



Management Discussion & Analysis of Financial Conditions and Results of Operations

Overview

On 30 May 2008, the Company completed the acquisition of the 100% equity interest of China International Telecommunications Construction Corporation (“CITCC”) from China National Postal and Telecommunications Appliances Corporation for a consideration of RMB505.46 million. In accordance with the acquisition accounting method under the International Financial Reporting Standards, the results of CITCC were included in the consolidated financial statements of the Group from the date of acquisition to 31 December 2008.

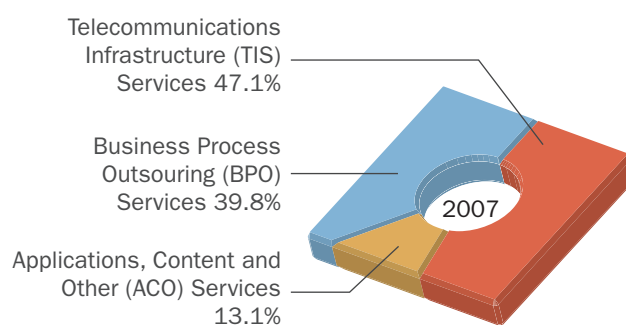
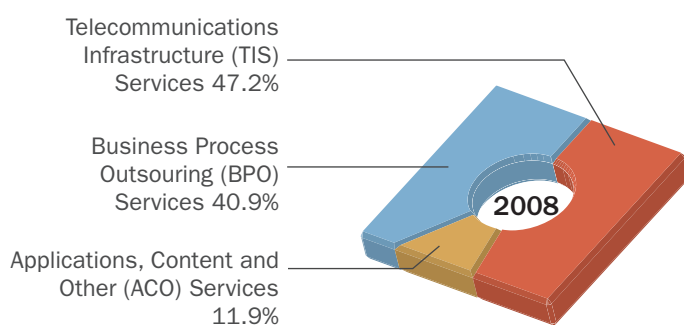
In 2008, there was a tremendous change in the market environment of the domestic telecommunications industry. The telecommunications industry restructuring plan was formally announced, and the PRC government’s policy for the granting of 3G licenses became clearer and was finally made in the beginning of 2009. All of the telecommunications operators began to increase their investments in 2G and 3G network construction, capacity expansion and optimization, thus providing new opportunities for our Group. As we were fully prepared for the aforementioned changes, our major businesses grew strongly in 2008 and we achieved favourable operating results. Our revenues amounted to RMB32,470.57 million, an increase of 37.9% from 2007. Profit attributable to equity shareholders of the Company was RMB1,316.27 million, an increase of 12.8% from 2007. Basic earnings per share were RMB0.232, an increase of 8.4% from 2007. The free cash flow amounted to RMB1,271.12 million.



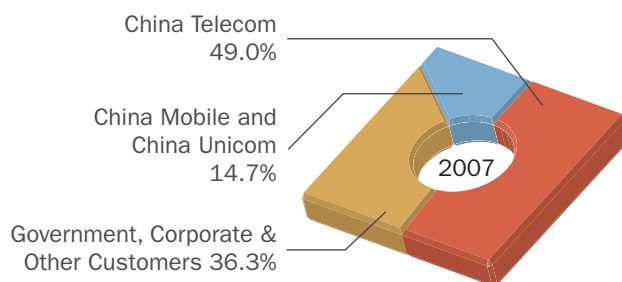
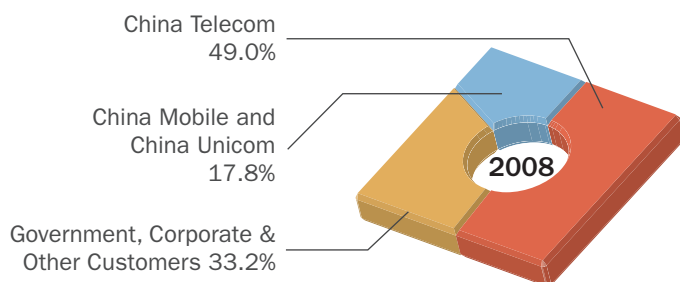
Revenues

Our revenues in 2008 were RMB32,470.57 million, an increase of 37.9% from 2007. Among our businesses, revenue from telecommunications infrastructure services was RMB15,329.46 million, an increase of 38.2% from 2007; revenue from business process outsourcing services was RMB13,288.37 million, an increase of 41.9% from 2007; revenue from applications, content and other services was RMB3,852.74 million, an increase of 25.1% from 2007. Telecommunications infrastructure services and business process outsourcing services were the major sources of our revenue growth in 2008. In terms of customer structure, the Group's revenues from our customers other than China Telecom amounted to RMB16,557.28 million, representing 51.0% of the total revenues, which was at the same level of 2007.

Business Mix



Customer Mix





The following table sets forth a breakdown of our revenues for 2007 and 2008, together with their respective rate of change:

	2008 RMB'000	2007 RMB'000	Percentage change
Telecommunications Infrastructure Services			
Design services	3,166,637	2,436,345	30.0%
Construction services	11,316,088	8,071,188	40.2%
Project supervision and management services	846,739	585,474	44.6%
	15,329,464	11,093,007	38.2%
Business Process Outsourcing Services			
Network maintenance	2,349,901	1,572,953	49.4%
Distribution of telecommunications services and products	8,985,256	6,097,148	47.4%
Facilities management	1,953,213	1,695,051	15.2%
	13,288,370	9,365,152	41.9%
Applications, Content and Other Services			
IT applications	1,997,523	1,546,478	29.2%
Internet service	361,170	478,022	-24.4%
Voice VAS	578,071	325,661	77.5%
Other	915,972	730,061	25.5%
	3,852,736	3,080,222	25.1%
Total	32,470,570	23,538,381	37.9%



Telecommunications Infrastructure Services

In 2008, our revenue from telecommunications infrastructure services was RMB15,329.46 million, which still remained as our primary source of income, and accounted for 47.2% of our revenues. As the telecommunications industry restructuring proposal was finalized and the PRC government's policy for granting 3G licenses became clearer, telecommunications operators began to increase their investments in network construction and optimization, providing tremendous opportunities to our Group. Given that we were well prepared for these opportunities, we were able to respond in a timely manner to telecommunications operators' demand and provide strong business support. Accordingly, our telecommunications infrastructure services business achieved substantial growth, and revenue from this business was increased by 38.2% in 2008 from RMB11,093.01 million in 2007.

Business Process Outsourcing Services

In 2008, our revenue from business process outsourcing services was RMB13,288.37 million, representing an increase of 41.9% over RMB9,365.15 million for 2007. Business process outsourcing services accounted for 40.9% of our revenues, representing an increase of 1.1 percentage points from 39.8% in 2007. Among our businesses, revenue from network maintenance was RMB2,349.90 million, representing an increase of 49.4% from 2007. It was mainly due to the telecommunications operators increasing their network capacity and continuing to actively progress with outsourcing of network maintenance with the purpose of improving service quality and lowering operating costs. In addition, revenues from distribution of telecommunications services and products amounted to RMB8,985.26 million, an increase of 47.4% from 2007. This increase mainly benefited from the strong growth in demand for telecommunications machinery and terminals by telecommunications operators. At the same time, the Group adjusted and optimized the business structure of our distribution of telecommunications services and products, and actively controlled the development of low-margin businesses to reduce operational risks and improve operational efficiency. Revenues from our distribution of telecommunications services and products in the second half of 2008 grew stably over the first half of the year.

Applications, Content and Other Services

In 2008, our revenue from applications, content and other service was RMB3,852.74 million, representing an increase of 25.1% over RMB3,080.22 million for 2007. Owing to the substantial growth in telecommunications infrastructure services and business process outsourcing services over the previous year, the proportion of revenue from applications, content and other service to our revenues was reduced to 11.9%, representing a decrease of 1.2 percentage points from 13.1% in 2007. Among the businesses, revenue from IT applications amounted to RMB1,997.52 million, representing an increase of 29.2% from 2007. Revenue from voice VAS was RMB578.07 million, representing an increase of 77.5% from 2007. The growth in these businesses was mainly attributed to the gradual implementation of call centres services outsourcing by telecommunications operators, and the Group's active expansion of businesses such as system integration to cope with the demand for informationization from government agencies and corporate customers. Revenues from Internet services amounted to RMB361.17 million, representing a decrease of 24.4% from 2007. In 2008, the Group further integrated this business in order to enhance its operational efficiency.



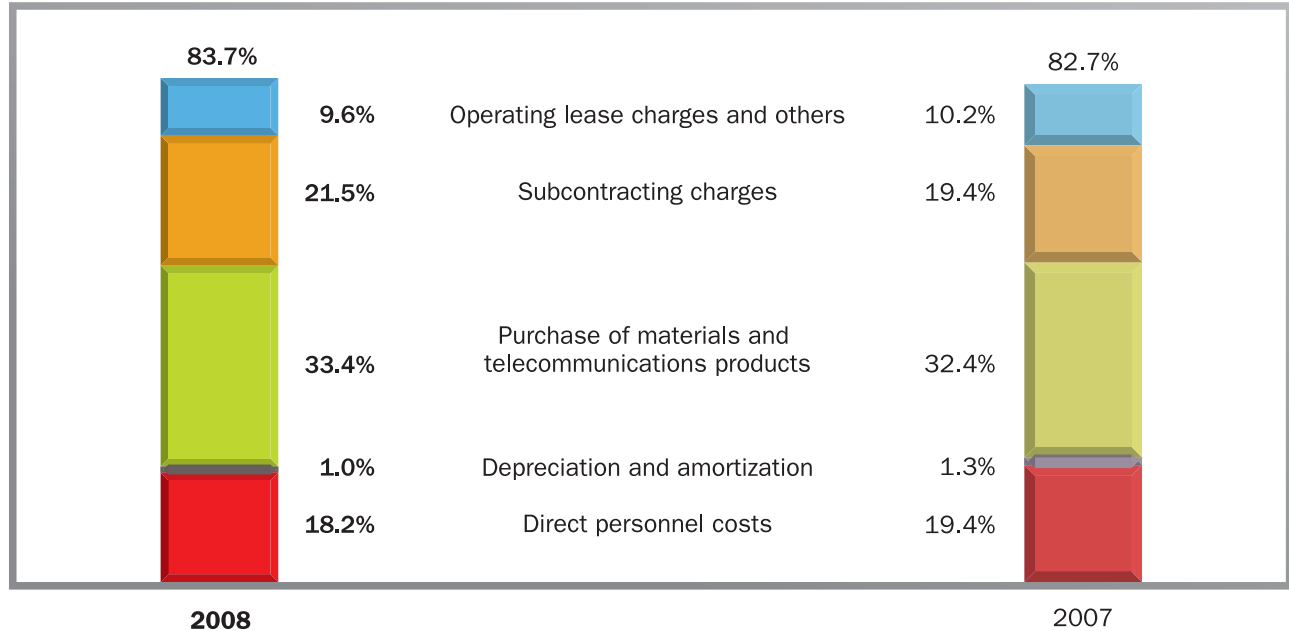
Cost of Revenues

Our cost of revenues in 2008 was RMB27,169.73 million, representing an increase of 39.5% from 2007 and accounting for 83.7% of our revenues.

The following table sets out a breakdown of our cost of revenues in 2007 and 2008 and their respective rate of change:

	2008 RMB'000	2007 RMB'000	Percentage change
Direct personnel costs	5,921,374	4,556,857	29.9%
Depreciation and amortization	334,590	305,205	9.6%
Purchase of materials and telecommunications products	10,829,497	7,632,433	41.9%
Subcontracting charges	6,966,405	4,577,237	52.2%
Operating lease charges and others	3,117,862	2,401,900	29.8%
Total cost of revenues	27,169,728	19,473,632	39.5%

Cost of revenues as the percentage of total revenues





Direct Personnel Costs

In 2008, direct personnel costs were RMB5,921.37 million, which accounted for 18.2% of our revenues and an increase of 29.9% over RMB4,556.86 million in 2007. The Group has always applied stringent control over its total headcount. After the formal announcement of telecommunications industry restructuring in 2008, the Group's business volume increased significantly. In order to respond promptly to this increase in demand for our business, we increased our recruitment of temporary workers to cope with ad hoc workforce demand and satisfy operators' tight work schedule. This expenditure item was the main reason for a rapid growth in our labour costs.

Depreciation and Amortization

In 2008, depreciation and amortization amounted to RMB334.59 million, which accounted for 1.0% of our revenues and represented an increase of 9.6% over RMB305.21 million in 2007.

Purchase of Materials and Telecommunications Products

In 2008, our businesses of distribution of telecommunications services and products and telecommunications infrastructure construction grew strongly, resulting in a significant increase in our revenues. Accordingly, the cost of purchasing materials and telecommunications products increased significantly, amounting to RMB10,829.50 million, representing 33.4% of revenues and an increase of 41.9% over RMB7,632.43 million in 2007. Among the cost, the amount of telecommunications products purchases was RMB7,304.39 million, representing an increase of 47.7% over RMB4,944.18 million in 2007, and that of construction material purchases was RMB3,525.11 million, representing an increase of 31.1% over RMB2,688.26 million in 2007.

Subcontracting Charges

In 2008, subcontracting charges were RMB6,966.41 million, which accounted for 21.5% of our revenues and represented an increase of 52.2% over RMB4,577.24 million in 2007. The increase in subcontracting charges was mainly derived from telecommunications infrastructure construction services. As the volume of our business increased significantly in 2008, we outsourced our low-end business (such as pipeline and cable related construction work) in telecommunications network construction, and this caused a substantial increase in subcontracting charges for the year.

Operating Lease Charges and Others

In 2008, operating lease charges and others were RMB3,117.86 million, which accounted for 9.6% of our revenues and represented an increase of 29.8% over RMB2,401.90 million in 2007.



Gross Profit

In 2008, the Group's gross profit amounted to RMB5,300.84 million, representing an increase of RMB1,236.09 million from RMB4,064.75 million in 2007, representing an increase of 30.4%. The Group's gross profit margin in 2008 was 16.3%, representing a decrease of 1.0 percentage point over 17.3% in 2007. The decrease in our gross profit margin when compared to 2007 was mainly attributable to the Group's adoption of a more competitive pricing strategy in order to capture more business opportunities that emerged after the telecommunications industry restructuring.

Selling, General and Administrative Expenses

Our selling, general and administrative expenses in 2008 were RMB3,854.38 million, representing an increase of 37.9% over RMB2,794.66 million in 2007, which accounted for 11.9% of revenues and was maintained at the same level as in 2007. We will strengthen our comprehensive budget management and performance appraisal to effectively control excessive growth in our selling, general and administrative expenses.

Net Financing (Expense)/Income

In 2008, we recorded net financing costs of RMB77.70 million, whereas we recorded net financing income of RMB41.68 million in 2007. This change was mainly due to the Group's borrowings totalling RMB1.6 billion to fund acquisitions of our parent company's specialized telecommunications support services businesses ("Target Business") in 13 provinces (municipality and autonomous regions) in 2007. This borrowing caused a substantial increase in the Group's financing costs in 2008 and also had a negative impact on our net profit.

Income Tax

Certain subsidiaries of our Group, which were classified as new and high-technology enterprises, are subject to a preferential income tax rate of 15%. Our subsidiaries located in Hainan Province, and Shenzhen, Zhuhai and Xiamen Special Economic Zones are subject to an income tax rate of 18%. Apart from these companies, the Company and other subsidiaries of the Group are subject to an income tax rate of 25%. The income tax in 2008 was RMB401.42 million and our effective tax rate was 23.2%. The difference between our effective tax rate and the statutory tax rate was mainly due to the effect of the aforementioned preferential tax rate treatment of our subsidiaries.

Profit Attributable to Equity Shareholders

In 2008, profit attributable to equity shareholders of the Company was RMB1,316.27 million, an increase of 12.8% over RMB1,167.25 million in 2007.



Capital Expenditure

We implemented stringent budget management, and adjusted our capital expenditure plan to accord with changes in market condition. In 2008, our capital expenditure amounted to RMB707.14 million, and remained at a similar level to RMB719.54 million in 2007. The capital expenditure in 2008 represented 2.2% of our total revenues, a decrease of 0.9 percentage point when compared to 2007. Our capital expenditure included the purchases of production facilities and equipment, machinery and meters, vehicles, office equipments, plant and buildings, intangible assets and other operating assets.

Cash Flow and Capital Resources

Cash Flow

In 2008, our net cash inflow was RMB1,783.41 million. In 2007, our net cash outflow was RMB1,530.37 million. By the end of 2008, our cash and cash equivalents amounted to RMB8,415.01 million, of which, 99.2% was Renminbi in cash.

The following table sets out our cash flow position in 2007 and 2008, respectively:

	2008 RMB'000	2007 RMB'000
Net cash generated from operating activities	1,950,309	1,663,776
Net cash used in investing activities	(43,609)	(5,183,186)
Net cash (used in)/generated from financing activities	(123,291)	1,989,038
Net increase/(decrease) in cash and cash equivalents	1,783,409	(1,530,372)

In 2008, our net cash generated from operating activities was RMB1,950.31 million, an increase of RMB286.53 million from RMB1,663.78 million in 2007. The significant increase in net cash inflow from operating activities was mainly due to the rapid development of our operations and the improvement of our working capital management.

In 2008, our net cash used in investing activities was RMB43.61 million, a decrease of RMB5,139.58 million from RMB5,183.19 million in 2007. This was mainly due to the Company's acquisition of the Target Business for a consideration of RMB4.6 billion in 2007. The cash used in investing activities during the year included cash paid for the acquisition of CITCC and the cash brought into our Group by CITCC.

In 2008, our net cash used in financing activities was RMB123.29 million. In 2007, net cash generated from financing activities was RMB1,989.04 million. The change in cash flow of financing activities in our Group during 2008 was mainly attributable to the proceeds from our share placement in April 2008 and the cash used for the repayment of short-term debts.



Working Capital

By the end of 2008, our working capital (i.e. non-cash current assets minus operating current liabilities) was RMB68.54 million, representing a decrease of RMB345.56 million from RMB414.10 million in 2007. With the substantial growth in our revenues, we strengthened our accounts receivable management and obtained better credit terms.

Indebtedness

By the end of 2008, total indebtedness of the Group was RMB1,954.43 million, and most of them were fixed interest rate loans and denominated in RMB. Our indebtedness decreased by RMB606.79 million from RMB2,561.22 million at the year end of 2007. The Company completed the acquisitions of the Target Business in 2007, and, by way of debt financing, raised RMB1.6 billion by the end of 2007. Through strengthening the centralized cash management, the Group repaid RMB0.6 billion by the end of 2008, leaving RMB1.0 billion outstanding. All other new loans in 2008 were short-term borrowings made by our subsidiaries to supplement their working capital requirements.

By the end of 2008, our gearing ratio⁽¹⁾ was 14.0%, a decrease of 7.1 percentage points from 21.1% in 2007.

Contractual Obligations

The following table sets out our contractual obligations as at 31 December 2008:

	Total	2009	2010	2011	2012	2013
	RMB'000	RMB'000	RMB'000	RMB'000	RMB'000	and after RMB'000
Short-term debt	1,954,426	1,954,426	—	—	—	—
Long-term debt	—	—	—	—	—	—
Operating lease commitments	214,103	95,227	55,805	28,756	16,323	17,992
Capital commitments	353,274	353,274	—	—	—	—
Of which:						
Authorized and contracted for	163,397	163,397	—	—	—	—
Authorized but not contracted for	189,877	189,877	—	—	—	—
Total of contractual obligations	2,521,803	2,402,927	55,805	28,756	16,323	17,992

⁽¹⁾ Gearing ratio equals to total interest-bearing debts divided by the sum of total interest-bearing debts and equity attributable to equity shareholders of the Company at the end of each financial year.



Exchange Rate

Most of our revenues and expenses are settled in Renminbi. Therefore the risks associated with foreign currency exchange rates have no significant impact on our business performance. By the end of 2008, the balance of our cash and cash equivalents in foreign currencies accounted for 0.8% of our total cash and cash equivalents.

Acquisitions and Integration

In May 2008, the Company completed its acquisition of CITCC. After completion of the acquisition, the Company immediately implemented integration of CITCC within the Group and has achieved a smooth transition. This further improved our overall competitiveness and enhanced the Group's strength in the northern provinces of China and overseas markets. For the period from the date of acquisition to the end of 2008, the operating results of CITCC fully reached our targets, with revenues and profits attributable to the shareholders of the Company amounting to RMB1,689.60 million and RMB41.10 million respectively. With further integration, we believe the operating results of the Group will continue to improve. Furthermore, the Group will also continue to implement the development strategy in combining our organic growth and external expansion to bring greater value to our shareholders.

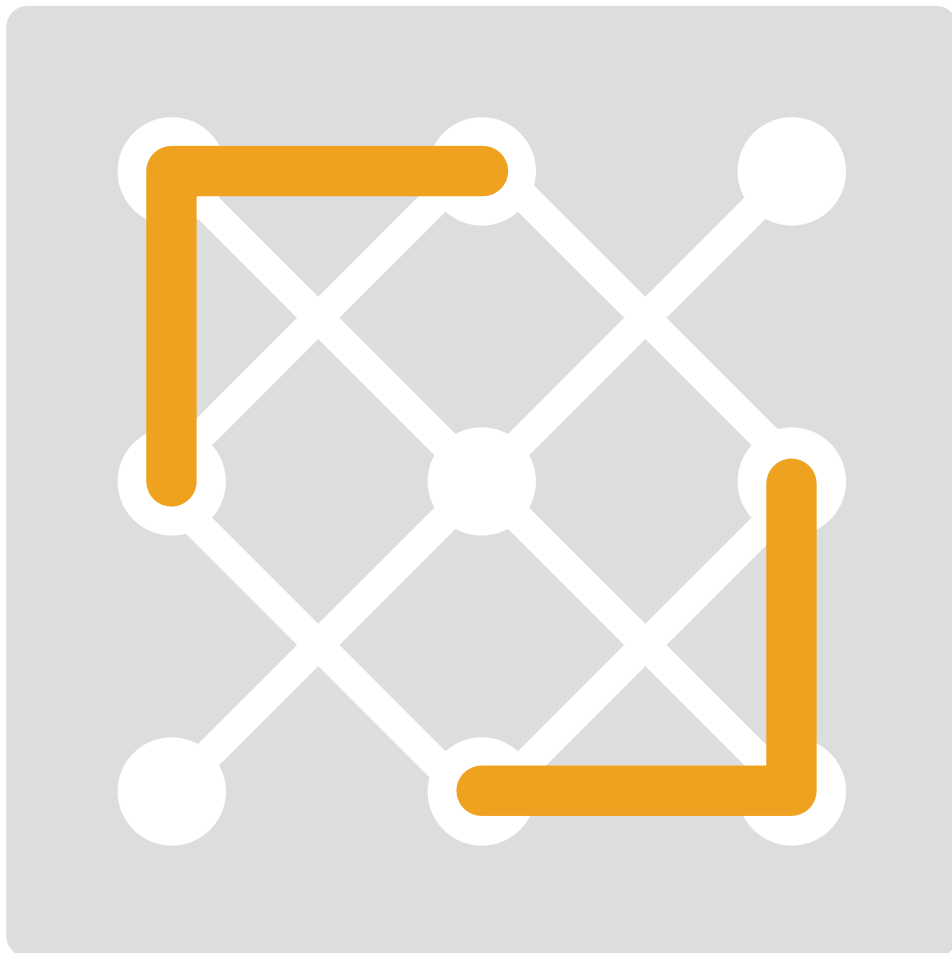
In 2008,
Revenue from
Three Major
Operator
Customers
up by **45%**



Revenue from
Government
Agencies and
Corporate Customers
up by **26%**



Focusing on customers



Focus on the business needs of operator customers in the 3G era and the opportunities from informatization construction of government agencies and corporate customers