

“As Soft and Accessible as Water”

Penetrating where there is an interstice, bypassing where there is an obstacle, water quickly flows everywhere without being obstructed.

“Strategy of Penetrating into Overseas Market”

Rapidly developing overseas market with focus on key regions, we extend our years of customer service experiences and capabilities to overseas market.



Management's Discussion and Analysis of Financial Conditions and Results of Operations

OVERVIEW

In 2010, under the circumstance of decreased capital expenditure by domestic telecommunications operators and a more competitive market, the Group put more efforts in executing its customer-oriented service innovation strategy and vigorously expanded businesses in the domestic non-operator market and overseas market, and thus maintained rapid growth momentum in all businesses. Our revenues amounted to RMB45,417.23 million, representing an increase of 15.0% from 2009. Profit attributable to equity shareholders of the Company amounted to RMB1,817.81 million, representing an increase of 13.7% from 2009. Basic earnings per share was RMB0.315, representing an increase of 13.7% from 2009. Free cash flow amounted to RMB628.37 million.

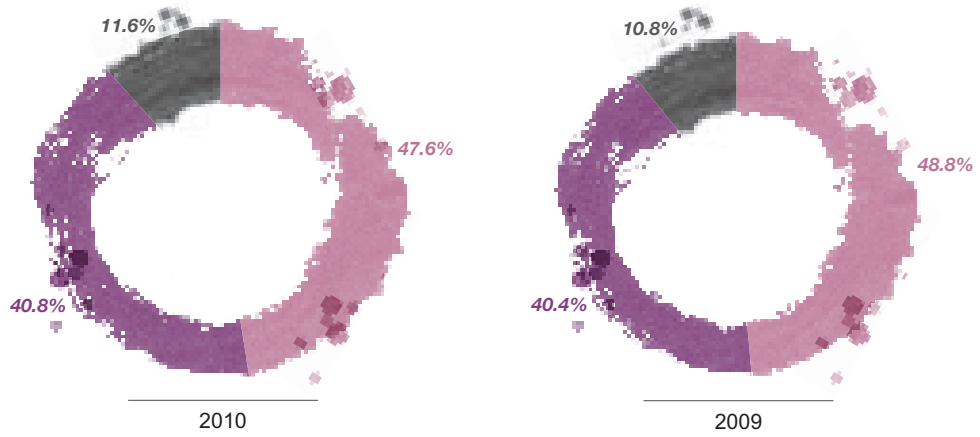
REVENUES

Our revenues in 2010 were RMB45,417.23 million, representing an increase of 15.0% from 2009. Among our businesses, revenues from telecommunications infrastructure ("TIS") services were RMB21,636.55 million, representing an increase of 12.2% from 2009; revenues from business process outsourcing ("BPO") services were RMB18,508.42 million, representing an increase of 16.1% from 2009; revenues from applications, content and other ("ACO") services were RMB5,272.26 million, representing an increase of 23.6% from 2009. TIS services was the major source of our revenues in 2010, while IT applications in ACO services and network maintenance services in BPO services were the two major businesses which experienced a relatively faster growth in revenue. In terms of customer structure, the Group's revenues from the three telecommunications operators amounted to RMB29,464.37 million, representing 64.9% of the revenues, an increase of 7.2% from 2009; revenues from the domestic non-operator customers and overseas customers amounted to RMB15,952.86 million, representing 35.1% of the revenues, an increase of 32.6% from 2009.

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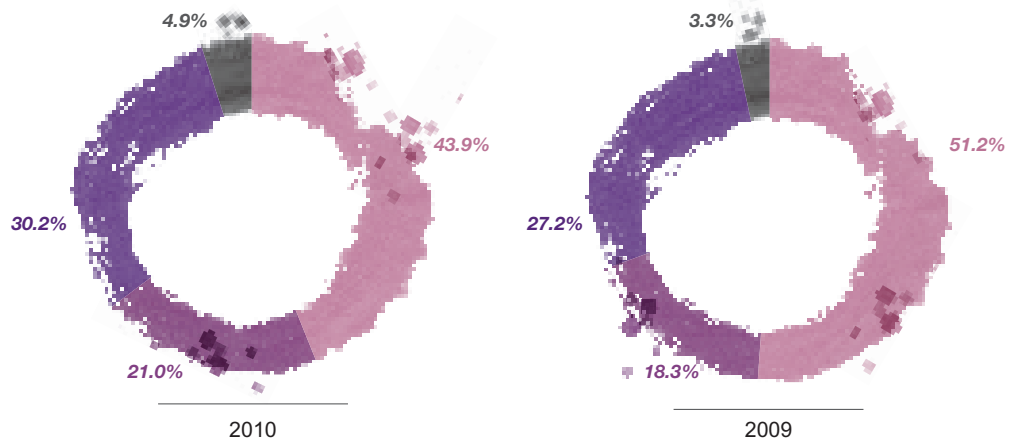
Business Mix

- Telecommunications Infrastructure Services
- Business Process Outsourcing Services
- Applications, Content and Other Services



Customer Mix

- China Telecom
- China Mobile and China Unicom
- Domestic non-operator customer
- Overseas customers



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The following table sets forth a breakdown of our revenues for 2009 and 2010, together with their respective rates of change:

	2010 RMB'000	2009 RMB'000	Percentage Change
Telecommunications Infrastructure Services			
Design services	4,453,627	4,021,105	10.8%
Construction services	15,796,460	14,086,311	12.1%
Project supervision and management services	1,386,458	1,182,163	17.3%
	21,636,545	19,289,579	12.2%
Business Process Outsourcing Services			
Network maintenance	4,269,869	3,484,132	22.6%
Distribution of telecommunications services and products	11,956,698	10,389,777	15.1%
Facilities management	2,281,857	2,069,417	10.3%
	18,508,424	15,943,326	16.1%
Applications, Content and Other Services			
IT applications	2,637,849	2,084,600	26.5%
Internet service	483,862	286,732	68.8%
Voice VAS	706,264	652,885	8.2%
Other	1,444,288	1,242,328	16.3%
	5,272,263	4,266,545	23.6%
Total	45,417,232	39,499,450	15.0%

Telecommunications Infrastructure Services

In 2010, revenues from TIS services of the Group were RMB21,636.55 million, representing an increase of 12.2% over RMB19,289.58 million from 2009, which was our primary source of revenues, and accounted for 47.6% of our revenues. Under the circumstance of decreased capital expenditure by domestic telecommunications operators, the Group adopted more proactive and effective measures, TIS revenues from domestic operators grew steadily and amounted to RMB16,409.25 million in 2010, representing an increase of 3.7% over RMB15,824.44 million from 2009. Meanwhile, assisted by the Group's vigorous expansion of the domestic non-operator market and overseas market, TIS revenues from such markets grew rapidly and amounted to RMB5,227.30 million, representing an increase of 50.9% over RMB3,465.14 million in 2009.

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Business Process Outsourcing Services

In 2010, revenues from BPO services of the Group were RMB18,508.42 million, representing an increase of 16.1% over RMB15,943.33 million in 2009. BPO services accounted for 40.8% of our revenues, representing an increase of 0.4 percentage points from 40.4% in 2009. Among our businesses, revenues from network maintenance were RMB4,269.87 million, representing an increase of 22.6% from 2009 and kept growing strongly. Rapid revenue growth mainly benefited from the strategy of full-service operations of telecommunications operators that have increased their investments in network optimization and maintenance services. In addition, the Group continued to strengthen the management of distribution of telecommunications services and products and optimize its business structure, and the low margin businesses was reasonably controlled and operating efficiency was improved. Revenues from distribution of telecommunications services and products amounted to RMB11,956.70 million, representing an increase of 15.1% from 2009. The proportion of revenues from the distribution of telecommunications services and products to our revenues remained stable.

Applications, Content and Other Services

In 2010, revenues from ACO services of the Group were RMB5,272.26 million, representing an increase of 23.6% over RMB4,266.55 million from 2009. ACO services accounted for 11.6% of our revenues, representing an increase of 0.8 percentage points from 10.8% in 2009. During this year, the Group further expanded the market of government and enterprise informatization services and the Internet application service to telecommunications operators, which led to a rapid increase in revenues from IT applications and Internet services and became a major revenue generator for ACO services. The revenues from IT applications and Internet services were RMB2,637.85 million and RMB483.86 million, respectively, representing an increase of 26.5% and 68.8% from 2009.

COST OF REVENUES

Our cost of revenues in 2010 was RMB38,018.25 million, representing an increase of 14.8% from 2009 and accounting for 83.7% of our revenues.

The following table sets out a breakdown of our cost of revenues in 2009 and 2010 and their respective rates of change:

	2010 RMB'000	2009 RMB'000	Percentage Change
Direct personnel costs	7,459,665	7,073,351	5.5%
Depreciation and amortization	359,100	351,402	2.2%
Purchase of material and telecommunications products	13,506,740	12,364,499	9.2%
Subcontracting charges	11,883,574	9,064,577	31.1%
Operating lease charges and others	4,809,167	4,273,684	12.5%
Total cost of revenues	38,018,246	33,127,513	14.8%

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Direct Personnel Costs

In 2010, direct personnel costs were RMB7,459.67 million, representing 16.4% of our revenues and an increase of 5.5% over RMB7,073.35 million in 2009. With the rapid growth in business volume in 2010, the Group consistently applied reasonable control over its total headcount and subcontracted our low-end tasks, thereby minimizing the staff costs and avoiding related risks. The proportion of direct personnel costs of our revenues decreased by 1.5 percentage points compared to 2009.

Depreciation and Amortization

In 2010, depreciation and amortization amounted to RMB359.10 million, representing 0.8% of our revenues and an increase of 2.2% over RMB351.40 million in 2009. Its proportion of our revenues was maintained at the relatively similar level as in 2009.

Purchase of Materials and Telecommunications Products

In 2010, the cost of materials and telecommunications products purchase was RMB13,506.74 million, representing 29.7% of revenues and an increase of 9.2% over RMB12,364.50 million in 2009. In 2010, the Group strengthened its management in the business of distribution of telecommunications services and products and controlled the development of low-margin distribution businesses. This effectively lowered the growth of the cost of materials and telecommunications products purchase. Its proportion of our revenues decreased by 1.6 percentage points compared to 2009.

Subcontracting Charges

In 2010, subcontracting charges were RMB11,883.57 million, representing 26.2% of our revenues and an increase of 31.1% over RMB9,064.58 million in 2009. The increase in subcontracting charges was mainly derived from the business of TIS services. As the business volume increased significantly in 2010, we outsourced certain of the specialized tasks required by domestic non-operator customers and low-end tasks after taking into consideration of efficiency and benefits. Its proportion of our revenues increased by 3.3 percentage points compared to 2009.

Operating Lease Charges and Others

In 2010, operating lease charges and others were RMB4,809.17 million, representing 10.6% of our revenues and an increase of 12.5% over RMB4,273.68 million in 2009. Its proportion of our revenues was maintained at the relatively similar level as in 2009.

GROSS PROFIT

In 2010, the Group's gross profit amounted to RMB7,398.99 million, representing an increase of 16.1% over RMB6,371.94 million in 2009. The Group's gross profit margin in 2010 was 16.3%, representing an increase of 0.2 percentage point over 16.1% in 2009. The Group was able to enhance gross profit margin in 2010 through optimizing its business and customer structures and controlling personnel costs.

SELLING, GENERAL AND ADMINISTRATIVE EXPENSES

Our selling, general and administrative expenses in 2010 were RMB5,627.04 million, representing an increase of 19.9% over RMB4,691.51 million in 2009, and accounted for 12.4% of our revenues, an increase of 0.5 percentage points over 2009. Due to the rapid business growth, the Group exerted more efforts in sales and marketing and increased investment in research and development.

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FINANCE COSTS

In 2010, the Group's finance costs were RMB57.73 million, representing a decrease of 34.7% over RMB88.44 million in 2009. The significant decrease was mainly due to the fact that the Group strengthened the centralized cash management and the cooperation with banks, and therefore improved our efficiency in cash utilization.

INCOME TAX

Certain of our subsidiaries were recognized as new and high-technology enterprises and were entitled to a preferential income tax rate of 15%. Our subsidiaries in Shenzhen, Zhuhai, Xiamen and Hainan Special Economic Zones were entitled to an income tax rate of 22%. Apart from these subsidiaries, the Company and other subsidiaries of the Group were subject to an income tax rate of 25%. The income tax of the Group in 2010 was RMB459.71 million and our effective tax rate was 20.2%, representing a decrease of 0.8 percentage points over 21.0% in 2009. This was mainly due to the preferential income tax treatment for new and high-technology enterprises and the preferential policy of double deduction for research and development expenses before income tax enjoyed by certain of our subsidiaries. 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 OF THE COMPANY

In 2010, profit attributable to equity shareholders of the Company was RMB1,817.81 million, an increase of 13.7% over RMB1,598.59 million in 2009. Profit attributable to equity shareholders of the Company accounted for 4.0% of our revenues, remaining at the similar level as in 2009.

CAPITAL EXPENDITURE

We implemented stringent budget management over capital expenditure, and adjusted our capital expenditure plan according to the changes of market condition. In 2010, our capital expenditure amounted to RMB832.96 million, an increase of 4.7% from RMB795.69 million in 2009. The capital expenditure in 2010 accounted for 1.8% of our revenues. Our capital expenditure included the purchases of production facilities and equipment, machinery and meters, plant and office buildings, intangible assets and other operating assets.

CASH FLOW

Our net cash outflow in 2010 was RMB390.06 million whereas that in 2009 was net cash inflow RMB336.68 million. As at the end of 2010, our cash and cash equivalents amounted to RMB8,470.25 million, of which 95.73% was denominated in Renminbi.

The following table sets out our cash flow positions in 2009 and 2010, respectively:

	2010 RMB'000	2009 RMB'000
Net cash generated from operating activities	1,526,412	2,062,227
Net cash used in investing activities	(1,055,364)	(814,115)
Net cash used in financing activities	(861,103)	(911,437)
Net (decrease)/increase in cash and cash equivalents	(390,055)	336,675

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In 2010, net cash generated from operating activities was RMB1,526.41 million, an decrease of RMB535.82 million from RMB2,062.23 million in 2009. The decrease in net cash generated from operating activities was mainly because more cash was needed to support the rapid development of the Group's domestic and overseas business.

In 2010, net cash used in investing activities was RMB1,055.36 million, an increase of RMB241.24 million from RMB814.12 million in 2009. Cash used in investing activities in 2010 mainly comprised of capital expenditure including the purchase of facilities.

In 2010, net cash used in financing activities was RMB861.10 million, a decrease of RMB50.34 million from RMB911.44 million in 2009. The decrease in net cash used in financing activities was mainly because the Group made the payment for previous dividends and increased the bank loans at the end of 2010.

WORKING CAPITAL

As at the end of 2010, working capital (i.e. current assets minus current liabilities) was RMB7,945.82 million, while working capital was RMB7,349.56 million in 2009. The increase in working capital was mainly due to the rapid development of the Group's domestic and overseas businesses.

INDEBTEDNESS

As at the end of 2010, total indebtedness of the Group was RMB1,780.52 million, and most of them were fixed interest rate loans and denominated in Renminbi. Our indebtedness increased by RMB512.24 million from RMB1,268.28 million at the year end of 2009.

As at the end of 2010, our gearing ratio⁽¹⁾ was 11.1%, an increase of 2.3 percentage points from 8.8% in 2009.

⁽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.

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CONTRACTUAL OBLIGATIONS

The following table sets out our contractual obligations as at 31 December 2010:

	Total RMB'000	2011 RMB'000	2012 RMB'000	2013 RMB'000	2014 RMB'000	2015 and after RMB'000
Short-term debt	1,780,523	1,780,523	–	–	–	–
Long-term debt	–	–	–	–	–	–
Operating lease commitments	465,914	180,699	96,437	51,233	38,038	99,507
Capital commitments	273,450	273,450	–	–	–	–
Of which:						
Authorized and contracted for	216,365	216,365	–	–	–	–
Authorized but not contracted for	57,085	57,085	–	–	–	–
Total of contractual obligations	2,519,887	2,234,672	96,437	51,233	38,038	99,507

EXCHANGE RATE

Most of our revenues and expenses are settled in Renminbi and therefore the risks associated with foreign currency exchange rates have no significant impact on our business performance. As at the end of 2010, the balance of our cash and cash equivalents in foreign currencies accounted for 4.27% of our total cash and cash equivalents, of which 2.42% and 1.16% were denominated in US dollars and Hong Kong dollars, respectively.