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Sun Kangmin
Chairman



Dear Shareholders,

The year 2016 marks the tenth anniversary of the Group's listing. During the past decade, and especially in recent years, the Group has upheld the principle of "facilitating changes in development, and promoting development through changes". We have strengthened our innovation and transformation and focused on value-driven development, and thereby realizing a sustainable and steady growth in revenue and profit, as well as a remarkable increase in the total market value of the Group. In return to the support by our shareholders, the Group has distributed dividends to our shareholders no matter in favourable or adverse operating conditions. In 2016, the Group upheld the management philosophy of "value-driven, seeking steady yet progressive growth and efficient development", appropriately allocated our resources and further expanded our markets, thereby recording favourable results. In view of this, the Board continued to propose a special dividend for 2016 to enhance shareholders' return.

OPERATING PERFORMANCE

In 2016, the Group focused on “optimizing structure, sustaining growth, strengthening capabilities and enhancing efficiency” and devoted more efforts to innovation and transformation. The Group expanded its business scope, customer base and regional presence, assisted domestic telecommunications operators to build superior networks and leveraged our business capabilities to further develop the “Two New Markets”¹, thereby realizing “a steady yet progressive growth with quality enhancement”. The Group recorded total revenues of RMB88,449 million, representing a year-on-year growth of 9.3%. Profit attributable to equity shareholders of the Company amounted to RMB2,536 million, representing a year-on-year growth of 8.6%. The cash conversion ratio² was 2.1, and free cash flow³ was RMB4,361 million, representing a year-on-year increase of 22.1%. The outstanding operating performance and sufficient funds have provided strong endogenous power for the Group's development and built a solid foundation for a new dimension of future growth.

SPECIAL DIVIDEND

The Board has proposed to distribute a final dividend of RMB0.1098 per share for the financial year ended 31 December 2016, representing a dividend payout ratio of 30%. Moreover, in view of the Group's outstanding operating results and free cash flow for the year, the Board has proposed to distribute a special dividend of RMB0.0220 per share for 2016. Taking into consideration of the above factors, the Company's total dividend for 2016 is RMB0.1318 per share, representing a year-on-year growth of 18.5% and a total dividend payout ratio of 36%.

MARKET EXPANSION

In 2016, the Group assisted domestic telecommunications operators to establish high quality 4G and fiber optic broadband networks and supported their transformation and upgrade. Meanwhile, the Group also leveraged on both “CAPEX and OPEX-driven”⁴ businesses to comprehensively enhance its market expansion. In addition to China Telecom, the Group also strived to expand its businesses with other operator customers (in particular China Tower) and enhanced its service quality and market share, which effectively mitigated the impacts of operators' CAPEX change to the Group. Revenue from domestic telecommunications operator market for the year recorded a year-on-year growth of 11.1%, and accounted for 68.8% of the total revenues, representing a year-on-year increase of 1.1 percentage points. By devoting more efforts in gaining market share, the revenue from operator customers other than China Telecom realized a fast growth and recorded a year-on-year growth of 29.6%.

In 2016, the Group focused on the breakthrough of key businesses, speeded up the development of the Two New Markets, and demonstrated new energy and new look on its corporate development. With an increasing understanding and confidence among the Group to devote more effort to expanding into the domestic non-operator market, the Group further refined its marketing system and gradually formulated a business expansion mechanism with appropriate separation over the functions of marketing and project delivery. The commercialization of our projects, including smart industrial park, smart security and smart transportation, were accelerated, and significant breakthroughs were achieved by the Group in various sectors, including government, transportation, internet, IT and power. With proactive control of the products distribution business with low efficiency during the year, revenue from domestic non-operator market for the year recorded a year-on-year growth of 3.4%, and accounted for 26.8% of the total revenues. Excluding products distribution business in such market, revenue from the core businesses⁵ recorded a year-on-year growth of 28.7% and accounted for more than 70% of the revenue in such market. The revenue structure of domestic non-operator market was further

¹ Two New Markets refer to domestic non-operator market and overseas market.

² Cash conversion ratio = net cash generated from operating activities/profit attributable to equity shareholders of the Company

³ Free cash flow = Profit for the year + Depreciation and amortisation – Changes in working capital – Capital expenditure

⁴ CAPEX and OPEX refer to the capital expenditure and operating expenditure of domestic telecommunications operators, respectively.

⁵ Core businesses of domestic non-operator market include telecommunications infrastructure services, business process outsourcing services (excluding products distribution), and applications, content and other services.

optimized and the gross profit margin recorded a moderate increase. The favourable growth of revenue from the Core Businesses of domestic non-operator market contributed significantly to the overall increase in the total revenues of the Group, demonstrating the sound results of our innovation and transformation. The Group promoted the development of new businesses in regional market, including Africa, the Middle East and South East Asia, and shifted its focus from project hunting to project initiation. The Group also focused on major turnkey projects, further promoted the "China-Africa Partnership Program in Trans Africa Information Superhighway" Project and made further progress. The Group proactively studied the feasibility to set up an industry investment fund with potential partners to promote the scale development of the overseas business. In 2016, the overseas business of the Group resumed steady development and realized a year-on-year growth of 19.3%, accounting for 4.4% of the total revenues.

BUSINESS STRUCTURE

In 2016, the Group actively developed its traditional businesses such as network infrastructure, and the revenue from telecommunications infrastructure ("TIS") services realized a year-on-year growth of 17.0%. Meanwhile, the Group strived to expand emerging businesses and cross-sector businesses, especially businesses with higher loyalty and value, such as maintenance, supply chain and facilities management. By continuously optimizing its business structure, the Group's revenue from the core business process outsourcing ("BPO") services⁶ for the year recorded a year-on-year growth of 10.7%. The Group has dedicated to the synergistic promotion of six major group-level products⁷, and duly launched new products and services in the market. Revenue from applications, content and other ("ACO") services achieved a year-on-year growth of 14.8%. The favourable business development of the ACO service also contributed to the Group's TIS business development. The aggregated revenues from TIS services, Core BPO Services and ACO services for the year accounted for 88.2% of the total revenues, representing a year-on-year increase of 4.4 percentage points. Under the proactive control of the Group, revenue from products distribution business recorded a year-on-year decrease of 20.0%, and its proportion to the total revenues decreased to 11.8%.

REFORM AND INNOVATION

In 2016, the Group continued to deepen its reform and proactively promoted the innovation of its systems and mechanisms. The Group has carried out meaningful exploration and trials in innovating operation and management model, business model, incentive scheme and mixed ownership scheme. Embracing the business opportunities created by the "Belt and Road" Initiative, the Group has adjusted the operation and management mechanism over its overseas business and refined its internal organizational structure. In order to respond more swiftly to the market, the Group relocated the management and decision-making office of its overseas business to Africa. The Group promoted the synergistic business operation in supply chains, distribution channels and property management, and unified its brand for each specified business. The Group directed its subsidiaries to participate in the trials on "PPP, BT and BOT"⁸, and tried to explore innovative business models with external funds and social participation. The Group actively explored innovation in market-oriented employment and remuneration mechanism so as to promote the vitality and creativity of its employees. The Group also encouraged its subsidiaries to pilot new business operation models to seek new directions for their corporate development, including external equity investments, joint ventures and introduction of private enterprises for business operation.

⁶ Core BPO Services include management of infrastructure for information technology (network maintenance), general facilities management and supply chain.

⁷ Six major group-level products include smart city, smart security, smart industrial park, intelligent building, cloud computing services and e-certification.

⁸ PPP, BT and BOT represent Public-Private-Partnership, Build-Transfer and Build-Operate-Transfer, respectively.

CORPORATE GOVERNANCE

The Group has always maintained standardized and effective corporate governance. The Company followed its board diversity policy which effectively facilitated scientific and rational decision-making. The independent non-executive directors of the Company fully performed their duties of decision-making and supervision by providing advices and recommendations on the effective governance and major decisions of the Group, thereby facilitating a healthy development of the Group and protecting the interests of minority shareholders. The Group further promoted its transparency and information disclosure, and organized a reverse roadshow in 2016 to assist investors to gain better understanding of the innovative development of the Company. Good market responses were received from the roadshow and the enterprise value of the Group was highly recognized by the capital market.

During the ten years since its listing, the Group has received many awards in the capital market. In 2016, the Group won various awards, including "The Best of Asia – Icon on Corporate Governance" once again in the "12th Corporate Governance Asia Recognition Awards" in 2016 held by *Corporate Governance Asia*, a famous corporate governance magazine in Asia, "Platinum Award – Excellence in Governance, CSR & Investor Relations" in "The Asset Corporate Awards 2016" held by *The Asset*, and "The Best Investment Value Listed Company in the 13th Five-Year Plan" award in the 6th China Securities "Golden Bauhinia Awards" organized by Hong Kong Ta Kung Wen Wei Media Group Limited. Furthermore, in the relevant award competitions held by *Corporate Governance Asia*, I was honored the "Best CEO" and "Asian Corporate Director", and Ms. Hou Rui, the Chief Financial Officer and Executive Vice President of the Company, was once again honored the "Best CFO". According to the "2016 FORTUNE China 500" released by *FORTUNE China*, the Group ranked 71st, moving up seven places as compared to the ranking last year.

SOCIAL RESPONSIBILITIES

The Group has always endeavoured to fulfil its social responsibilities. The Group has made many valuable contributions in solving unemployment issue, disaster relief, major communications restoration and environmental protection. Every year, the Group offers many employment positions and also stimulates the employment of the upstream and downstream enterprises, and played an important role in stabilizing employment situation in the society. In 2016, many regions in southern China suffered catastrophic floods resulting from severe convective weather. The Group proactively participated in flood prevention and disaster relief, and deployed more than 24,000 person-times and 8,400 vehicles/times to repair and restore more than 13,600 communications facilities. During the year, the Group played an important role in the construction and maintenance of communications networks for G20 Hangzhou Summit and the Third World Internet Conference, successfully accomplished all missions and was highly praised by the government.

PROSPECTS

In 2016, the Group recorded sound operating results and achieved many new highlights and new changes in its development, which laid a solid foundation for its future development since the commencement of the "13th Five-year Plan". Currently, despite of the uncertainties of the macroeconomic circumstances under the "New Normal", the PRC economy has developed steadily and positively in general and opportunities will outweigh challenges in the future. As the government has promoted the supply-side structural reform and further implemented various strategies including "Network and Information Country", "Cyberpower" and "Innovation-driven Development", a favourable operating environment has been established for the growth of the Group. Enormous business opportunities will be brought from the booming of cloud computing, big data and internet of things with substantial investments in the new form of ICT and strong demand in industry informatization. The acceleration of transformation and upgrading of domestic telecommunications operators will stimulate the increasing demand in technologies, software, network maintenance and information security, which will create a favourable condition for the reinforcement of the Group's fundamental business performance. Along with the implementation of the "Belt and Road" Initiative and the Group's major projects such as the "China-Africa Partnership Program in Trans Africa Information Superhighway" Project, the prospects of the expansion of the Group's overseas business will be promising.

By persisting in the management philosophy of “value-driven, seeking steady yet progressive growth and efficient development” and the concept of “market-oriented, creating value for customers”, the Group will strive for market penetration and expansion so as to increase its market share and further maintain its leading position in domestic telecommunications operators market. Targeting at the informatization demands from the society and industries, the Group will accelerate the industrial breakthroughs in targeted markets and expand the domestic non-operator market. By leveraging the opportunities arising from our “China-Africa Partnership Program in Trans Africa Information Superhighway” Project, the Group will focus on the implementation of key projects and speed up the expansion in overseas market. The Group will explore the utilization of various financial instruments and facilitate the development of the Group in the future through integration of industries and finance. In addition, the Group will enhance its own capabilities, refine its marketing system and strengthen its capability in project delivery. Leveraging on its own technological competitive edges and investing more resources in innovation, the Group will enhance its capability in research and development and marketing for its products. In order to increase its operation efficiency, the Group will strengthen its synergistic management and cost control. The Group will continue its sound trajectory of steady growth with quality improvement and create greater values for its shareholders and customers through better development.

Finally, on behalf of the Board, I would like to take this opportunity to express my sincere gratitude to the shareholders and customers of the Group and all sectors of society for their longstanding care and support to the Group, and sincerely thank all the employees for their dedication over the years. I would also like to express my sincere gratitude to Mr. Zhang Junan, who resigned as a non-executive director of the Company, and Mr. Wang Jun, who resigned as an independent non-executive director of the Company, for their outstanding contributions to the development of the Group during their tenure, and express my sincere welcome to Mr. Liu Linfei for joining the Board.



Sun Kangmin
Chairman

Beijing, PRC
30 March 2017

