared to the same period of last year. The total number of wireline broadband subscribers grew beyond 150 million, representing a net addition of 4.39 million. Of which, the proportion of broadband subscribers for 100Mbps and above reached 69.6% and the triple-play penetration rate⁷ reached 63.3%.

¹ Service revenues are calculated based on operating revenues minus sales of mobile terminals, sales of wireline equipment and other non-service revenues.

² Revenues from emerging businesses include revenues from data traffic, Internet applications and DICT services.

³ EBITDA is calculated based on operating revenues minus operating expenses plus depreciation and amortisation.

⁴ Net profit represents profit attributable to equity holders of the Company.

⁵ In order to more objectively reflect the Company's free cash flow, enable a comparable basis to free cash flow of prior periods and avoid incomparability of free cash flow resulting from the application of IFRS 16, the original free cash flow calculation "free cash flow = EBITDA minus capital expenditure and income tax" has been changed to "free cash flow = EBITDA minus capital expenditure, income tax and depreciation charge for right-of-use assets other than land-use-rights."

⁶ DICT is the converged smart application service integrating three technologies, namely communications technology, information technology and cloud & Big Data technology.

⁷ Triple-play penetration rate represents the proportion of broadband subscribers by identity document who also subscribe to mobile and e-Surfing HD services at the same time.

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Cloud-network integration as the driving force, the new impetus rapidly strengthened. The Company proactively expanded and consolidated the resource endowment edges offered by cloud-network integration, further explored and fostered new informatisation demand within the household, government and enterprise markets. We continued to enrich our Smart Family applications portfolio, and facilitated the rapid development of DICT and IoT by leveraging cloud-network integration and IoT-cloud integration as the driving force. We also explored the organic integration of informatisation solutions with new technologies such as edge computing and network slicing. In the first half of the year, the number of e-Surfing HD subscribers reached 111 million, and the number of smart gateway and family cloud subscribers reached 61.80 million and 32.15 million respectively. DICT and IoT businesses together contributed 3.0 percentage points within service revenues growth, with revenues from IDC and cloud services increasing by 11.0% and 93.2% respectively compared to the same period last year. Revenue from IoT increased by 52.0% compared to the same period last year. Revenue from Internet Finance increased by 112.2% compared to the same period last year, while the gross merchandise value grew by 40.4% over the same period last year.

Focus on development to enhance capabilities, reform and innovation to increase vitality

In the first half of the year, aligning to high-quality development, the Company strengthened its capabilities on network, customer service and business operation, and incentivised the vitality of employees.

Strengthen network edges and speed up "Cloudification"⁸. The Company continued to conduct targeted coverage and dynamic capacity expansion of its 4G network, with the number of 4G base stations reaching 1.52 million, supporting the full commercialisation of VoLTE service and safeguarding the user experience for large data traffic customers. To further consolidate the quality advantages of broadband access, the Company deployed on-demand Gigabit fibre broadband in over 180 cities. The Company also extensively built up its comprehensive edges in "Omnipresent network for IoT" based on its mobile, NB-

IoT, fibre networks and cloud. The Company promoted the "Cloudification" of its network infrastructure and accelerated the construction of a new generation cloud-based network that is simple, agile, efficiently-centralised, open and secure. The Company carried out targeted construction based on demand in certain key areas. The number of IDC cabinets reached over 340,000 units, maintaining an industry-leading position in terms of scale. The Company also built a high-quality Optical Transport Network (OTN) for government and enterprise customers to satisfy corporate customers' demand for cloud network products with high quality, excellent reliability and low latency. The number of e-Surfing Cloud resource pool exceeded 100 nationwide. The Company's market share of IaaS public cloud currently ranks 7th in the world, rendering us the only telecommunications operator ranked among the top 10 globally⁹.

Promote value-focused scale development guided by customer-oriented principles. With scale as the base, the Company collaborated extensively to innovate, constantly enriched its ecosystem and seized the vast value potential brought about by the evolution of communications consumption to informatisation solutions. The Company capitalised on its subscriber and network resource endowment to accelerate innovation of Smart Family applications, build product and servicing system that encompass smart broadband, platform, applications, security and services. The Company collaborated closely with leading smart home enterprises to launch over 100 different types of smart terminals. The Company continued to explore the extension of its family informatisation solutions to the community and city levels, while promoting the coordinated eco-development of Smart Family, DICT, and IoT. With cloud network as the core, the Company optimised key capabilities and core application platforms of DICT, accelerated the promotion of dedicated cloud network, hybrid cloud and software-defined wide area network (SD-WAN). The Company also strengthened the intelligence and security attributes of dedicated lines. All of these efforts were made to enhance the overall service capabilities of DICT in an all round manner. Focusing on high-quality development, the Company built up a customer-oriented operation system, and enhanced service quality led by user experience. The Company also built up a new service system and attached greater importance to customer service evaluation. Through

⁸ Cloudification refers to the comprehensive upgrade of service and network to cloud in terms of infrastructure, products service capabilities and sales mode, with a focus on cloud computing.

⁹ Source: IDC

these efforts, the Company established a service benchmark model that customers can enjoy freely and rely on, maintaining its industry-leading position in service quality. The Company also explored new sales models for ecological expansion in channels as well as scene marketing under the new forms of business, while optimising its incentive mechanism and strengthening the capability of its sales channels. In the first half of the year, the Company ranked the industry's best with overall customer satisfaction, as well as satisfaction with mobile and wireline broadband Internet access services¹⁰.

Intelligent operation driven by IT and Big Data analytics to increase efficiency. We continued to upgrade our IT capabilities to support high-quality development. After gradually implementing the BSS 3.0 system, the time required for product launch has been reduced significantly, which greatly improved our capability to quickly respond to market. We also further reduced the time required for billing, leading to a continual enhancement of customer experience. Through our focus on "Cloudification", dedicated cloud network services can be activated within minutes in more than 20 provinces. To promote intelligent operation, we continued to strengthen our Big Data capability. Our Big Data platform is now collecting over 300TB of data daily. Coupled with AI technologies, the Big Data platform is gradually introduced to areas such as contracts, financial accounting and others, so as to improve management efficiency. Focusing on efficiency enhancement in key resources such as cost, investment, and taxation, we can intelligently identify abnormal costs, conduct analysis of return on investment, and manage product cycles more accurately. We also promoted "4-precision"¹¹ applications, with precision sales and marketing as well as precision service now covering 240 million customers. This also facilitated more precise human resource allocations among frontline staff, and provided support for the dynamic capacity expansion of the 4G network as well as the planning for future networks construction.

Corporate vitality inspired by in-depth reform. Guided by high-quality development, the Company promoted reform and innovation on all fronts and enhanced our capabilities and vitality. We reformed our operation systems based on customer-oriented principles, while continuously deepening the establishment of capabilities centres and supporting system reform for Smart Family, IoT, Cloud, DICT and Internet Finance. We

have built a vertical channel for co-sharing data capabilities and accelerated the launch of products and applications. Facing new technologies and new business models, we sped up the exploration of reform to our operation system for government and enterprise customers, as well as reform to our organisation system for network operation, sales and marketing and service. These efforts were made to increase the end to end response rate for customers and enhance our capability to provide integrated information services, for the step-up transformation of traditional industries. We further deepened our system reform for technological innovation and continued to increase investment in R&D for new emerging technologies. We also made further strides in building a team of leading experts and accelerated the innovation of proprietary core technologies. The Company published the industry's first *Smart Family White Paper and Artificial Intelligence Development White Paper*. The Company also deepened the three-dimensional inter-driven reform comprising "Sub-dividing Performance Evaluation Units, Top-down Service Support System, and Professional Operation". As a result, the Company fully motivated its employees and promoted "Sub-dividing in management", further reducing costs and improving efficiency. The Company also further promoted the mixed ownership reform of its professional subsidiaries, while Internet finance company was successfully included in the fourth batch of pilot mixed ownership reform for state-owned enterprises (SOE), and the "Double-hundred Action" list for SOE reform.

Collaborative innovation and comprehensive planning to accelerate 5G commercialisation

Following the official issue of 5G licenses, the 5G scale commercial launch is fast approaching. Insisting on the open and cooperative principles featuring capacity sharing, value co-creation and mutual wins of industry peers, the Company is accelerating its planning for 5G on all fronts to proactively grab opportunities brought by 5G industry.

In areas of technology R&D, we have actively built up our core capabilities of 5G, and promoted innovative convergence of 5G with technologies such as cloud computing and AI. We sped up the establishment of edge computing platform and network slicing

¹⁰ Source: MIIT

¹¹ "4-precision" refers to precision management, precision sales and marketing, precision service and precision network operation.

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management platform, banded together with our industry partners to jointly release 5G "Super Uplink" solutions and rolled out all-cloud and all-fibre based 5G cloud network solutions for enterprise customers. The Company also continued to promote co-building and co-sharing, low-cost indoor coverage as well as the innovation of core technologies such as AI enabled 5G, striving to elevate the Company's position in the 5G industry chain.

In the area of application innovation, the Company has carried out extensive cooperation and innovation, and accelerated the proliferation and launch of informatisation solutions with 5G features for individual lifestyle, families and communities, as well as government and enterprise customers. For the individual consumer market, we have developed personal applications such as cloud gaming and cloud VR. We explored innovative service models based on membership and module combinations of "communication + privilege + applications", with the hope to build differentiated market competitiveness and open up room for value growth. For the family market, we sped up the expansion of Smart Family applications of "5G + Gigabit broadband + Cloud", and collaboratively developed innovative products that are exclusive for 5G or Gigabit broadband such as 8K panoramic video, 4K giant screen theatre, and cloud VR games. This will enable us to occupy a commanding height ahead of others within the Smart Family market. For government and enterprise customers, we continued to explore the integration of DICT and IoT with the capabilities offered by 5G, edge computing and AI, to build our synergistic edges of 5G, cloud-network integration, as well as cloud-edge computing. The Company spared no efforts in building its differentiated edges with "5G + IoT + fibre network + Cloud", to cater the new informatisation demands in the digital transformation of various industries with the brand-new 5G cloud network solutions. The Company has already signed contracts with more than 400 enterprise customers to carry out collaborative innovation of 5G+ industrial applications, covering industries that encompassed transportation, environmental services, medical service, live broadcast, education, and tourism, among others, thereby greatly enhancing the breadth of 5G use cases.

In the area of network construction, the Company persisted in standalone (SA) network as the direction and attained a number of industry-leading achievements such as 4G and 5G interoperability, interoperability of equipment from different vendors, and interoperability of SA chipsets with various vendors under the SA network architecture. Taking into consideration the maturity of technologies, the industry chain and application scenarios as well as the market competition, the Company will launch standalone/non-standalone (SA/NSA) hybrid networks in about 50 cities at the initial stage, following a market- and customer-oriented approach. Continuous coverage with scale in the urban areas of certain key cities will be achieved. The Company will promote the value chain maturity of SA and strive to begin SA network upgrade in 2020, and offer its 5G differentiated network capabilities such as SA-based edge computing and network slicing. At the same time, the Company will proactively explore and promote co-building and co-sharing of 5G network infrastructure resources to reduce the cost of network construction, operation and maintenance, while jointly promoting the industry's prosperity and sharing the fruits of its development with domestic and foreign partners.

Corporate Governance and Social Responsibility

We strive to maintain high level of corporate governance and have always adhered to excellent, prudent and efficient corporate governance principles. We insist on governing the Company in accordance with laws and regulations, and attach great importance to risk management and control, and continue to enhance our corporate transparency to ensure the healthy and sustainable growth of the Company. In the area of corporate governance, our efforts have been widely recognised by the capital market. We were awarded "No.1 Best Managed Company" in China, "No.1 Best Investor Relations", "No.1 Best ESG" and "No.2 Best Growth Strategy" by *FinanceAsia*. We were also awarded "The Best of Asia — Icon on Corporate Governance" by *Corporate Governance Asia*. The Company's outstanding performance in areas of corporate governance, social responsibility, and environmental protection, among others, continues to be widely recognised and highly appreciated by the capital market.

We adhere to the core values of “comprehensive innovation, pursuing truth and pragmatism, people-oriented approach and creating shared value”. We are committed to integrating corporate social responsibility matters such as environmental protection, social responsibility and corporate governance into our development strategy, daily operations and management, while proactively fulfilling our obligation to stakeholders and continuing to enhance our overall corporate value. We continued to implement the construction of Cyberpower, to enable the development of digital economy. We also continued to implement policies of “Speed Upgrade and Tariff Reduction” while actively promoting “mobile number portability”. Furthermore, we earnestly implemented industry regulatory policies to maintain market discipline and protect customers’ rights, while safeguarding our network and information security and creating a clean and healthy cyberspace. We enhanced the capability and efficiency of our intelligent services to fulfil our obligations to customers, while promoting energy saving and emission reduction initiatives to drive our green development. We also effectively reduced duplicate construction by promoting co-building and co-sharing of communications infrastructure facilities. In support of the “Belt and Road” initiative, we continued to promote further network interconnection and intercommunication with relevant countries and provided quality integrated information service for customers. We proactively participated in community welfare projects and carried out precision poverty alleviation through various measures. We also received a high level of recognition and appreciation from the wider society for our efforts in successfully delivering telecommunication assurance for major conferences and events including the Boao Forum for Asia (BFA) and the “Belt and Road”, as well as providing communications services in the times of floods and other natural disasters.

Outlook

With China going through the process of digital transformation, the commercialisation of 5G will accelerate the conversion of old impetuses to new ones, while also propelling the digital economy to a new stage of development. The communications and information industry will set in motion a historic development opportunity and a chance for further value creation in the build-up of Cyberpower, Digital China and Smart Society. Meanwhile, we have seen the new challenges arising from network evolution and business models in the 5G era and severe landscape where the external environment remaining complicated and volatile while the traditional consumer market becoming even more saturated.

Like all things, success is found in advanced preparation, so despite the various challenges, we are in full confidence about the future. We will adhere to the new development principles, constantly build on our edges in the areas of network, customer service, intelligent operation and talents, striving to maintain steady growth in terms of operating results. Leveraging integrated edges in areas such as cloud-network integration and well-endowed government and enterprise customer resources, we will continue to embrace the 5G trend. Insisting on the customer-oriented principle, we will strengthen our value-driven approach, innovate and accelerate our development in a coordinated way, and continue to adhere to the open cooperative principle to work together with industry partners to forge the new era of 5G. We will promote high-quality scale development with high-quality 5G as the driving force. We will also take new steps to contribute to the building of Cyberpower, economic and social progress and peoples’ better living and continue to create new value for shareholders.

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Finally, on behalf of the Board of Directors, I would like to take this opportunity to express my sincere appreciation to all shareholders and customers for their support. I would also like to express my sincere thanks to all our employees for their hard work and contributions. At the same time, I would like to welcome Mr. Liu Guiqing and Mr. Wang Guoquan to our Board of Directors.



Ke Ruiwen

*Chairman, Chief Executive Officer, President and
Chief Operating Officer*
Beijing, China

22 August 2019